The economic impact of Covid-19 on businesses and commercial lending portfolios

June 2020

EXPERIAN INSIGHTS

Using the power of data to help you

ADAPT, SURVIVE AND THRIVE

Contents

To understand more about the methodology and source of insight within this report, **please click here**.

Overview and introduction

It's clear that the country is facing one of our most challenging economic times. Lockdown meant many businesses were unable to operate. Now as we return to normality and businesses begin to reopen, there remains the added challenge of consumer confidence in visiting stores, and spending. The Office for Budget Responsibility (OBR) has warned the coronavirus pandemic could see the economy shrink significantly over the coming months.

While much of this should be a temporary shock, the outbreak has the potential to make a broad and severe impact on the UK economy. The Government has taken unprecedented measures to alleviate this, including furloughing, CBILS (Coronavirus Business Interruption Loan Scheme), Bounce Back Loan Scheme (BBLS) and Future Fund. But much will depend on how quickly the virus is contained and how long it takes before normality, even in a new sense, is resumed.

As a lender, you will need to balance the fair treatment of customers with the mitigation of a significantly increased risk in your portfolio.

You'll need fast and reliable onboarding processes to deal with the rising number of applications for financial support; insight into what's changing at portfolio and account levels; greater awareness of fraud; and a robust collections process.You may even need to adapt your business model to navigate the changing needs of your customers.

This guide looks at the challenges you're facing and shows you how Experian's breadth of data and innovative capability suite mean we are perfectly placed to help you. Not only during the current crisis, but also as a key partner to support your ongoing success once the situation starts to resolve.

#1 The economic impact of Covid-19

a Macroeconomic outlook

Economic impacts, across the majority of sectors, are:

- Failure of micro-companies and independents, and the resulting reduction in consumer spending.
- Significant difficulties for SMEs, in addition to large corporate companies, due to the slowdown of activity in the most impacted sectors, including retail, hospitality, transport and leisure.

Experian's analysis of the current macroeconomic climate points towards a large fall in output in the second quarter of 2020. This could exceed 20%[1]. Consumer demand will also suffer as social distancing and low confidence lead to a big drop in discretionary spending, especially for big ticket items like recreation, leisure and travel.

On top of this, investment is likely to decline as the pandemic hits business confidence and cashflow, leaving projects postponed or cancelled, and export demand limited by lockdowns overseas.

While the short-term contraction in output is set to be large and result in some long-term scarring to the economy, Experian's central economic scenario projects that UK output will rebound. The analysis assumes that the outbreak is brought under control within the five-month timeframe presented by Imperial College London.

[1] The OBR has recently released a scenario suggesting a 35% fall in output. We have developed a forecast which closely resembles this, available on request, but it does not constitute our central view. Our central view differs from the OBR as we have a more favourable assessment of the effectiveness of the Government's stimulus measures.

b Asymmetrical risk at a sector level

The UK's mix of industry sectors has altered radically in the last few decades. Internet and mobile technology have made it easier than ever to start up a small business selling knowledge and expertise, rather than actual goods – and many of these can sustain a level of trading from home. However, those sectors that rely on physical proximity are being severely impacted.

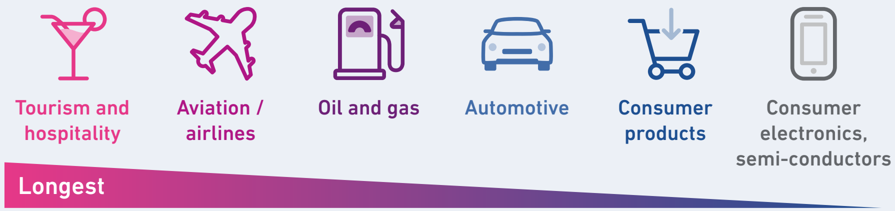
c Variable regional impact due to industry clusters

It's not unusual for certain industries to become concentrated in particular areas. Hounslow has a quarter of the UK's air and water transport industry, based on workforce jobs. Derby, Sunderland and Solihull are the largest centres for transport equipment.

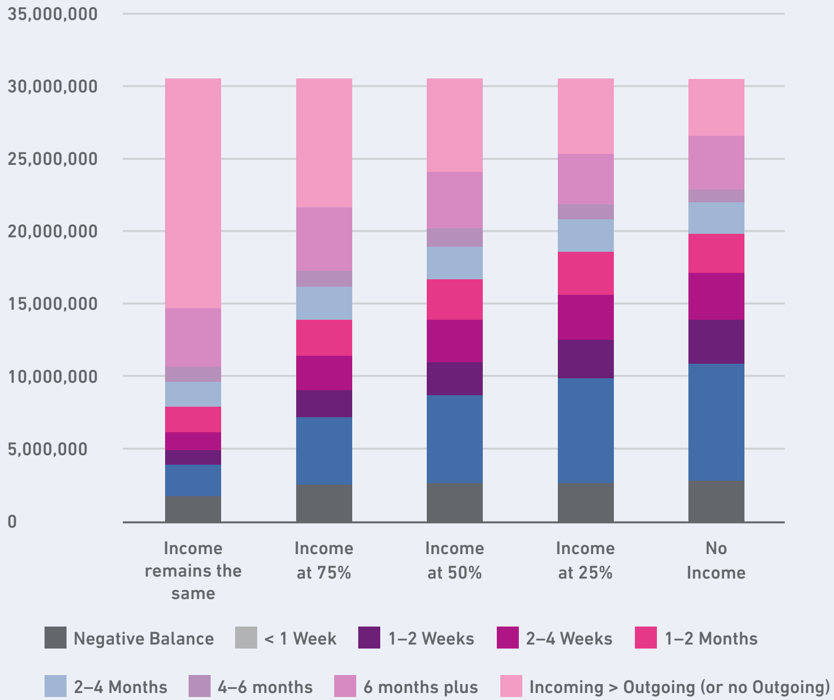
A high concentration of workers doesn't always mean a reliance on those sectors. Equally, some areas appear to be less dependent on at-risk sectors, but are actually more susceptible to harm due to an already-fragile local economy. What is clear is that impacts are UK wide and not isolated to one area. It's important that when you assess a business, you do so in the full context of its region's strengths and vulnerabilities.

> At-risk sectors account for 15% of the UK economy, equal to 8.7 million workforce jobs.

The key sectors that have been identified as most at risk are:



Employees at risk of business insolvency



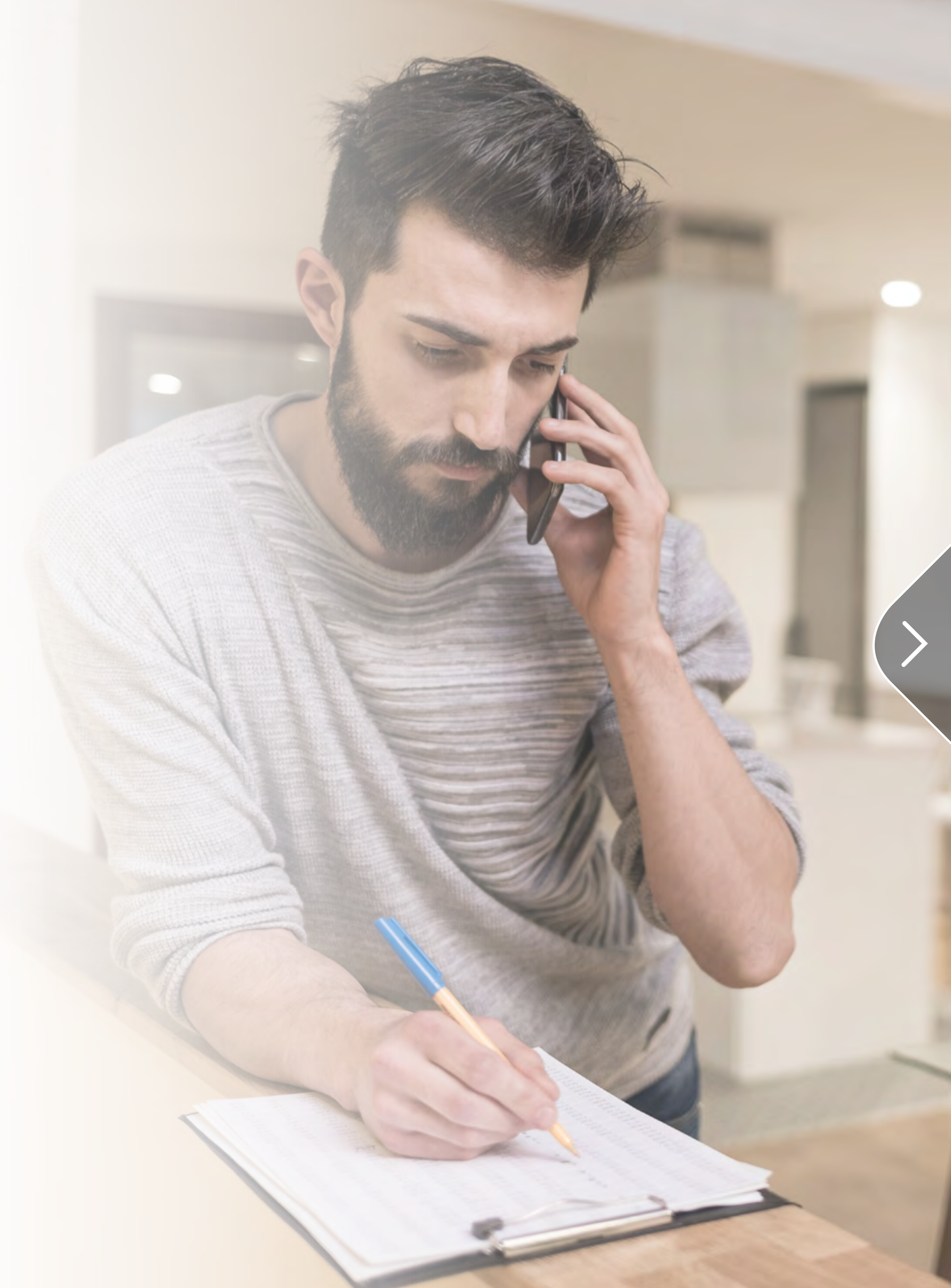
#2 What does this mean for your portfolio?

The current situation is adding a layer of uncertainty to every aspect of lending. Now, more than ever, you need fast and extensive insight into a business's true financial status before making a decision.

Access to more in-depth data, more frequently, can give you some much needed clarity at a time when traditional models and assumptions are being challenged. We recommend using the full breadth of data available, both in-house and externally sourced, to get as comprehensive a picture as possible of existing customers and new business applicants. Metrics like credit and debit turnover ratios, trends in minimum balances over time, and payment delays can offer a much more accurate view of a business's status than relying solely on traditional scores calibrated on a 'normal' economic cycle. Helping you to understand:

- A business's pre-COVID viability and how they're performing now
- The stress indicators that might predict a business's ability to pay
- A small business's sustainability under stress conditions

The right data at the right time gives you the opportunity to track changes as they happen, so you can deliver an informed response to these new and unexpected challenges.



An increase in demand for credit from SMEs

Experian's figures show that, if income completely dried up for all businesses wholly reliant on cash reserves, 17 million jobs could be at risk. Approximately 6 million of these are businesses in the at-risk sectors that can't easily operate from home, such as leisure and hospitality.

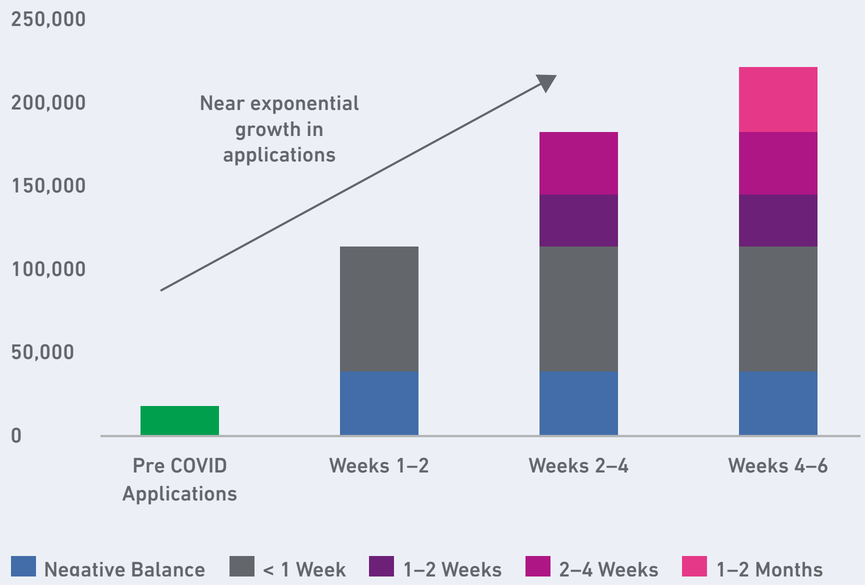
As businesses run out of working capital and exhaust any internal funding that the owners inject, they will turn to you to cover their short to medium term funding needs.

Helping businesses access much needed funding

There has already been a raft of applications for the Government's Coronavirus Business Interruption Loan Scheme (CBILS), which helps small and medium-sized businesses access finance up to £5 million. This spike in applications has put immense pressure on the existing onboarding processes of the over 60 accredited lenders involved in the scheme. In addition, there's a need to assess whether a CBILS applicant has "a borrowing proposal which the lender would consider viable, were it not for the current pandemic". It's not hard to see why there has been a perceived delay in processing applications at the speed and scale required. Especially as many of you are dealing with branch closures, reduced staff capacity and only partly-digital application processes.

Experian's analysis reveals that the market is likely to witness more than 100,000 applications a week from SMEs looking for capital to survive. Faster methods to onboard and evaluate these SMEs will be crucial for everybody.

Potential number of applications assuming 30% in each category can inject personal funds and only half ask for credit



Use digital onboarding to manage the speed and scale of applications

Banks have been gradually moving towards fully digital onboarding journeys for a while, but the current crisis has brought its benefits into sharp relief. Digital onboarding improves speed, enhances the customer experience and reduces the percentage of applications that are unlikely to make it through.

While it may be unfeasible to radically change your customer journeys in the short-term, there are some ways we can help you quickly remove some of the clunky steps in applications:

Experian Commercial Acumen Data Sharing Portal:

Lets applicants give you access to alternative data such as Open Banking data and management account data, and combines it with our credit history data, commercial credit score and adverse financials. This gives you deep insight into what your customers can afford and the products that will suit them, so you can make fast and fair lending decisions.

Trusso:

Our transaction categorisation engine automatically interprets the data from bank accounts. It classifies it into predefined categories of income and expenditure, making it easier for you to interpret. It helps you pick up subtle patterns and signals in behaviour, giving you the insight you need to make better and more informed affordability calculations.

BusinessIQ:

Draws on our business, director, consumer and payment history data to give you a clear view of your customer's business. You'll have instant access to credit reports, and you can add modules to customise the platform. These include: Alerts, so you're notified of key changes in the business; Portfolio, to analyse and evaluate risk levels across all your accounts; Decisioning, to set and manage your own credit policies; and Authenticate, to identify and validate the key people within the business.

Powercurve Customer Acquisition:

Make automated lending decisions 24/7. This takes your applicant's information and enhances it with credit, fraud and internal data, mixed with predictive scoring and policy rules to trigger instant decisions. It improves the speed of applications and reduces applicant drop-out. You can also move decisioning to the front of the application process, weeding out applications unlikely to be successful and making the volume of remaining applications more manageable.

Faster onboarding:
what you can do

1. Use integrated digital data solutions: risk and business profile APIs, access to open banking and management accounts, AML screening, automated decisioning

2. Quickly enhance existing non-digital processes with standalone risk, AML and consented data platforms

3. Regularly update risk data to pre-assess portfolio: get (and give your customers) rapid indication of likely application success, removing the majority of unsuccessful applicants early

Changing risk profiles across your portfolio

Models and assumptions that usually determine pricing and probability of default (PD) are being challenged. Businesses that would have passed onboarding risk policies with flying colours before are now facing extreme turbulence and stress. As our research has shown, this is particularly pertinent to at-risk sectors and certain regions.

To adapt to these changes, you'll need a high-level understanding of how your portfolio has changed. At an account level, the sooner you're able to identify critical signs of stress in a customer, the greater your chance of taking action to minimise losses. You may want to look at measures you previously felt were too extreme – such as punitive interest rates, tightening terms, reducing credit limits or removing pre-assessed lending limits. You may want to proactively approach your customers to discuss adapting repayment plans where they've gone beyond terms – or if they're still within terms, to reduce overdraft and card limits at renewal.

Spot signs of stress in real-time

No two lending portfolios will be impacted in the same way. It will depend on your customers' ability to adapt and keep trading. A simple sector-based segmentation is unlikely to be accurate or actionable. Our capabilities can help you understand your changing risks in real-time at a macro, full-portfolio level, giving you the best chance of mitigating losses from payment failures while continuing to trade. Use our data insight to:

Monitor current accounts

CATO (Current Account Turnover) data gives you a view of a business's cashflow over time, helping you assess its financial health and creditworthiness. It continues to be the most reactive data set we've got, with the most recent data being just 15 days old. Banks are already using it to monitor current account activity, and it's now available to non-bank lenders – although it's relatively new to market. You can use this alongside CAIS (Credit Account Information Sharing) data - information from our shared database of more than 13 million commercial credit accounts. This shows you a business's credit commitments and credit account behaviour. By combining the two, you get a full view of monthly changes to credit/debit turnover, average balance, days in excess and rejected payments – all of which are very real indicators of a business' tangible ability to pay.

Anticipate acute stress

With a month-on-month cash flow analysis, you will be well placed to assess a small business' sustainability while under stress conditions. Should you see signs of a drop in liquidity, you can take measures to help businesses through it, perhaps by extending an overdraft or granting payment holidays for outstanding loans. You may also be able to help firms restructure their wider short-term expenditure to mitigate against any unnecessary outlays.

Understand your concentration risk

Portfolios that house a large number of at-risk businesses will themselves be vulnerable. Comparing your portfolio to 'UK plc' will help you spot signs of over-concentration in the high-risk sectors and see how your customer base is segmented, so you can understand more about the risks you're facing.

We've developed a dashboard to analyse the longevity of your customer base, based on various revenue impact scenarios (COVID-19 impact segment, trends in payment performance, number of credit applications, and cash reserve depletion rate). We can slice the data by company sector, size, region and age. And we can also run bespoke analysis on specific portfolios. This lets you see the position of your portfolio relative to the overall UK population as a benchmark, and can be run as a one-off or on a regular basis.

It's important to note that, while we see many sectors in the high-risk category, we also see opportunities. Differentiating these, so you can prioritise applications, will help balance risk and potential for growth moving forwards.

Adapt your business model for survival funding

In recent years, we have seen new entrants at both ends of the lending need spectrum: immediate cash to ease liquidity, and asset finance or loans to underpin growth. Prior to COVID-19, both ends of this spectrum were fairly buoyant. But now growth plans are effectively on hold for the short-term; we expect 'survival' funding to be the dominant request until well into the eventual recovery period.

If you're a growth-focused lender, you may need to adapt your product set, market positioning and risk policy to survive, or you'll experience a serious shortage of new applicants. Assessing the viability of a loan application from a business on the brink of survival, compared with one that is on a strong proven growth path, will mean changing risk-based pricing models, policy rules and the set of key assessment metrics used to underpin an approval decision.Our risk data is applicable to both types of lending; our consultants can help you define new policies and products so you can tap into the increasing need for survival funding.

Understand credit risk: pre-Covid, current and post-Covid

Our risk scores are a powerful range of metrics that enable you to quickly assess the risk within your existing portfolio and for new applications.

Commercial Delphi Score:

Predicts business failure over the next 12 months

Commercial Delphi for Cashflow Score:

Predicts arrears and defaults within the next 12 months

Financial Strength Score (FSS):

Predicts insolvencies within the next 12 months

Distress Warning Score (DWS):

Identifies the most at-risk balances within your portfolio

We have enhanced our Commercial DCM (Delphi for Customer Management) so you can automatically append the following sets of attributes to your portfolio at account level. And we'll be adding new 'stress indicator' attributes as they come online:

- CATO credit account summary
- Commercial Delphi score
- DWS, FSS, Commercial Delphi for Cashflow scores
- CAIS bureau variables - to identify businesses that are already over-committed to credit, or those with an adverse credit history, to help you make appropriate lending decisions
- Payment Performance attributes - our sales ledger sharing programme that gives you in-depth analysis of your customers' payments across suppliers, helping you manage risk and collections
- Adverse events such as CCJs and company events
- Covid-19 business stress specific variables

By combining these, you can view both current and historic trend summary data: this lets you see risk levels prior to Covid-19, as they are now, and the likelihood of survival post-crisis. And you can set up alerts based on key stress indicators. Portfolio accounts are monitored on a daily basis; when an account crosses a threshold it is added to an email with details of the trigger event and sent to key parties.

Ensure you are tracking stress

It is important to note that government measures may create a few grey areas when it comes to interpreting risk. If your current snapshot shows a business lengthening the time it takes to make payments, this could indicate stress, but could also demonstrate wise cash management put in place to avoid future stress. And while a furlough application could suggest a current lack of demand for a business' products or services, if the scheme works as it should there will be minimal long-term impact as businesses start to recover and move away from it. All of which reinforces the importance of considering as many data sources as possible before making your final lending decisions.

Managing risk: what you can do

1. Use sectoral / segment level analysis to give understanding of risk concentration in portfolio
2. See how you benchmark against the rest of the market
3. Get timely market and customer-based insight with more frequent bureau feeds and triggers
4. Track asset value
5. Allow immediate intervention (light/ no-touch); identify and implement the best next action
6. Create a three-dimensional view of your applicant
7. Historical data so you can assess the business's health pre-Covid
8. Current data to indicate immediate status
9. Recovery likelihood based on sector and economy projections
10. Use the 'standard' credit risk score to reflect relative balance sheet strength
11. Monitor fast-reacting stress-related attributes, such as CATO data, current account balance and cash flow indicators
12. Adapt risk threshold and pricing to cope with weaker applicant set
13. Consider changing product set to focus on cash flow versus growth support

Phoenixing

Identify a business returning back to the same supplier as a new customer by linking new businesses to their forebears to stop 'phoenixing' - where businesses start to trade under a new legal entity to abandon their old debts.

Business Authentication

Run an applicant business against a series of data sets to give a graded level of certainty that the business is legitimate, trading and has been trading for certain period-of-time. Behind the business, key people also need to be authenticated, verify these people exist, live at the address provided and have a credit footprint. This service is also built-in to Experian Commercial Acumen.

C Greater potential for fraud

Many fraudsters will see the current economic downturn as an opportunity rather than a threat. We have seen an increase in client need for a business authentication service to weed out businesses that are not legitimately eligible for the service, loan, grant or dispensation they are applying for.

With the government moving fast to put various economic protection measures in place, there is no time for the normal level of due diligence. You will need an accurate way to determine which businesses are genuinely in need of financial help, and which are merely exploiting the situation.

Staying alert to new vulnerabilities

By collating data points derived from different, uncorrelated sources, you can continually validate the accuracy of your information.

We have created two products, ready immediately, to address the heightened need for anti-fraud measures. One links new businesses to their forebears, to stop 'phoenixing' - where businesses start to trade under a new legal entity and simply abandon their old debts. The other runs your applicant against a series of data sets to check the business is legitimate, trading and has been trading for a certain period of time.

> When economic survival is threatened the line separating acceptable and unacceptable behavior can, for some, become blurred.

Recognising fraud:
what you can do

1. Identify deliberate non-payment: monitor inconsistent bank account health through CATOs

2. Understand possible links between new applicants and bad debt book, through details such as directors and addresses; spot returning phoenix businesses

3. Look for inconsistency in the digital profile of applicant business - things like cloned accounts, dead directors, mismatched management and filed accounts

4. Check applicants against fraud bases like CIFAS and Hunter

5. Assess the data footprint of the business and confirm the existence of owners

Higher incidences of bad debt

An inevitable result of the increased financial stress from Covid-19 will be an increase in bad debt. Effective collections processes will be critical when the time comes to recover cash. Collections is a logical extension of portfolio management, and ideally any defaults will not be a total surprise. You can look to manage any accounts in pre-delinquency through payment freezes, or adapted payment plans, to avoid full recovery paths and ultimately Debt Control Agency (DCA) involvement.

Inform your approach to collections

With up-to-date data, it should be possible to pre-empt issues (such as non-contactability) on delinquent accounts as soon as the account starts showing signs of stress and potential non-payment.

By combining your internal payment history with our commercial scoring models, we can analyse debtor risk and segment into logical groups. This helps your collections teams understand each customer's financial situation, so you can handle accounts fairly and efficiently. You may be able to offer alternative arrangements for those in financial difficulty.

Where your data has aged or is no longer complete, we can offer you a service to track a business and its key people. By uncovering the information you need, you can more easily separate those that genuinely can't pay due to lack of funds, from those that can but won't pay.

Effective collections: what you can do

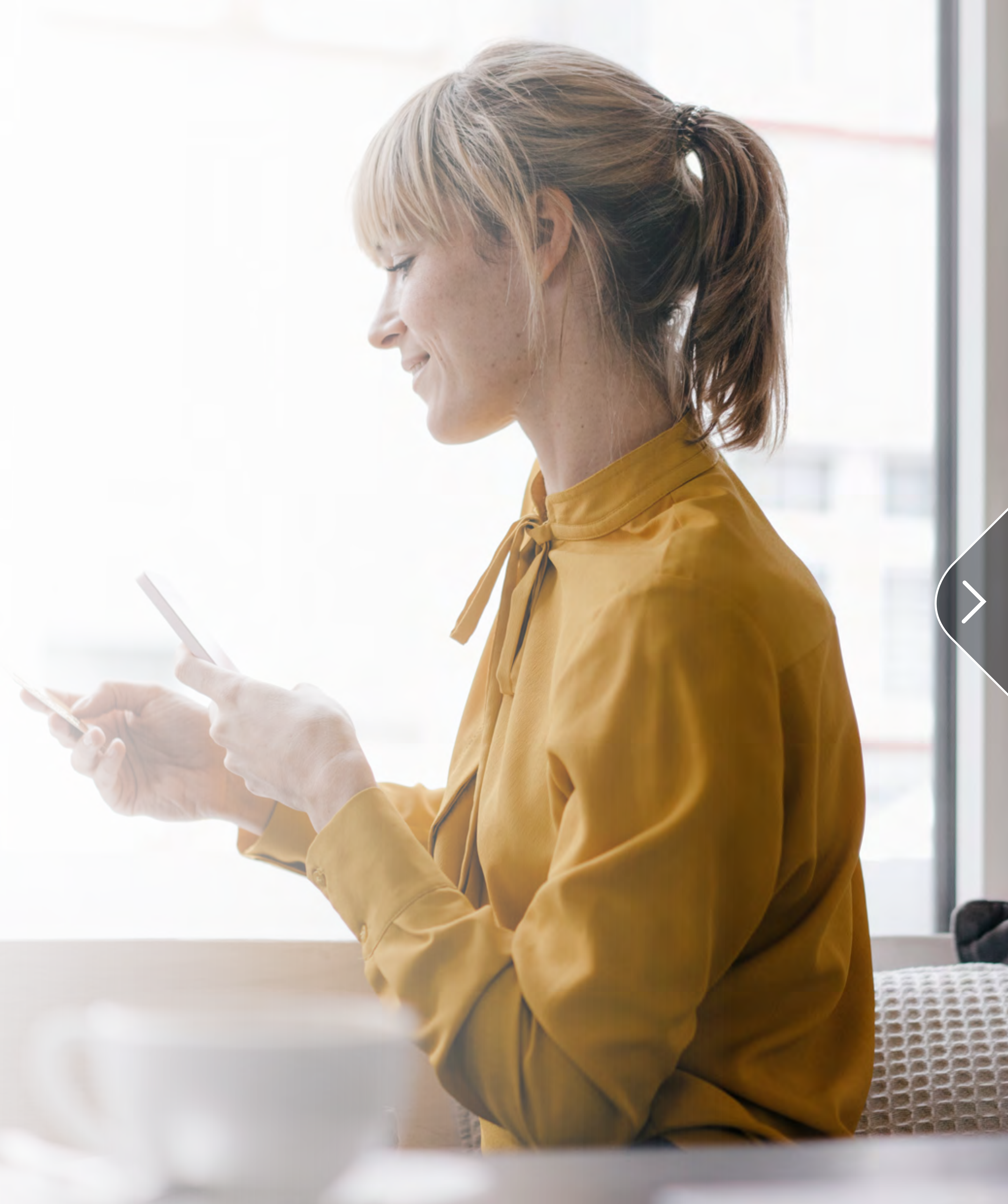
1. Carry out pre-delinquency triage on high-risk high-exposure accounts
2. Gain early sight of delinquency through active in-life customer monitoring
3. Recalibrate customer management/ collections scorecards, policy rules and strategies
4. Use segmentation to identify self-cure vs can't/ won't pay, focusing your collections resource where it counts
5. Access open banking and management accounts to underpin payment plans
6. Enhance and validate customer data to ensure accuracy

Conclusion

There are many areas where we see businesses needing support. For those already striving for more digitisation and insight, the pandemic shock is simply accelerating this need. Others have more specific strategies that need to be reviewed and implemented to help them effectively manage risk.

Here at Experian, we're committed to sharing our data and insights to help you understand the changing landscape and where your concentrations of risk are, as well as unearth new trends.

We are in the unique and unrivalled position of being able to overlay economic foresight onto credit insights to get both a back and forward-looking view – and our innovation agenda is committed to developing tools which can help you and your customers thrive, even in these uncertain times.



Visit our website for more information on how we can help:
www.experian.co.uk/business

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The insight contained within this report is prepared using research performed on both Experian data and external data sources, in addition to market research. All sources, unless referenced, are from Experian insight.

The information contained within this report is designed to help businesses manage the complexity brought by a national crisis - and is a summary of key areas and capabilities. To understand more about the breadth of market-leading capability Experian has, or to access further detail on the impact of Covid-19 on consumers, business and lending portfolios - please contact us.

Stay up to date with our latest thinking, by bookmarking our thought leadership portal:
www.experian.co.uk/latest-thinking

Visit our Covid-19 resources and support hub to find further information aimed to help and support people and businesses.
www.experian.co.uk/about-us/covid-19-resources

Content methodology

The insight contained within this report is correct at the time of publishing. Insight is derived from Experian data sources, incuding analysis produced by our award-winning Economics team. Note that Experian owns the copyright in this document and the information that it contains is the confidential information of Experian. We are providing this to you because we believe it is in the public interest to do so at a time of national crisis. However, the confidentiality provisions of our contractual arrangements apply and you may not share this further.

We also wanted to let you know that Experian will shortly be adding a transparency information page to its website to let data subjects know how we are using data to help at this extraordinary time.

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