

### After the “Go-Go Days” Part 3 The Current State of Play

BIIA has asked *Phil Cotter, an expert in the consumer and commercial credit information industry and BIIA’s newest contributing staff writer*, to express his views about the shape of the credit information industry post financial crisis and how the major players intend to grow their business.

Part two was published on August 21, 2011 in the [BIIA News Section](#) on [www.biaa.com](http://www.biaa.com) and focused on the three major Consumer Credit Risk Management services providers, Experian, Equifax and Transunion and how they were faring in the current environment and where they were focusing their attention in pursuit of future growth.

#### Part 3: The Current State of Play - an Assessment of FICO and CRIF

*Part 3 focuses on FICO and CRIF and how they are adapting to the current environment, the progress they are making in executing their plans and where they are focusing their attention in pursuit of growth in the future.*

#### Largest Players in Credit Risk Management Solutions



It is worth reminding ourselves where these two organizations fit in the rankings of the major players in the global credit information market, providing a context in which we can look at their relative performance.

Whilst both are significantly smaller than the three companies featured in

the last article they are never the less significant players in today’s global market.

As in the previous article we will focus on three key questions:

- How have FICO and CRIF grown to become the global players they are today?
- How are they performing in the current environment and what does this tell us about their prospects for the future?
- How do they plan to grow in the future and what implications does this have for them and their competitors?

### ***FICO (Fair Isaac)***

#### ***The Vision: “Providing Connected Decisions across the customer lifecycle in Banking”***

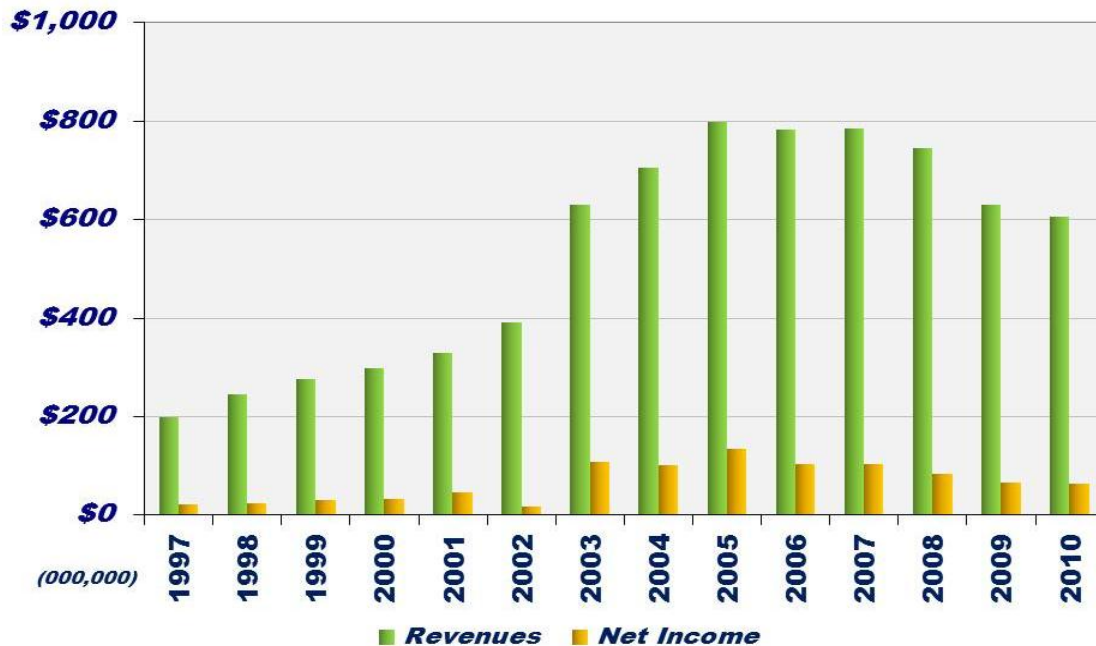
FICO's vision is based on the prescience of its founders Bill Fair and Earl Isaac who formed the company in 1956. They believed that data, used intelligently, could improve business decisions. Initial attempts at persuading others that this was the case met some resistance when only one of the 50 largest credit grantors in the US replied to an invitation to explain the concepts of credit scoring in 1958.

Through the 60's and 70' s FICO began to build a strong customer base as it introduced credit scoring systems to manage originations and existing customers into a number of US banks, retailers and insurance companies. Significant milestones along the way were the first introduction of credit scoring models into Europe in 1974, the launch of the first FICO Bureau score in the US in 1981 and it becoming a public company in 1981.

As it developed its business through the 90's and 2000's the FICO brand became synonymous with credit scoring in the US, with US banks and consumers alike treating the FICO score as the benchmark of creditworthiness. There is no doubt that FICO has made a significant contribution to the development of the science of credit and behavioral scoring and played its part in the process of industrializing credit granting and credit risk management around the world.

However a glance at FICO's growth story over the last 10 years shows that somewhere along the way the wheels came off. This is illustrated in the graph (next page), which charts the growth In FICO's revenues from 1997 to 2010, peaking in 2005 before declining over the following years through to 2010. This negative development raises the question what caused this reversal in fortunes and what implications does it have for FICO's future?

### ***FICO Revenue and Net Income 1997-2010***



*Notes to Graph:*

- FICO merged with HNC in 2002 hence increase in revenues 2003
- Disposals and changes to accounting practices result in revenues post 2007 not being a like to like comparison prior to this period.

### ***The 21<sup>st</sup> Century – A Roller Coaster Ride for Growth***

In 1999 FICO appointed Tom Grudnowski, previously a Managing Partner at Accenture, to the position of CEO. Grudnowski replaced Larry Rosenberger who had overseen the company's growth through the 1990's. The board believed that Grudnowski's experience at Accenture of emerging ecommerce technology would be an important contributor to growth in the future.

Grudnowski set about growing the business through a series of new product launches, strategic partnerships in the US and internationally and through acquisitions, culminating in the acquisition of HNC in August 2002. At the time of the deal HNC had revenues in the region of \$250m and its neural network technology was seen to be a perfect fit with FICO's core business. HNC, founded in 1986, was one of the early movers in the development of neural network technology and at the time of the acquisition was seen as a market leader in the detection and prevention of fraud, particularly in the credit card sector.

Although revenues continued to grow from 2002 to 2005, net income (profit) failed to grow at the same rate and most of the revenue growth came through acquisitions and not organic growth. On November 1<sup>st</sup> 2006 following stagnation in FICO's share price and under pressure from shareholders Grudnowski resigned as CEO, to be replaced by the current CEO Mark Greene.

Since this time, partly as a result of restructuring the organization by the new CEO, but more significantly due to the impact of the credit crunch and subsequent recession FICO has seen revenues and net income continue to decline.

### ***FICO's Performance Today?***

FICO's third quarter results continue to show a downward trend. Revenues in Q3 2011 are down nearly \$5m on the same quarter the previous year at \$150.7m.

Under the surface of these numbers is a potentially more worrying trend, with transactional and maintenance revenues shrinking from \$115.9m to \$111.7m (-3.6%) and license fee revenue shrinking from \$13.9m to \$9.4m (-32%). Only service revenues grew from \$25.5m to \$29.6m (16%). The declining revenue streams are likely to have higher margins than the margins generated from service revenues placing further pressure on FICO's bottom line.

In response to this continuing trend of declining revenues FICO has reduced costs by \$10m compared to the same quarter in 2010. A further worrying trend is that bookings (new business) for software sales declined for the fifth quarter in a row to \$50m some \$13m below Q3 2010. This suggests that there are likely to be further declines in transaction, maintenance and license fees in the future.

This performance bears unfavorable comparison to Experian's announcement that revenues for its Decision Analytics business had grown by 6% in the last quarter, with growth in US revenues at 13% for the same period.

The 2010 annual report gives some insight into the challenges FICO is facing at present. International Revenues grew in 2010 to \$209.6m from \$199.8m in 2009 (\$246.3m 2008) an increase of 10%. Given total revenues of \$630m in 2009 and \$605m in 2010, this suggests that revenues from the US declined from \$431m in 2009 to \$396m in 2010 a decline of 10%. Indeed since 2008 US revenues have declined by almost \$100m according to the author's calculations.



FICO faces a challenge on a number of fronts:

- It is operating in a highly competitive financial services market where the likes of Experian and internal analytic teams in major banks are competing for market share.
- In vertical markets such as insurance it faces increasing competition from Lexis Nexis, now that it has acquired Choicepoint.
- The use of FICO's scores as part of the rating process for RMBS (retail Mortgage Backed Securities) and ABS (Asset Based Securities) and the subsequent roles these instruments played in the credit crunch, has in the opinion of the author, caused a number of organizations to consider whether other methods should be used in assessing the risk of customer across the lifecycle.

In addition to the threat of increasing competition, FICO has been engaged in a long and acrimonious legal battle with Experian, Equifax and Transunion over the Vantage Score, a competitor scoring model designed to compete with the FICO score.

FICO claimed that the action of the three bureaus was anti-competitive, potentially damaging to the FICO brand and an infringement of trademark rights. These claims have been dismissed by a number of courts in the US, and the latest rejection was handed down by the US Court of Appeals. This in turn has obviously placed the relationships between FICO and the three bureaus under considerable pressure, perhaps not the wisest of moves given the amount of revenues the bureaus generate for FICO.

The detailed analysis of FICO's performance in its 2010 annual report shows that it was seeing declining revenues in each of its 3 main segments *Applications, Scores and Tools*. This is due to a combination of factors:

- FICO's revenues, particularly in applications and scoring, are highly dependent on credit activity in new loan origination. This exposure is particularly prevalent in the mortgage market where FICO scores account for 75% of all scores used in mortgage originations. The current low volume of originations has a significant negative impact on revenues.
- 20% of its revenues in its Scores segment are dependent on the three main credit bureaus Experian, Equifax and Transunion. However these three large customers turned into competitors by building their own credit scores and analytics and co-operated in creating VantageScore, a credit score that uses data from all three credit bureaus.

- Experian's cancellation of its contract with MyFICO (provision of FICO scores to consumers through Experian's Credit Expert service) accounted for much of the \$5.4m reduction in consumer score revenues from the MyFICO product.
- The reported decline in its bookings suggests that FICO is finding it more difficult to find and convert new business a worrying trend when 25% of its revenues have to be found every year (recurring revenues accounting for 75% of total revenues).

### What will the future hold for FICO?

In a presentation to investor's in May 2011, FICO stated that they were in the right place, predictive analytics and decision management, at the right time and ready to capitalize on opportunities. However there are two factors cited in the presentation which would have an impact on future growth:

- Economic recovery in the US would drive increase in core banking market and particularly score revenues
- They had rebuilt the executive team to accelerate sales and product delivery

Unfortunately as the most recent quarter's results have shown there is little sign of either of these factors having a positive impact on revenue growth. The recovery in the US economy and accompanying increase in demand for credit still looks some way off.

FICO has suffered five consecutive years of revenue declines and its main focus was on cost reduction to protect profitability. They may have well been in the right place at the right time, but today it is also a place where others want to be, notably Experian, IBM and SAS and in mature markets many banks have comparable in house capabilities in scoring and analytics.

It's not clear to the author, how FICO is going to turn around their fortunes and win in an increasingly competitive environment in the future.

### CRIF

***The mission: CRIF's corporate mission is to support credit lenders, businesses and consumers with its complete range of information services and solutions so that they can easily make prompt and effective decisions.***

CRIF was established in 1998 in Italy as a domestic consumer credit bureau. Within 10 years it became an international player by taking a very opportunistic approach, which its key adversaries never expected. CRIF is privately held and through partnerships and a series of acquisitions expanded operations across Europe including the UK, North and South America and into South Asia and Asia Pacific.

CRIF is the leading consumer credit bureau in Italy and through its acquisition of D&B's operations in Italy in 2009, forming CRIBIS D&B one of the leading players in business information in that market. In Europe CRIF has focused primarily on eastern European markets acquiring Consumer Credit Bureaus in the Czech and Slovak republics in 2005 and working with banks in Russia to establish the National Bureau of Credit Histories (NCBH). In 2009 CRIF gained a license to operate the first privately owned Credit Bureau in Hungary. CRIF claims to be the largest credit bureau operator in continental Europe.

In other markets CRIF has taken a different approach to market entry, in the UK it has provided database and analytics services to the insurance industry since 1999, competing with Experian. It supplied scoring and analytics services to European credit bureaus. In North and South America, CRIF has focused on acquiring a range of software and analytics businesses in the areas of loan origination and online risk management services. It has also partnered with Transunion in these markets to provide decision management and analytics services. In emerging markets CRIF assists local credit bureaus with technology and decision services.

More recently it has expanded into Asia Pacific, forging partnerships with Huaxia in China to form HuaxiaCRIF, a business providing consumer risk expertise and information services to the Chinese market, it has also partnered with Highmark to launch a consumer credit bureau in India and with PCB in Vietnam to launch a credit bureau in that country.

In 2010 CRIF's revenues grew by an impressive 22% to €261m and the company now employs directly or indirectly over 1,300 people around the world.

### ***What is CRIF Currently Focusing On?***

Having been on a buying spree of various software providers operating in the loan origination market, in the US, including Magnum and APPPRO (acquired from Equifax) CRIF announced in August 2011, that they had bought all the companies together under the banner of CRIF Lending Solutions, serving over 650 financial institutions in the US across the banking and consumer finance sector. Under the banner it provides three different software solutions for loan origination to different sectors of the market ranging from Credit Unions to Credit Card Issuers, it also provides consultancy on analytics and scoring.

CRIF has also announced this year its application to run a credit bureau with partner Neal & Massey in Jamaica and the work it has done to help create online credit bureau services in Bangladesh.

Being a private company there is very little information available on CRIF beyond that which it publishes on its own web site. However in the author's opinion CRIF is executing a multi-faceted strategy which is different to that of the three large credit bureaus Experian, Equifax and Transunion.

The main elements of this strategy are:

- CRIF is expanding in the USA through the acquisition of loan origination software platforms. This avoids them being in direct competition with the three large credit bureaus but potentially allows them to position themselves as the “value-adding” partner to their customers. In theory, in a market where lenders are used to using a multi-bureau approach to gathering credit information, CRIF as the provider of the platform that accesses this data, applies the customers credit risk strategies and embeds the decisions created into the customer's workflow, should be able to position itself as a premium priced solutions provider against the bureaus as commodity priced data providers.

Loan origination platforms also tend to be very “sticky” solutions as they are an integral part of the lenders operational workflow and as such they offer the potential to provide revenues to CRIF over a long period of time. This strategy does however mean that at present in the USA CRIF are exposed to the downturn in loan origination, the impacts of which have been covered in the section on FICO and the challenges they may pose to securing new business for these platforms and the reduced demand for CRIF's expertise in analytics and scoring.



- Outside of its core market in Italy and some markets in continental Europe, CRIF has positioned itself as a technology partner and provider of consultancy on best practice Credit Bureau processes. This has allowed it to partner with existing players in markets such as China, Jamaica and the UK to support the launch of new credit bureaus or in the case of the UK an insurance claims database. Whilst details of these partnerships are not revealed in full, the author assumes that they provide the potential for long term revenue streams to CRIF through a combination of revenues from ongoing management and development of the technology infrastructure and in some cases an equity share in the organization formed with the partner. With the exception of Transunion who its partners with in some markets, this is not a model followed by the other major credit bureaus
- CRIF is also using this partnership model to gain access to new markets for its analytics and credit scoring services. Using the contacts, local knowledge and brand of its partners, such as Huaxia in China, to establish a presence in new markets.
- CRIF has also expanded its CRIF Business Information Services (CRIBIS) through the recent acquisition of D&B Italy, alongside its existing operations in Italy, Poland and Czech Republic, it also provides access to Business Information worldwide through a network of partners and its CRIBIS.biz platform.

### ***What does the Future Hold for CRIF?***

In the absence of more detailed financial information and any further insights into its strategy it is difficult to form a detailed opinion on CRIF's current performance or the likelihood of success in the future. Whilst its revenue growth has been impressive the author believes that much of this has been driven by the acquisitions it has made and it is unclear what rate of organic growth has been achieved.

Its strategy for building its presence in the US market will bring it into direct competition with the likes of FICO and Experian in the analytics and consulting sector. Its loan origination platforms may provide it with an advantage in some segments of that sector where customers are seeking an holistic solution for loan origination, but as previously covered in this article analytics and scoring is a highly competitive market and one that is seen as an area for potential growth not just by the existing players but also the likes of IBM and SAS.

CRIF's model of partnering with incumbent players to enter new markets is indeed interesting. CRIF provides the technology and ongoing support thus creating the potential for developing additional revenue through analytics and scoring expertise.

Partnering with existing players to enter a new market mitigates some of the risks involved in going alone. Subject to the agreements reached with the partners, it is possible that some of the revenues derived from provision and support of the technology are not dependent on the performance of the bureau itself. How this approach will fare against the different models being deployed by the other major credit bureaus, where they may partner but are clearly the lead player, only time will tell.

Finally CRIF's acquisition of D&B in Italy has arguably secured its position as the leading provider of business information in that market and it has leveraged its position in the consumer credit bureaus in Poland and Czech Republic to build business information businesses there as well. However beyond this it is unclear to the author quite how this fits into the overall strategy and what future opportunities exist to expand this part of the business.

In conclusion the author observes that CRIF despite being a relatively small player has developed and is executing a strategy that is distinct in parts from the larger global players. It has demonstrated that it can grow its business through a combination of acquisition and (presumably) organic growth, whether it intends to compete more aggressively with the global players or follow a targeted niche growth strategy in the future could be the key to its future success.

### **Conclusion**

***In this article we have featured two organizations, FICO and CRIF, who are currently experiencing contrasting fortunes.***

**FICO**, who have possibly more than any other company contributed to the development of credit scoring and analytics as the foundation of modern credit risk management, have been struggling for the last five years to achieve consistent growth. Due to the dependence on loan origination activity in the US market it is difficult to see where this growth will come from without a significant improvement in the economy and accompanying demand for credit. In the longer term it potentially faces increasing competition in its core consultancy, analytics and scoring markets from the three global credit bureaus and potentially the likes of SAS and IBM who see this an expansion opportunity for them.

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**CRIF** has grown strongly in recent times, has demonstrated an appetite for acquisitions that fit its strategy and in the opinion of the author has developed and executes a strategy that is distinct from some of the other players. The author believes that CRIF also benefits from “operating under the radar” as far as the global players are concerned so it is not seen as being a direct competitor. This may change with its entry into India, China and other emerging markets that the global players are also operating in or intend to enter in the future.

A question in the author’s mind is in an industry where scale and size really does matter, are FICO and CRIF big enough to survive on their own or will they, for contrasting reasons, become potential acquisition targets in the future.



In the next article Phil Cotter will be focusing on the **Global Business Information** market. In particular he will be looking at the strategy and performance of D&B and who else might compete with D&B in the future.

Phil Cotter is an expert in the Consumer and Commercial Credit Information industry and BIIA’s newest contributing staff writer. He can be reached at: e-mail address: [philip.cotter@btinternet.com](mailto:philip.cotter@btinternet.com).

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**Business Information Industry Association Asia Pacific – Middle East Limited**

1101 Wilson House, 19-27 Wyndham Street, Central, Hong Kong  
Telephone: +852 2525 6120; Fax: +852 2525 6171; E-mail: [info@bii.com](mailto:info@bii.com); [www.bii.com](http://www.bii.com)