

White Paper

Learning Lessons from the Private Sector in Segmentation

Each year local authorities seek to collect around £20bn of council tax. Of this, 96.5% is collected effectively each year, leaving around £600mn in uncollected tax. While some of this is eventually collected, both the collection process and the uncollected tax have significant impacts on local authorities, their tax payers and even the courts. Today, the process followed for collections is generally one-size-fits-all, dependant upon the use of bailiffs and the courts, not linked with benefit programs (or from one authority to the next) and thus it is relatively inefficient in managing the debt problem.

There is a large opportunity for local authorities to learn from the private sector, where debt collection has become more sophisticated in the last 10 years through increased use of analysis and customer segment focused strategies to the benefit of debtor and lender alike.

The Challenges

While private companies typically utilise sophisticated customer screening models to reduce their lending to risky individuals, local authorities do not have the luxury of choosing their customers. This ultimately results in a more difficult collections environment, but this is a structural challenge that cannot be avoided. To overcome this, authorities must be even more effective in addressing the challenges of typical collection approaches:

- Authorities have limited information on their customers.
- This lack of information drives a one-size-fits-all approach that does not allow different strategies to be developed for specific groups. For example, treating those who genuinely cannot pay differently from those who can, but choose not to pay.
- Bailiffs may be effective at getting people to pay, but too many are given the incentive to drag-out the payback period and maximise their profits.

- The courts are used as a blunt tool, adding pressure to an already overstretched system.
- The scale economics of improving collections make most investment prohibitively expensive for most individual authorities and necessitates that authorities begin working together.
- Authorities' revenue and benefits departments are often not well integrated, resulting in confusion and challenges for those individuals who represent genuine hardship examples.

Unfortunately, it is those customers who do pay their council taxes promptly and regularly that are the ones who bear the cost through ever increasing rates to cover revenue shortfalls. Gershon has highlighted efficiency savings as a key priority for the government and seeks local authority savings of £6.45bn per annum over the next 3 years. Collections are an obvious area that can drive both efficiency savings but also real cash contributions. However, to address these challenges will require a more joined-up, data intensive, analytical, customer driven approach.

Lessons from the Private Sector

The Private Sector has long been using advanced analytics and technology to improve the efficiency and effectiveness of the collections process. One of the main techniques used is segmentation. Segmentation works by using various data sources to identify discrete groups of customers who behave similarly and are best managed with a similar approach. These data sources can range from publicly available sources (e.g. census data, electoral roll, etc) to data provided by the customer (e.g. name, address, etc) to calculated data based on statistical probabilities.

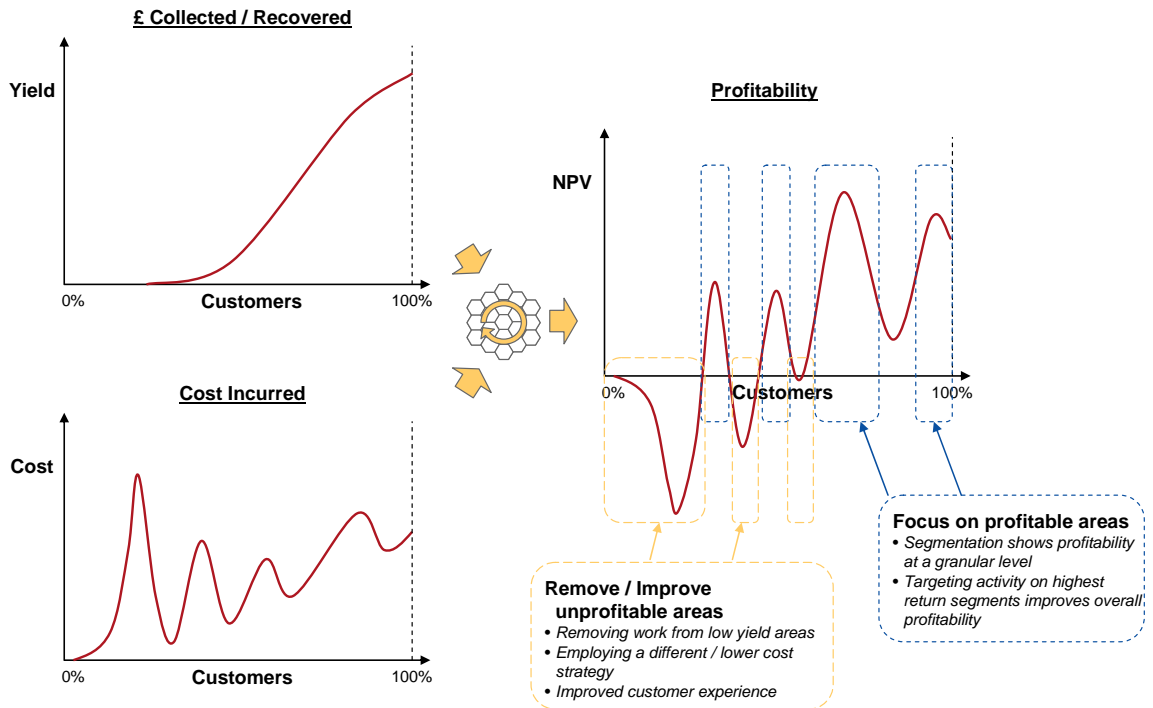
Whilst segmentation alone does not improve collections, it enables strategy differentiation between segments and can be used to help select the most appropriate collection route. In financial services, this approach has often achieved 20-30% improvements in collection rates as customer segments are matched with specific, customized operational collection strategies. It also typically reduces the average cost

of collections as expensive strategies are only executed on those customers most likely to respond positively.

An example of how segmentation can be applied in the public sector is Bankruptcy profiling. The main reason that the bankruptcy route is not widely used is the high risk (and cost) of failure. Our recent research shows that up to 75% of people typically pushed down the bankruptcy route are not appropriate for recovery through bankruptcy. With each case costing around £1,500, a local authority needs to collect nearly £4,500 from each successful bankruptcy to break-even on this strategy. By profiling customers, a segment with a high chance of bankruptcy success can be identified, which reduces the risk and improves the return rate. Within the UK several Local Authorities have recently begun using this approach to improve rates of return.

Segmentation, however, is dependant upon good customer data (both internal and external) and good analysis. Both of these can be achieved by local authorities, but require an increasingly joined-up approach (both between revenues and benefits and between authorities). This joined-up approach is increasingly being discussed (in thinking such as Gershon) and steps are being taken to make a move in this direction (such as the recent ODPM e-Innovation programme).

Segmentor Outputs



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Conclusion

There is a clear opportunity for local authorities to improve collections. Segmentation is an important tool which should be increasingly be used and will become increasingly powerful as authorities join-up. These improvements can positively impact authorities' source of revenue, their customers and even the courts.

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