

The search for solid ground
Can outsourcing stabilize
your debt management
performance?

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Uncertain times

Throughout the global recession, the number of consumers and businesses falling into catastrophic debt has grown relentlessly. Though technical recovery may be underway in some countries, it is likely to be a long time yet before confidence returns or finances ease. There can be few businesses that haven't seen their cash flow damaged and their list of debtors rise. But, almost as worrying as the rise in debt, is the fall in predictability. Established patterns of payment and default are shifting, placing pressure on the credit management staff and systems that must struggle to deal with them, and upon businesses unused to living with the financial uncertainty those shifting patterns bring.

To date, most credit management departments have looked to outsourcing as a tactical measure to address short term challenges or to reduce their losses on hard core debt. In this paper, Martin Kochman, Chief Strategy Officer for Transcom – one of the world's largest outsourced credit management and debt collection providers – recommends an advanced approach to outsourcing that can help regain the stability lost in recent months and provide the solid ground upon which your credit management future can be built.



This paper recommends an advanced approach to outsourcing: solid ground on which your credit management future can be built.

The sources of instability

The recent recession has given rise to three factors that have thrown credit management departments into disarray.

First and most obviously, the sheer number of debtors – and levels of debt they incur – has increased. Because this has, for most, been accompanied by a fall in sales volume, the pressure on companies' cash flow has been intense. It has led board directors to place significant pressure on their credit management departments to recover debt quickly, and to take aggressive measures if necessary.

Second, even 'good' payers have become 'slow' payers. Customers who would typically pay on the nose when the invoice became due are now extending their payment terms – from 30 days to 60, or from 60 to 90. This is compounded by the fact that many of the traditional instruments that have allowed companies to ease their way through payment intervals, such as invoice factoring, are simply not available or, like most sources of credit, have become too expensive to access.

Finally, the nature of debtors has changed. It isn't just that more customers are defaulting on their payments, but that – all too often – the default has been unexpected and unpredictable. Many of those now in payment arrears have previously been 'good' customers, but at present, they find themselves to be 'reluctant debtors' forced by circumstances they can't control into situations they can't remedy. With this group of debtors, an aggressive debt collection approach will be expensive and will rarely deliver results. After all, the problem isn't that they won't pay; it is, quite simply, that they can't pay.

The number of individuals likely to fall into the 'reluctant debtor' category is extremely high, simply because consumers' approach to debt has changed over the past ten to fifteen years. More and more individuals now see indebtedness as a natural state. Most manage that state well, making payments diligently and moving debt around to get the best lending deals. It does, however, place them on a knife edge, making them highly vulnerable to financial crisis when the economy turns sour.

Across the developed world, levels of consumer debt have risen inexorably.

A report by the European Consumer Debt Network in October 2009 concluded that at least 20 million Europeans were over-indebted. The situation is most severe in the UK, where levels of indebtedness going into the last recession were, at £1.4 trillion, almost level with GDP. Similarly, in the US, consumer debt hit 100% of GDP in 2007 and, though it has fallen slightly, it still stood at 94% of GDP (\$13.66 trillion) in October 2010. It is interesting to note that the only other occasion on which US consumer debt hit 100% of GDP was in 1929, the year of the Wall Street Crash.

A unique bind

These three factors leave credit management departments in a unique and torturous bind. First, the pure volume of default means they have more debt to manage than people to manage it. We've come across companies struggling to manage increases in debtor numbers of anywhere between 20% and 100%. Unsurprisingly, their pleas to recruit additional staff to deal with that increase fall on deaf ears within their cash strapped organizations.

Second, the changing debtor profile means that their tried and tested approaches simply no longer work; yet they have limited ability to change them. At the very moment when they need to introduce more flexible approaches to debt collection – installment plans or 'payment holidays' for reluctant debtors, for example – they're discovering that the technology systems they depend upon simply can't support them. It's surprising how many credit management departments still rely on inflexible billing systems rather than dedicated credit management support infrastructures – we estimate around 7 in 10. And, once again, this probably isn't the best time to be asking the board for technology investment!

Finally, the challenges presented by inflexible systems are compounded by inappropriate skills. In strong economies, credit management is a largely 'administrative' task. Most late payments are the result of oversight or accident rather than an inability to pay or determination not to. The small minority of 'genuine' debt is managed through standard processes that escalate – typically after a 90-day period – to a legal process, usually involving the company's inhouse or external counsel. Credit management teams have been built accordingly, with a base team of 'progress chasers' supplemented by a small number of debt managers whose predominant expertise is legal. Few frontline staff have the relationship management skills needed to adopt varied approaches according to the debtor profile; to take a sensitive, conciliatory approach with reluctant debtors, while progressing determinedly with hard core 'won't pay' individuals.

All of this means that most organizations find themselves on shaky ground as far as debt is concerned. Their ability to predict, manage and recover it is severely compromised, while their options to recruit new skills or develop new approaches are financially constrained. In this climate, outsourcing, which allows people, processes and technologies to be accessed by means of variable cost rather than capital investment, must seem like an attractive option.


The way forward

Farsighted organizations are looking to external partners who, first and foremost, can help them overcome their short term staffing requirements. Yet they also seek partners that can address their entire debt management lifecycle – from credit risk assessment of new customers, through invoicing, dispute handling, collections and enforcement. They are looking to these organizations to bring stability to their finances, and to fast-track the development of sophisticated new approaches that will meet their needs through the recession, recovery and beyond.

Those new approaches will, for the most part, be focused around three guiding principles:

1. The use of advanced customer management approaches to manage reluctant debtors.
2. The adoption of analytics based techniques and technologies to implement a risk based approach to debt management.
3. The use of flexible payment models to keep cash coming in and to prevent expensive escalation.

Let's look at each in turn.



Outsourcing can fast track the development of sophisticated new approaches for the recession, recovery and beyond.

1. Managing customers or pursuing debt?

With the current unprecedented levels of consumer indebtedness, it's a sad fact of life that debt is no longer an aberration. Instead, it is an integral part of the typical customer experience. Yet most organizations treat 'customer relationship management' and 'credit management' as two completely different disciplines, housed within departmental silos. Skilled outsourcers bring them together, using finely tuned customer management skills to manage reluctant debtors through investigation, empathy and negotiation... and finally to implement flexible payment plans that deliver results for both parties.

For example, if a reluctant debtor simply can't afford the monthly minimum repayment on their loan, it probably makes sense to accept a lower payment, providing they commit to an agreed repayment schedule. This at least keeps some funds coming in and the two parties still talking. After all, what's the alternative? If an impasse is reached and no payment is made, the debt will escalate into a post 90-day legal process that is costly, delivers poor results, and is likely to destroy the customer relationship along the way. Remember, when the immediate crisis is over, these customers are likely to return to their usual good financial health – becoming once again the valuable customers you've known them to be. The only way to maintain your share of their future prosperity is by taking an approach that favours conciliation and arbitration, delivered by an operation that is targeted on retention and rehabilitation as well as debt recovery.

2. Analyzing the risk

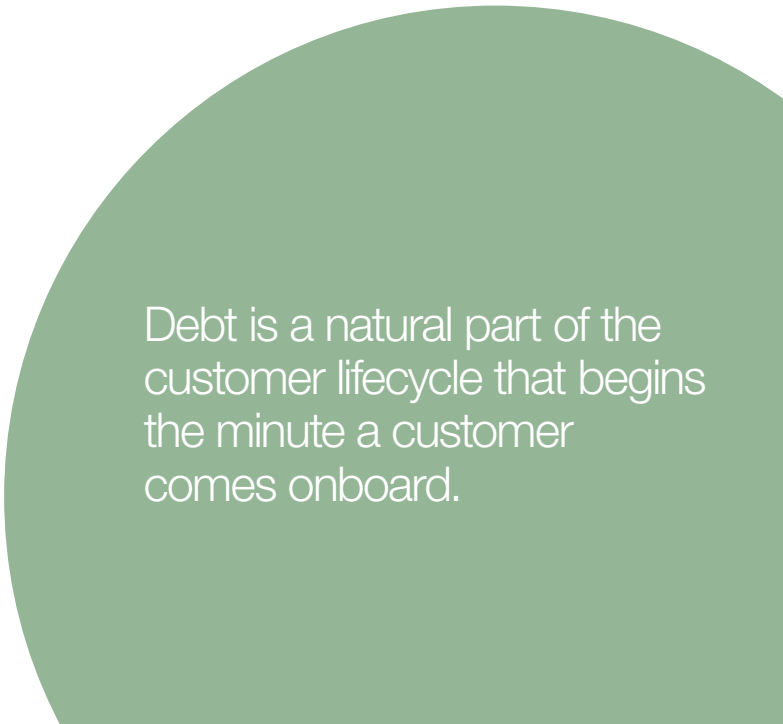
If we accept that future success depends upon managing customers rather than debt, we can view debt not as an isolated incident, but as a natural part of the lifecycle that begins the minute the customer comes onboard. And we can manage the risk accordingly.

An analysis of historical customer data will reveal the commonly shared characteristics of those who have defaulted on payment to your organization. This, coupled with established geo-demographic profiling standards, makes it possible to forecast other customers' likelihood to default – both the customers you already have and those you hope to bring onboard. An appropriate risk score can then be applied that will govern the way that customer is managed. For example, a credit card company will take a cautious approach when extending credit limits for a customer with a high risk score. By the same token, a mobile phone operator might choose not to proactively offer a contract option to a high risk customer on a 'pay as you go' deal.

Analytics will also help predict which collections approach is most likely to be successful. For example, we've been able to identify particular demographic segments – call them 'experienced' or 'wily' debtors, if you like – who will allow debt to escalate but pay immediately and in full when a legal process is threatened or undertaken. The best policy in these cases – potentially disastrous in others, as previously discussed – will be to move quickly to litigation.

Quite simply, a risk based approach allows companies to make a direct correlation between the level and type of risk posed by an individual customer and the way they are treated – both before they get into debt (how much credit do you extend) and after (what recovery approach do you take).

For instance, on behalf of one of our internet service provider clients, Transcom uses risk scores to determine our response when a customer exceeds their credit limit or when their daily usage increases uncharacteristically. A low risk customer is sent a gentle customer care message in the first instance and the escalation process that follows is measured and 'soft touch'. A high risk customer will receive an immediate phone call, followed by a much more assertive process.



Debt is a natural part of the customer lifecycle that begins the minute a customer comes onboard.

3. Building flexibility

If analytics provides the insight needed to fuel a segmented, risk based approach towards customers and their debts, it rests with technology to provide the engine. As long as companies continue to manage their credit operations via inflexible billing systems, their progress will be hampered. Transcom has worked with clients whose internal systems – programmed to issue an invoice and recognize its payment in full – simply can't accommodate partial payments, deferrals or payment by installment. These companies have found themselves facing a simple choice: either take on a time consuming and laborious manual process to reconcile the payments, or turn their backs on flexible payment options. Both choices would have cost money. If a debtor was able to pay, say 75% of the bill, the company would likely have felt inclined to accept and call it quits. But, if they'd been able to be flexible, they might have been able to recover 85% or 90% of the debt through several payments made over a longer time period.

Fortunately, by outsourcing to Transcom, they managed to avoid both of these expensive scenarios.

Which brings us to a final point about outsourcing: Cost.

Buy 'results'

We've established that the landscape of debt across Europe and North America has changed dramatically in the last fifteen years. The evolution of credit management departments – by and large – has not kept pace. The pressure is now on to develop the kind of sophisticated approaches – supported by advanced credit management systems and analytics – quickly. The fastest way to do so is by working with a specialist partner, leveraging their skills, insights and processes.

New contracting models, which share risk and reward by linking vendor remuneration to success, mean you're able to buy 'results' rather than 'activity'.

In short, they allow you to create a direct link between the price you pay and three key success measures:

- The percentage of debt recovered
- The percentage of debt recovered without recourse to expensive legal action
- A falling incidence of debt achieved through a risk based approach to the pre-debt customer relationship

Some of the most innovative outsourcing deals go further still by removing fixed asset burdens and even provide a much needed cash injection. There is now an established trend towards leveraged outsourcing deals, in which the outsourced service provider takes over not just credit management activities currently undertaken inhouse, but also the staff responsible for them, the premises in which they're housed and the infrastructure on which they depend.

The first benefit comes in terms of the fair market value paid for the fixed assets. The second in the alleviation of long term asset management cost. The third, from the outsourcer's commitment to not just 'take over' but 'transform' the adopted operation, delivering ongoing operating cost reduction and performance improvement on an agreed glide path.

For organizations that have previously thought of outsourcing as a 'short term fix' this will be revolutionary thinking indeed. But for those eager to exchange instability for solid ground, it presents a realistic and achievable way forward.



New contracting models
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About Transcom

Transcom is a global outsourced service provider entirely focused on customers, the service they experience and the revenue they generate. Our customer and credit management services are designed to strengthen our clients' customer relationships and secure their revenue streams.

Our broad service portfolio supports every stage of the customer lifecycle, from acquisition, through service, retention, cross and upsell, then on through early and contingent collections to legal recovery. Expert at managing both customers and debt, we make a positive contribution to our clients' profitability by helping them win customers, grow business and secure their payments.

And, while our services are designed to maximize revenue, our delivery operations are built to drive efficiency. Through our global network we can provide service in any country where our clients have customers, accessing the most appropriate skills and deploying the best communication channels in the most cost-effective locations.

Every day we handle over 600,000 customer contacts in 33 languages for more than 350 clients, including brand leaders in some of today's most challenging and competitive industry sectors. The experience we gain is used to constantly refine our service portfolio, processes and delivery, allowing us to respond quickly to changing market conditions and client requirements.



Find out how working with Transcom
could transform your customer and
credit management performance.

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