

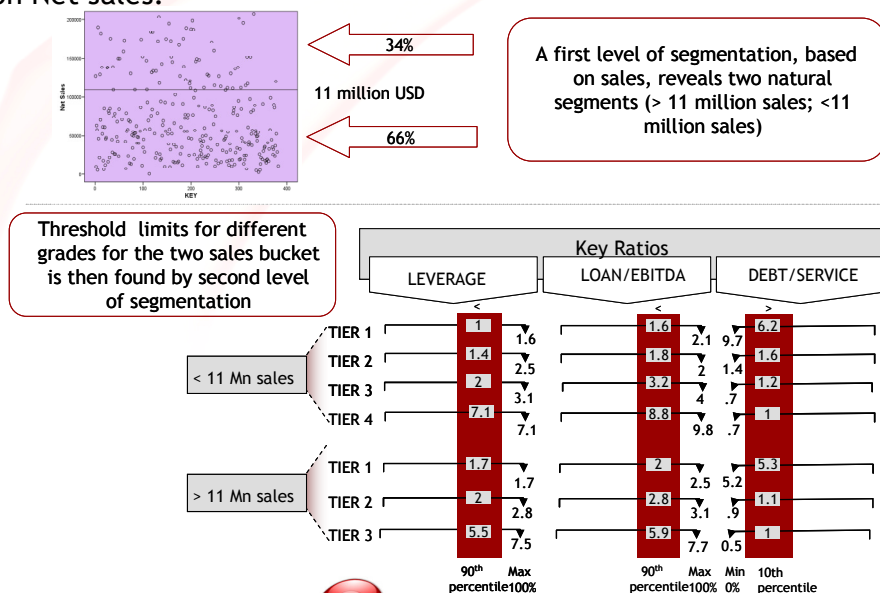
## Risk based segmentation (Commercial segment) of Large Indonesian Bank

### • Situation & Challenges

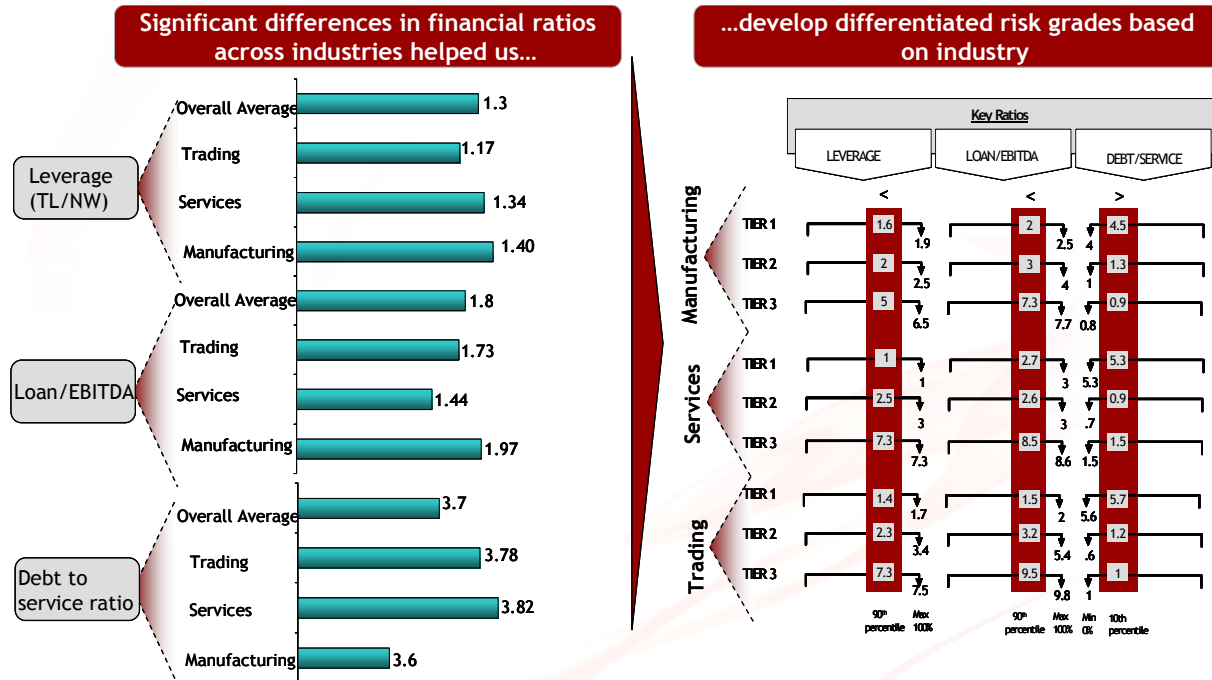
Our client, one of the largest private banks in the region, is a progressive leader with an aggressive growth record. Their Commercial segment consisted of large family owned businesses whose scale of operations may be as large as Corporates but their style of running the business was still akin to SME. Their financing need could go up to 15 million USD. Clearly, such a high exposure meant that ‘riskiness’ of every loan application needed to be accurately assessed. One of the key aspects of this assessment was financial health of these companies which could be estimated from companies’ financial ratios (e.g., Leverage, Loan/EBITDA, Debt to Service ratio). Client’s method of using ‘proposed credit limit’ to segregate customers into different risk buckets (grades) was not appropriate as no significant correlation was observed between the loan-amount-applied-for and these ratios. This was expected as a typical commercial customer would have loans at several banks and his share of wallet would rarely be greater than 50% at any of their bank. Realizing the obvious flaw in their methodology, they asked us to develop a methodology based on which they could accurately classify each loan application in to different risk buckets which would help them assess the repayment capacity of these companies

### • Our Approach

We gathered data available with the client (600 excel files) into one view. Proper business judgment was used to treat outliers & data noise. We then identified segments and ratio cut-offs based on Net sales.



We identified the need for applying an additional filter and differentiated risk grades further based on industry level nuances. We studied cut-offs for past customers and their performance on the loan to arrive at logical cut-offs.



Client incorporated all suggested modifications into product program

## • Result

Client, now has a scientific approach to differentiate (and judge) Commercial customers based on Industry, sales and financial ratios. The segmentation by industry was incorporated into the product program as it gives a sharper cut across tiers for all the three ratios. The sales-based approach was used to support and justify deviations.