Surviving the Credit Crunch:

7 key strategies to maximise collections effectiveness

A Decision Analytics briefing paper from Experian

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Introduction
The knock-on effects of last year’s US sub prime crisis are now directly impacting collections operations as massive debt write downs precipitate a significant tightening of credit markets worldwide.

Although there remains an element of debate over the severity of the credit crunch and the longer term economic effects, there is no doubt that increased delinquencies and write offs are going to be a fact of life for the foreseeable future – even for the best run collections operations.

• For those who look to the US as an economic barometer, recent statistics are chilling. The delinquency and foreclosure rate for mortgages is already standing at 10%, and with the American average debt to disposable income ratio of 100% well below the UK figure of 170%, UK economists are understandably concerned.
• Indeed, UK debt servicing burdens have now become dangerously close to the repossession peaks of the 1990s (see fig 1) with the Financial Services Authority recently warning that more than one million mortgages are a “cause for concern” because of their riskier lending characteristics.
• Chiltern, the UK-based debt management company, reported in January that nearly 500,000 people have missed a mortgage payment within the last six months, which equates to 4 per cent of the 11.8 million outstanding mortgage loans.
• Rapidly rising living costs are also piling pressure on already strained consumer purses. Utility bills are up by 16% and the BBC reports that the average family food bill has risen by 12% in the last year.

The last 15 years of stable economic conditions has led to a relatively benign collections environment, leading to limited investment and a focus on reducing costs and write-offs, rather than preparing the department for a dramatic growth in delinquent accounts. As a result, most collections operations have been left over exposed and under prepared, with systems and processes simply not ready to meet the new collections paradigm.
In addition, with experienced collections personnel already in short supply, a lender’s ability to ramp up staffing levels to cope with an onslaught of new debtors will be limited. Collections performance will inevitably take a hit and all creditors will face increased write-offs as a result. With worried market investors turning their full attention to profit statements and the underlying debt related trends, taking the right steps to arrears management in this new world of collections has never been so critical.

So, faced with operations inadequately prepared for the sudden change in collection dynamics, what options are open to collections managers to improve the arrears management process, and ensure that their businesses come out of the credit crunch stronger and better prepared.

Based on our in-depth understanding of the complete customer lifecycle, we have identified 7 clear strategies for minimising write off levels and delivering maximum collections efficiency. Taken individually, each strategy can have a positive impact on the collections process. Taken as a whole, they can support each other and deliver the best opportunity for managing collections in difficult times.

1. **Intelligent use of bureau data**
   Being alert to early signs of a problem is crucial, particularly under rapidly changing market conditions. As a high percentage of individuals in arrears owe money on several accounts, the faster a creditor reacts to the fact that a customer is about to, or has just gone into delinquency, the greater the chance of the monies being recovered.

   Credit reference agencies offer creditors excellent sources of externally gathered data to augment a lender’s risk profiling process. Bureau credit scores, and initiatives like Experian’s Consumer Indebtedness Index, can be combined with internal behavioural data to provide a more complete assessment of default risk and collectability.

   Modern collections systems also support the easy integration of automated alerts, used to trigger internal processes that can dynamically update a consumer’s risk score. In this way creditors are empowered to act immediately, proactively managing cases with increased delinquency risk and assigning accurate collections priorities.

2. **More effective use of existing collections resources**
   In the new world of collections, increased write-offs are inevitable. However, smart collection teams can minimise losses by re-prioritising collections staff and processes to deal only with those accounts where a repayment schedule is likely to succeed. In all cases the cost of recovery needs to be strongly weighed against the
likelihood of success and the value of the debt being chased.

For example, sub-prime borrowers, estimated at between 5 and 15 per cent of the total UK mortgage market, have large debt servicing commitments and many will struggle to stay solvent. *A sizeable portion of these customers will not be rehabilitated.*

As a result, once identified and upon default, an accelerated collection treatment path should be deployed, within the boundaries of regulatory requirements. This will differ per sector but could involve the debt being quickly passed or sold to a debt collections agency if no response is forthcoming after a reduced early collections timeline. Extremely high risk cases may need to be written off immediately and sold or passed to recovery.

There is little point in deploying expensive staff and systems chasing debt that has very little chance of recovery when the resource can be used more effectively in targeting accounts that can be rehabilitated.

Where there is potential for recovery, the use of “self cure” strategies and “best time to call” analytics can play a key part in ensuring that the performance of hard pressed collectors is fully optimised.

**3. Increased use of automation**

With a large volume of customers in arrears, automation can have a significant impact on operational costs. If the number of delinquent debtors doubles it is impossible to double the number of agents to manage collections in the old way. It is therefore essential that automated processes are reviewed and deployed in areas where manual intervention would have been used in less troubled times.

Dedicated collection systems use advanced work flow technology very effectively to streamline all of the standard activities related to arrears management, moving debtor accounts through predefined stages in order to recover payment. They can automatically activate the sending of reminders, capture debtor response, monitor actual payments against any arrangement obligation and escalate to the next collection action within a predefined period if required. As a result, manual intervention is minimised and collections staff are released to focus on more complex, higher value cases.

Best of breed systems support the integration of modern communication channels, reducing the cost to collect even further as well as improving work load balance. For example, the automated sending of low cost SMS messages to different groups at prescribed delivery times can be used to generate inbound calls, helping normalise incoming workloads against available call centre resources, boosting productivity.

A new development is the use of self-serve collections portals where the debtors themselves propose payment arrangements – which the creditor can accept automatically if they fall within rules-driven pre-defined guidelines.

**4. Investment in better collections management information**

While collections reporting is already a key part of all collections departments, the functionality typically deployed in most operations does not match up to modern state of the art business intelligence tools.

The use of business intelligence (BI) functionality should also be seriously considered, either as an upgrade to existing systems or as part of a system replacement. Visual interactive dashboards with definable collections’ KPIs allow real time performance evaluation of current processes. Management decision making can also be significantly enhanced by BI reporting software that highlights
areas that are performing well, while identifying those areas that require further enhancement.

Analysis and simulation techniques such as champion/challenger and ‘what if ’ simulators can be used to remove the guesswork that often surrounds the fine tuning of collections processes. By testing the variance of specific work practices on a representative sample, the collections department can accurately assess the cost/benefit impact without compromising the effectiveness of the ongoing collections activity.

5. Improvements to staff management and training

It is not only borrowers who are facing an uncertain future. Collections staff will also have to navigate the new credit paradigm. They will need additional motivation, support and training to be at their most effective and collection managers will have to staunch the traditionally high attrition rates they can now ill afford.

Training in the psychology of over-indebtedness is a new approach, allowing staff to develop a better understanding of what is behind the rising levels of consumer debt1. And, as collectors become more attuned to a debtor’s personal psychological drivers, they will also need to develop the skills to respond better.

This may include more emphasis on how correspondence is phrased, phone training that focuses on handling new types of scenarios and a fresh look at how to negotiate payment arrangements for the many debtors for whom being in arrears may be a new experience.

Collections systems can also support collectors, providing them with both the tools to probe for and record quality data and the information needed to make informed decisions. Scripted question flows, screens providing an at a glance real time picture of a debtor’s total commitments and an end-to-end visualisation of his collections treatment path also helps to ensure that the appropriate payment arrangement is offered.

6. Use external agencies more effectively

With the pressure already mounting on overstretched collections managers, it is inevitable that external Debt Collection Agencies (DCAs) will need to be engaged earlier in the collections lifecycle, and more often. Managed well, they can significantly improve recovery rates and increase collections efficiency.

Common concerns when outsourcing early collections tend to centre around lack of control and customer alienation. These can be tackled with good planning and effective management of the process from the outset.

Careful consideration must be given to allocating debt to the agent most adept at handling it, thereby maximising cash collected. For early stage arrears outsourcing, agents may need to be trained to operate in the ethos of your organisation so they can act as a true extension of your team. Regular communication and effective reporting ensures all agencies are working to clearly defined performance criteria.

Modern collections tools can streamline management of a wide variety of agencies, from automated allocation and retrieval of accounts through to commission calculations and payment. Daily interface feeds between the in-house collection software and DCA systems ensures the correctness of account data, improving customer service and reducing complaints. With modern collections systems, it is possible to give agency staff direct, secure access to the collections system so that they can work and update their allocated accounts in real time.

1For more information on this topic see ‘The Psychology of Debt’ Briefing Paper from Experian Decision Analytics
These systems also help to ensure that operational and regulatory guidelines are followed.

7. Deploying a new collections system
The sudden spike in delinquencies, even from lower risk prime borrowers, is catching many lenders by surprise. Similarly in the UK, economic conditions and borrowing profiles are quite different from the last recession and as a result, the behaviour patterns of British consumers may be a lot less predictable as the crisis unravels.

As a result, legacy collections platforms and procedures are unlikely to support the flexibility required to adapt to changing market conditions.

Collections managers need to urgently review the capabilities of their existing systems, and establish if they offer the agility needed to quickly alter strategies as required. This may be on a subtle level, using user definable parameters to refine segmentation profiles or quickly changing the type, tone or timing of collections activities.

Coping with growing delinquency volumes may, however, demand more significant changes; the adoption of customer level collections based on overall exposure and the integration of new technologies such as automated email alerts, more sophisticated dialler applications and third party analytics engines.

However, with the credit crunch, at best, predicted to last at least two years, time is not on the side of traditional lengthy software implementation projects that tie up valuable collections personnel for months on end and eventually deliver functionality well after it was desperately required.

While this may tempt management to just batten down the hatches and try and ride out the storm, modern collections systems are now available that offer creditors a rapid means of targeting the majority of debtors in a more automated but also meaningful way. This kind of hard hitting functionality can now be deployed within less than three months, meaning an extremely rapid return on investment. Parameter driven, such systems then allow companies to tailor profiling models, fine tune collections strategies and drop in additional capabilities quickly and easily as the full reality of collections in the credit crunch emerges.

The jury is still out on whether the credit crunch is the pre-cursor to a long deep recession or just an economic downturn that will take two or three years to work through the consumer credit system. What is clear, however, is that there is a rapidly growing number of over-indebted households who are beginning to suffer under higher interest rates and the lack of previously easily available credit. The looming threat of negative equity is likely to be the catalyst for further decline and many prime borrowers will also be affected.

Mortgage providers will not be the only lenders facing losses. Credit card providers, telcos, utilities and suppliers of auto-credit and retail finance will all be chasing the same customers for outstanding payments.

It has therefore become incumbent for organisations to put in place the staff, systems and processes that will have the ability to handle the new collections paradigm - before conditions significantly deteriorate.

The seven strategies recommended here can all help collections operations weather the forthcoming storm. No one strategy is, in itself, a silver bullet to the new collections challenges. Taken holistically however they represent a platform for forward looking collections managers to build an operation that can help their organisations through today’s difficult times and build a robust platform for future lending.
No lender is likely to come through the next few years unscathed. But seizing the opportunity now to invest in modern systems and best collections practice will go a long way in protecting you, your team and your organisation’s bottom line from the brunt of the storm.