

White Paper

Improving Debt Recovery: How to compete with Financial Services for debtor's income

The Debt Environment

At the end of 2006, the total amount of lending outstanding in the UK was £1.2 trillion, a rise of 12.9% over 2005 figures and 48.2% higher than the figure recorded in 2001. During the first half of 2007 the level of mortgage repossessions were up 29% on the first half of 2006, and were almost four times the level of the first half of 2004. Increasingly delinquent debtors are now no longer individuals' finding it difficult to manage their budgets on the margins, but over-leveraged middle income households who have borrowed beyond their means to fund increased 'lifestyle' spending.

The Impact on Utilities

Historically, debt losses have had a measured but manageable impact on utility companies. Throughout the 1990's however, a growing market fuelled aggressive marketing campaigns to both win over and retain customers. As market growth slowed and competition for new customers increased, utility companies had to look for operational efficiencies to drive down costs. These alone have not been sufficient to address the impact on the bottom line. Today utility FD's see their core customer base becoming increasingly delinquent, and the questions of debt and how it is managed are now high on the priority list.

The primary difficulty faced by utility providers is that the consumers that owe them money are the same consumers who are indebted to a large number of other creditors - including the major financial services institutions. They compete for a share of the same decreasing pot of consumer disposable income.

Competition for debt recovery

Success amidst this competition is biased heavily towards the financial services sector for a number of reasons but fundamentally because of the core purpose of each of the competitors:

- Banks core business is lending and collecting money
 - Their systems, processes and people were specifically developed to maximise return from their lending business
 - Their collectors are specialists, whose sole job is to minimise losses on delinquent loans
 - They are analytically driven and have invested heavily in improving their capabilities in debt recovery
 - As lending margins have been squeezed so the focus on optimising recovery against bad debts has intensified
- Utilities core business is generating and distributing its service to consumers
 - Collecting from delinquent bills is important but not a core part of the utility business
 - The systems, processes and people were developed as tools to help service consumers
 - The collectors have adopted a 'generalist approach' of identifying and solving queries along with trying to cure bad payers
 - Data is generally of poor quality and is poorly understood; even knowing where all the debt is located and whether it is being worked proves extremely challenging
 - Investment in this area is being cut rather than increased, making improvement very difficult

Furthermore, the utility sector has had to overcome inherent constraints in recovering debt making the picture look very bleak:

- Limited ability to penalise non-payment → Inability, or where legally allowed, difficulty, to disconnect supply
- Having property rather than customer based systems and processes
- Lack of credit agreements making attaining CCJs and affecting credit rating difficult
- Requirement to continue to provide supply to non-payers

The opportunity for Utilities

However, one can adopt a different perspective on this 'imbalance' between utility companies and financial service companies and the opportunity for dramatic change in utility companies is significant. There are a number of 'quick and easy' fixes that can be implemented which will have a material impact on performance:

- Stop being a cheap/soft source of finance
 - When a person is truly in financial difficulty they will pay the most painful debts first
 - As utility companies are competing with the financial services industry for the same money it is important to align practices
 - Fees and penalties for non-payment are standard – not having them puts you at the back of the queue
- All customers are not the same. Appropriate treatment of customers will maximise the NPV to the company
 - Develop differentiated collections paths for rehabilitation and recovery
 - Segment customers to the appropriate path
 - Monitor and adjust segmentation and paths
- Evaluate all options to minimise cost to collect
 - Some segments will be cheaper to collect externally than internally
 - Identifying those segments will enable better focus and efficiency internally and enable external agents to find and recover their debt earlier
- Align targets and monitor performance
 - 'If it is measured it will be managed'. Ensure that the key performance indicators (KPIs) at all levels from agent to department are aligned to departmental goals
 - Align incentives with the KPIs
- Maximise value from final accounts
 - Effective segmentation of debtors prior to passing to DCA's and effective performance monitoring and management can give significant recoveries uplifts
 - Well developed strategies for placement, second placement and third placement can also yield significant revenue uplift

The future

Any utility company not currently reviewing and improving its debt management strategy will increasingly struggle to manage the growing debt challenge. The current debt problem has happened in a stable, even favourable, macro-economic environment. Even without significant changes to the economy, rising energy prices and the likelihood of mortgage rates rises will further increase the burden of servicing debt and the growing number of debtors.

Major system investments and process overhauls would enable some of the changes but finding the resource to invest in this area will prove extremely challenging. It is far better to spend the resource and investment on the core parts of the process by optimising the flow of accounts through collections and focusing on the debt that is cost effective to collect in house. Significant values are achievable when coupled with a good external partner to manage other debts.

The cost of not acting is not just 'more bad debt' but escalating customer dissatisfaction as the cost of debt is passed on through rate increases to paying customers.

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