# Debt collection in lean times

An Experian briefing paper

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# Executive summary

- Rising levels of unemployment and declining real household incomes had a major impact on the ability of some consumers to service debt and pay their bills throughout 2009.

- In this environment you'd expect it to be boom time for Debt Collection Agencies (DCAs), however, the industry has come under increasing cash-flow and other financial pressures.

- There are over 600 DCAs in the UK employing over 14,000 people. Combined, these firms have a turnover of almost £700 million per annum.

- 10 per cent of DCAs ceased trading during 2009, up from six per cent in 2008.

- Analysis of DCA financial strength reveals that the proportion of DCAs with a D-rated commercial credit score - the second riskiest band - doubled between December 2008 and December 2009. Typically, Experian would expect between 1.4 per cent and 1.8 per cent of firms with a D rating to become insolvent in the next year.

- The number of DCAs rated in each of the A, B and C bands, the safest to average risk firms, declined over the same period.

- To meet current challenges and thrive in the future, there are a number of 'quick wins' that can drive immediate improvement in effectiveness and efficiency. Medium-term projects, such as integrating all collections activities into a single architecture, can further enhance capabilities.

# Introduction

Simon Waller, Head of Collections, Experian UK & Ireland.

We all know that 2009 was a tough year. Rising levels of unemployment and declining real household incomes had a major impact on the ability of some consumers to service debt and pay their bills. Consumer lending organisations experienced a substantial growth in the volume and mix of accounts becoming delinquent and their collections organisations had to cope with increasingly strained operational capabilities.

In this environment you'd expect it to be boom time for Debt Collection Agencies (DCAs). However, despite facing strong demand for their contingency priced services to deal with this increase; DCAs who buy debt are facing very real difficulties brought about by the deteriorating economic climate. The industry has come under increasing cash-flow and other financial pressures and the year ahead is unlikely to be very different.

These are lean times for consumers, and the answer for DCAs is to act smarter, focusing on the best short-term returns, while planning for the longer term. DCAs that are able to use data, software and analytics to maximise their effectiveness and efficiency will be best placed to profit by collecting more debt and reducing the cost to collect. Those that cannot become more effective or reduce their operational costs could face bleak times.

DCAs have widely differing levels of capability in this area. While some are incredibly savvy, there are many others that are far less sophisticated.

In this paper, which draws on our extensive data insight into the commercial world and the combined expertise of our dedicated collections consultants, Experian discusses the challenges facing DCAs, and how simple steps can enable many to operate more effectively and efficiently.

### Experian's collections expertise

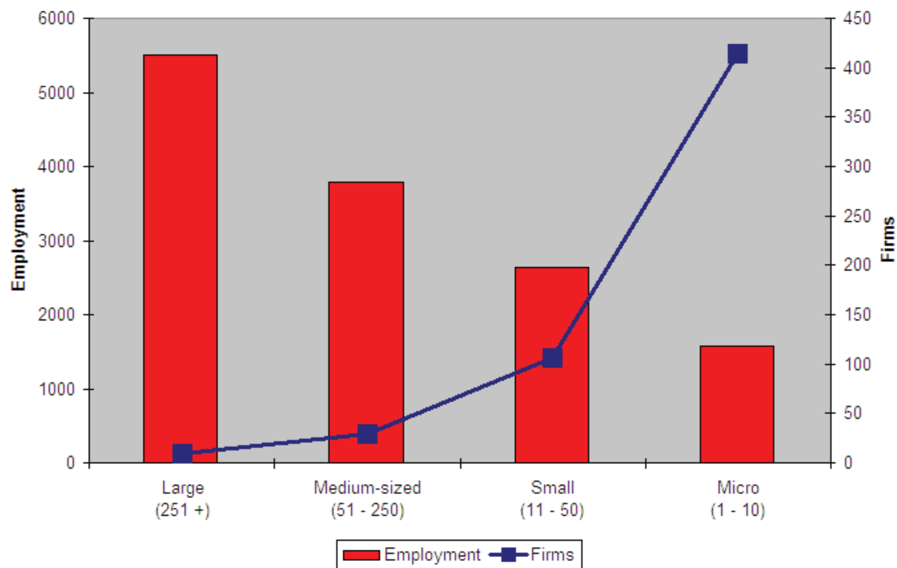
Experian is a global leader in providing information, software and analytical services to organisations to help manage the risk and reward of commercial decisions. Today, more than 90% of the UK's leading banks, building societies and debt collection organisations, as well as many of the UK's largest utility and telecommunications companies, rely on one or more components from Experian's debt collection and recovery suite, the most comprehensive range of collections services and software available, to drive their collections success. For further information, or to discuss your collections requirements, please contact us on collectionsandrecoveries@uk.experian.com or 0115 941 0888.

# DCA sector analysis

## Sector scale

Experian analysis has revealed that there are over 600 DCAs in the UK, employing over 14,000 people. Combined, these firms turn over almost £700 million per annum. The top 10 firms account for just over 39 per cent of industry revenues and 35 per cent of employment. 74 per cent of firms in the sector are micro-firms employing less than 10 employees. 19 per cent are small firms.

Figure 1: Spread of DCA size and employment




Source: pH, an Experian company

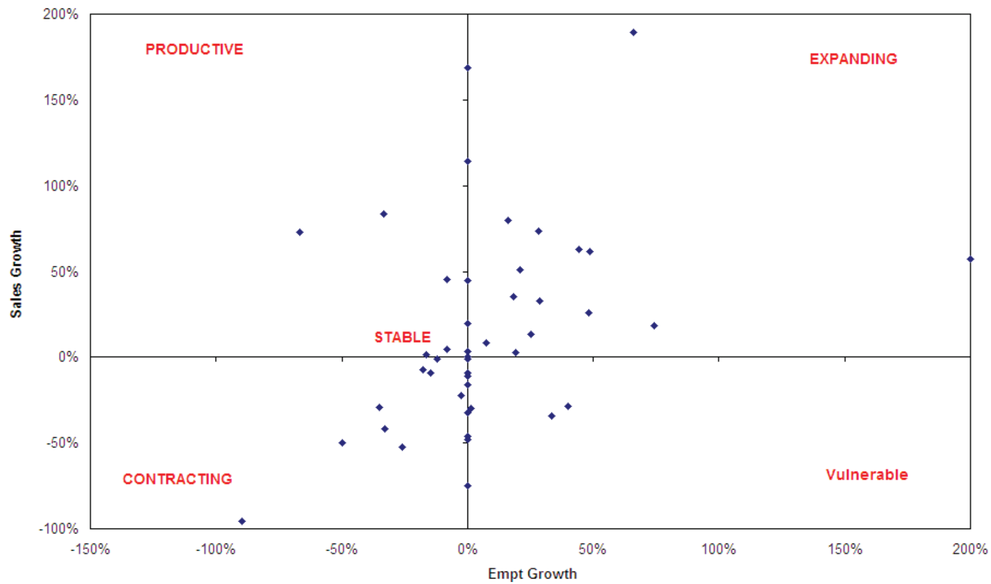
The data indicates that there are slightly more firms growing their turnover than seeing it shrink. Most of those that have seen a decline have reduced headcount accordingly. The majority (64 per cent) of firms that have grown turnover are also expanding their employment.

A smaller proportion of firms (36 per cent) are successfully managing to grow turnover, but without an increase in employment. Indeed, some of these have even managed to reduce headcount. These organisations, which have succeeded in making their existing collection operations increasingly productive, are well placed to grow their margins.

## Profitability

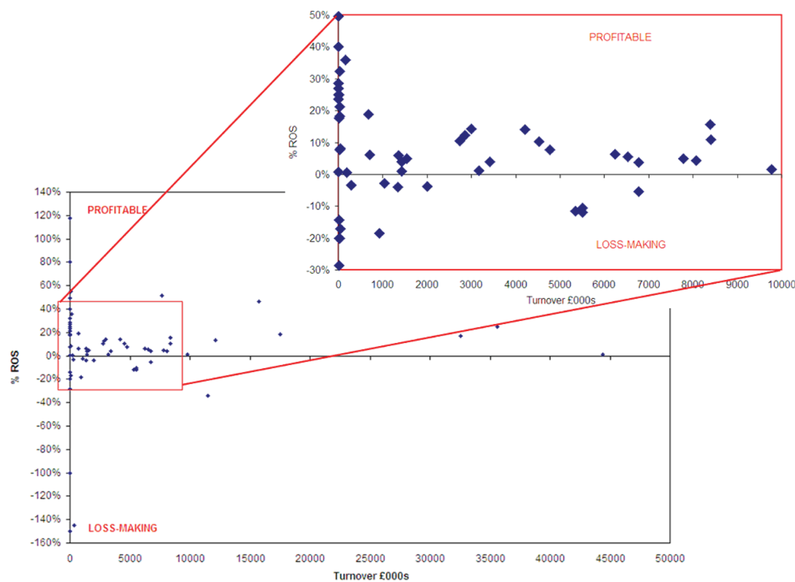
Analysis of profit margin data reveals that, despite the difficult economic times, most DCAs are profitable. At the micro and small business end, there are a number of firms making between 20 per cent and 30 per cent pre-tax profit each year. Naturally, such margins become more difficult to achieve for the large scale DCAs. Margins of between five per cent and 15 per cent are more common for DCAs turning over between £1,000,000 and £10,000,000.

### Figure 2: Growth profile of DCAs




Source: pH, an Experian company

### Figure 3: Profit margin by size of DCA




Source: pH, an Experian company

# DCA sector challenges

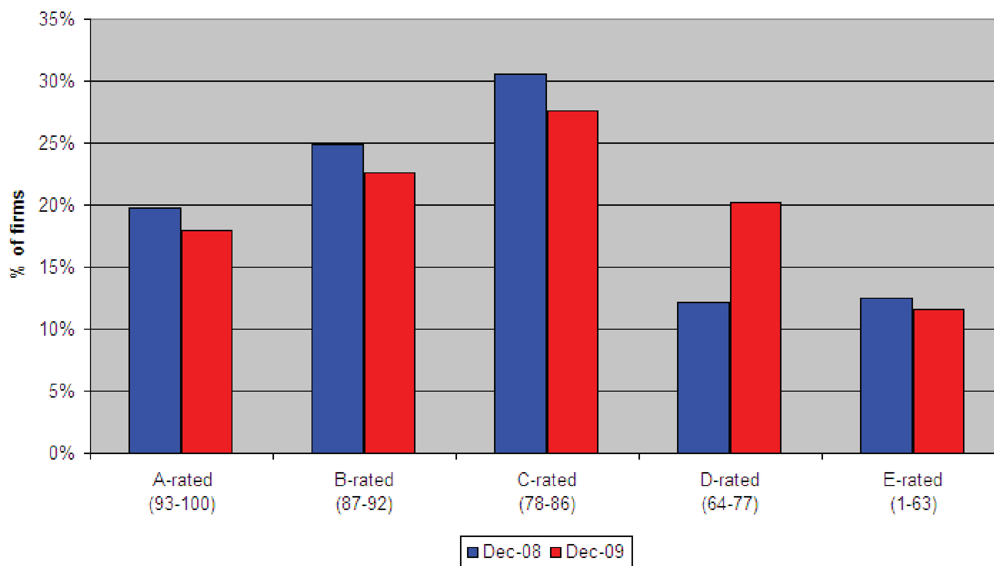
The demands on DCAs, whether operating on a contingency basis, debt purchase or a mixed approach, are pressing.

## Declining financial strength

Analysis of DCAs financial strength undertaken by pH, an Experian company, reveals that 18 per cent of debt collection agencies held an A-rated commercial credit score (between 93 and 100) in December 2009. 12 per cent of DCAs fell into Experian's maximum risk E-rated band (scoring between one and 63). E-rated firms are greater than 30 times more likely than their A-rated counterparts to become insolvent over the following 12 month period.

While the proportion of E-rated firms, the most risky, has remained stable on December 2008, there were declining proportions of A – C-rated DCAs, the safest to average risk firms. Furthermore, the number of D-rated firms, the second riskiest band, doubled year-on-year.

Figure 4: DCA financial strength, December 2008 – December 2009



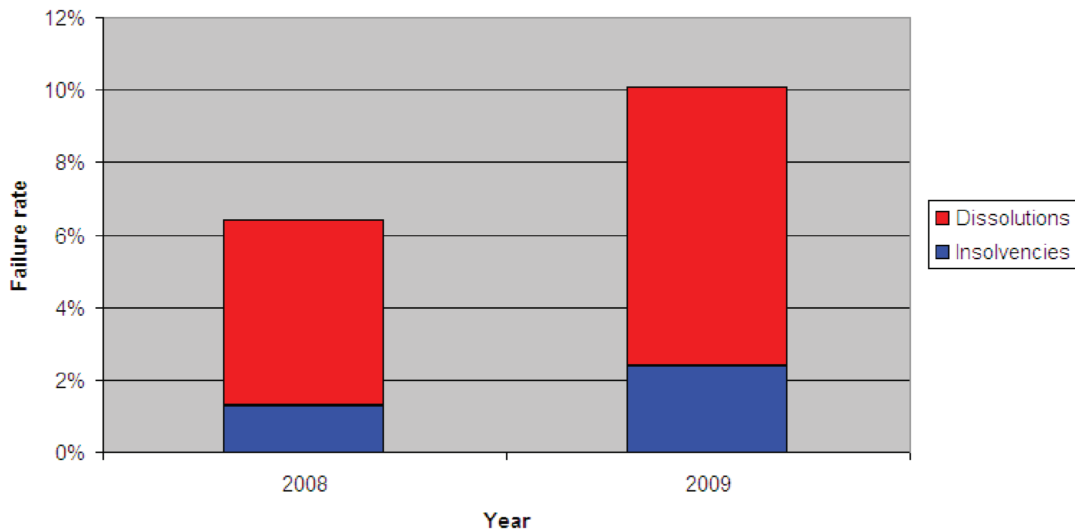

Source: pH, an Experian company

## Rising company failures

This decline in DCA financial strength has coincided with a period in which the perennial DCA challenge, how to collect back more than was originally paid for the debt, has become increasingly more difficult to achieve. With many debt buyers having signed ongoing contracts with lenders, the result is a potentially downward spiral.

The pressures affecting the DCA market has led to increasing numbers of firms ceasing trading. One per cent of DCAs became insolvent during 2008, leaving creditors out of pocket, while a further five per cent were wound up with no debts. In 2009, however, this had increased to two per cent of DCAs becoming insolvent owing money, and a further eight per cent being dissolved.

Figure 5: DCA failure rates, 2008 - 2009




Source: pH, an Experian company

## More difficult to finance debt purchase

Financing debt purchase has become significantly more difficult. In the past, investors were happy to lend money to DCAs, so they could buy debt, collect on it and ultimately provide the financers with a return on their investment. Now, after many years of expansive debt purchasing policies, debt-buying DCAs are facing significant losses on their portfolios. Investor confidence is low and, with capital constrained, there is less money available for DCAs to borrow to purchase new debt, placing a premium on managing for cash to fund future activities.

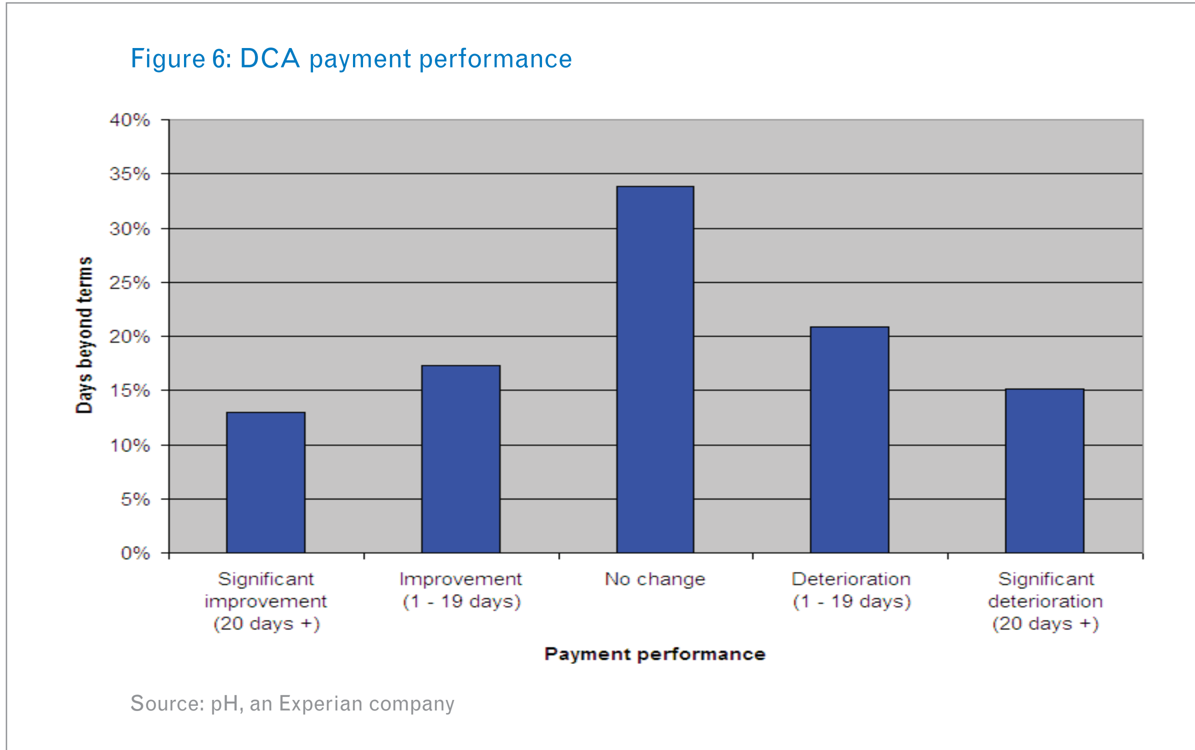
## Loss of personnel

Furthermore, many organisations are struggling to cope with a loss of personnel. Although 64 per cent of DCAs increased their staffing levels during 2009, corporate insolvencies and significant downsizing from contracting DCAs has resulted in a reduction in the number of staff working within the UK DCA sector. The loss of staff – in many cases experienced collectors who have moved to first party lenders – puts more pressure on remaining staff as they are pushed to increase productivity to collect more debt.

## Declining confidence

The speed in which DCAs settle their bills is a useful indicator of business confidence. When firms are financially healthy and confident they are less inclined to delay payment as a way of managing cash flow. Figure 6 demonstrates that DCA payment performance deteriorated slightly during 2009.

Figure 6: DCA payment performance




Source: pH, an Experian company

# Adapting to survive and thrive

So how can DCAs best adapt to this radically different market? What adjustments should DCAs be making to their strategies? And how can DCAs obtain a competitive advantage using their existing tools and resources?

### Don't simply throw more people at the problem

It's not a numbers game. Recruiting more collectors is not the answer. DCA management must seek to maximise the performance of their existing workforce, especially as they may be working with reduced numbers of frontline staff.

### Gain competitive advantage through data insight

At the very least, DCA collections operations should make use of available credit, demographic and behavioural data to prioritise accounts according to risk and the likelihood of collections success in order to define which customers to call first. This thorough understanding of each customer's circumstances, intelligently filtered and presented on-screen to the collector, can also help to ensure a more informed call that accurately reflects each customer's individual circumstances and ability to pay.

### Cleanse contact data to get closer to your debtors

Equally important is knowing how to get hold of debtors. Validating and updating customer data with the latest contact details will maximise right party contacts and minimise the time and effort wasted chasing wrong numbers.

### Integrate and automate for effectiveness and efficiency

While the steps identified above can be incorporated quite quickly into an existing DCA environment, the ultimate operational goal, however, must be seamless integration of all collections activities in a single architecture, ensuring that collection agents have access to accurate customer data and productivity tools to enable fast and accurate decisions.

While there are significant advantages that can be obtained from replacing legacy collections systems, this should be a medium term strategy, given proper due diligence and with a clear ROI expectation from the new modern system.

Modern systems can use strategic segmentation and sophisticated process management to automate many of the customer interactions, freeing up collection agents to concentrate on the more difficult cases requiring individual attention.

Source: Experian Victims of Fraud Survey (March 2010)

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