

## **Collections: The Success Factors**

Delinquency levels are rising for many consumer credit operations. In 1990 Citibank Savings saw delinquency increase by fifty percent over a matter of months on the motor finance portfolio. The response by the Head of Collections was to try and stem the tide. Agents were moved from mid-cycle collections to early collections. By telephoning more customers earlier, the idea was to prevent the 2 plus delinquency rising further. However, since there was no increase in head count, the point of repossession was delayed until the accounts reached the pre-charge-off team. On average repossession occurred at four payments in arrears rather than three. The result was that delinquency continued to rise and the loss per vehicle doubled. Delaying the repossession of vehicles results in further depreciation and dilapidation of the asset.

The strategy hadn't worked. However, the response was quite typical of the reaction to deteriorating portfolios. The reason the actions didn't work is because they failed to respond to the cause of the problem. Of course the UK economy was a major issue at the time, but the cause of the problem was more about the quality of business that had been acquired over the previous two years. The new business quality had deteriorated sharply, but due to the maturity of the portfolio, the impact had taken two years to significantly reflect in the overall delinquency.

### **Knee Jerk Reaction**

Many companies seeing a deterioration of results in Collections, focus on alternative collections approaches before identifying the underlying cause. The initial reaction is usually to look at the performance of the agents. The logic is that if the agents work harder, more money will be collected and so delinquency will be reduced. If the operation is not as efficient as it could be, there may be opportunity to increase productivity. However, it is usually true that working harder does not equate to being smarter. There may be an initial impact on results, but very quickly the agents' performance will deteriorate as they tire and time off due to sickness increases. When the operation should be looking to increase headcount, management can find that staff attrition becomes an added problem.

If the operation can't solve it, the next reaction is that other senior management become involved. Task forces are quite common, the idea being that more heads can be put together to come up with a solution. The result is often dramatic actions, such as was seen in the Citibank case study.

When this approach doesn't work, the company often takes more drastic actions that usually involves a reorganisation and can result in senior people losing their jobs.

## The Success Factors

The kernel of an efficient and successful Collections operation is comprised of four elements. These are: A 'people programme'; A test and learn culture; Collections MI that separates agent productivity and strategy performance, and; Analytics to identify the cause of problems early.

The people element refers to the development and assignment of good agents to the appropriate stage in Collections. It also refers to a business that calculates required resource and ensures that the right number of trained agents are available at the right times.

Many organisations run challenger strategies, but the successful ones ensure that tests are rigorously performed and analysed. They are appropriately designed, implemented and subsequently analysed. Figure 1 illustrates the test and learn cycle of a leading organisation.

Figure 1: Test and learn cycle



Management information is critical. To know whether the issue is caused by agent productivity, their results should be benchmarked and analysed independently. The cause of an increase in delinquency should be understood and reports such as 'dynamic delinquency analysis' go a long way to identifying whether newer business or mix is to blame.

Predicting results based on historic agent performance, Collections entry volumes and strategy expectations provides the operation with a comparative figure by which to understand actual results. Using a tool like analysis of variance can then isolate the issues.

### Analysis of variance

Differences between expectations and observations (Variances) can often be broken down into constituent parts. For example, imagine we get the following results: target recoveries of £38,500 thousand and actual recoveries of £39,520 thousand. We have a positive variance of over £1 million. This seems to be a cause for celebration. However, we can break results down into constituent parts. An obvious one is to look at the arrears stages. Figure 2 shows that the improvement has come from Early Collections where as Mid and Late Collections results are worse

Figure 2: Results by Area (thousands)

Area	Target	Actual	Variance
Early Collections	£21,000	£22,680	£1,680
Mid Collections	£14,000	£13,870	(£130)
Late Collections	£3,500	£2,970	(£530)
Total	£38,500	£39,520	£1,020

However, Early Collections aren't as good as they seem. We could break down these results by volume of cases, promises made and money collected. Figure 3 shows the Early results where volume of cases times promise rate and pounds collected equals the total recovered.

Figure 3: Components of the results for Early Collections

	Target	Actual	Variance
Volume (thousands)	1,000	1,250	250
Promise rate	70%	64.8%	(5.2%)
Average £	£30	£28	(£2)
Total recovered	£21,000	£22,680	£1,680

Figure 4 shows the financial impact of each of the variances. The financial impact can be calculated by formulae that depend on the number of constituent parts. For example the volume impact is calculated by the volume variance times the expected promise rate times the actual average payment.

Now we see that the better results are only due to the increase in cases entering Collections. The deterioration in agent performance has reduced the potential of almost £5 million higher recovery to the £1,680 thousand seen.

Figure 4: Financial impact of variances (thousands)

	Target	Actual	Variance	Impact
Volume	1,000	1,250	250	£4,900
Promise	70%	64.8%	(5.2%)	(£1,820)
Average £	£30	£28	(£2)	(£1,400)
Total Variance				£1,680

### **Conclusion**

Fire-fighting actions should be avoided at all costs. Firstly strategies tend not to suddenly stop working. Secondly it is unlikely that an untested 'left field' strategy will address the problem.

The cause of an increase in delinquency must be identified by good analysis. This usually starts with MI that dissects results and compares expected to actual performance. A simple tool like the analysis of variance will isolate the financial impact of critical factors. This will ensure that the business focuses on the drivers that have the greatest impact.

The best Collections operations are managed through the use of analytics. They understand that the success factors must be in place to gain improvements through knowledge acquisition and a scientific approach to the deployment of staff.

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