



Up in flames

Are leasing companies losing money through poor debt management?

Peter Hunt reports

YOU might think debt management is a key to success for a lending business, but do all leasing companies give it the attention it needs? Many executives responsible for debt management think not. Stephen Bassett, chief operating officer at Broadcastle, commented succinctly, "collection should be as important as sales. Companies that pay more attention to debt management make more profit."

Part of the reason appears to be that many leasing companies have a strong sales culture. The focus is on turnover growth, with back-office functions largely divorced from the fundamental drivers of the business. That, says Bassett, is a mistake, "assessing the risk of putting the money out then speedy and professional collection are what finance companies are really all about."

Those taking a holistic view see three complementary parts to debt management. Firstly, write business that won't incur debts, secondly, monitor and manage the portfolio to

mitigate future risks and thirdly, the arrears management process itself.

New business

For many, new business processes set the scene for effective arrears management, notably in underwriting and the use of pre-credit checking, the latter minimising the risk of future default through careful market selection, and allowing future portfolio bad debt to be priced into finance margins.

Another key role of new business processes is to secure high quality information and accurate documentation. It seems every debt manager has stories of "bluffing" a defaulting customer when documentation is incomplete, and sales people are notoriously poor at paperwork. Typical problems include unsigned or lost agreements and direct debit mandates and missing director's details when a guarantee exists. Customer and transaction data also needs to be effectively maintained through the lease term.

With experience of re-

engineering new business processes in several leasing companies Andrew Denton, a director of CHP Consulting, recommends streamlined data capture, heavy use of checklists and audit trails. The hidden costs of poor data in terms of debt management can be significant, and at least one major lessor now uses the quality of documentation as an important metric for its sales people.

Web-based systems like the one used by Nissan Finance offer a positive example. "With almost 100 per cent of proposals going through the system, it provides quality data to achieve high acceptance rates and better debt management" confirmed Steve Gowler, managing director of Nissan Finance.

Other ways to ensure high quality information include commission clawbacks on non-recovered debt and, more positively, developing database marketing capabilities to create lead generation opportunities from the data provided.

Portfolio management

Regular portfolio reviews encourage well-developed intermediate credit processes, as in one leading lessor looking to actively manage deteriorating lessee credits. These include monthly reviews (accessing the customer's monthly management accounts), escalated auditing frequency on stocking and other facilities and regular credit department visits to the customer.

Greater analysis of existing portfolios will be driven by bank-owned lessors employing Advanced IRB under the new Basel Accord, forcing them to credit rate business customers and retail portfolios at least annually. In time, this should drive more sophisticated approaches to worsening credits within the portfolio. Companies such as Equifax also provide Gazette data (including when a liquidator, receiver or administrator has

been appointed) and specific portfolio monitoring services, gathering key event data to indicate worsening customer credits. Equifax claims its Gazette data service can spot eight out of ten business failures before they occur.

Debt collection

Arrears management should begin the day a customer misses a payment is the consistent message from leading debt management proponents.

Early customer contact is essential. However, care should be taken to resolve benign technical default through a simple customer service intervention, costing less and delivering a more appropriate response. Examples include direct debit failures where paperwork has not been completed correctly, switches from direct debit to cash or cheque payment and consistent marginal late payments by a customer. "Lots of people make their debt management more efficient, but they don't always make it more effective" concludes Denton. "Workflow enabled processes and better arrears categorisation – getting cases into the right work queues – can make a big difference."

Categorisation also applies in determining the correct approach for each customer, with three basic categories – "can't pay", "will pay" and "can pay but won't". Early process steps should flush out these positions and generate repayments from the "will pay" debtors. "Can't pay" customers can be written off, cleaning the lessor's book – or increasingly, the debt is rested until the customer is in an improved financial position (for example, a family death or unemployment may cause short-term financial difficulties, which may be resolved in the medium term). Focus can then be applied to the "can pay but won't" customers, with acceleration through the legal processes.

After initial contact, views differ on how best to recover

outstanding debt. Nissan Finance, for example, makes contact frequently and consistently, with phone calls at least every ten days.

Alternatively, Steve Heighway, head of legal recoveries at DLA, observed that during the initial, intensive period of customer contact, it is usually possible to establish in one telephone conversation whether the customer is likely to repay. Emphasis is placed on customer rehabilitation, but quick action means DLA can take whichever action is most appropriate to maximise value for its client.

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In either case, two basic rules seem to apply. Never lose contact with the customer and have an active, frequent review process of the arrears portfolio.

One key advantage for DLA is its status as a law firm. Anecdotal evidence suggests letters from lawyers have greater impact than from the finance company. As a result, DLA is launching a free letter service for clients to benefit from its legal status while still continuing to manage the debt process.

Tailored letters get a better response than standard ones, especially for complex lease transactions, but cost more. Gresham Financial Services has developed a mass customisation approach, combining standard paragraphs and statements in non-standard letters. This requires the ability to establish the dynamics of each case and represents an added value service, perhaps more suited to smaller debt collection agencies. Telephone calls and letters both have their place.

Whichever route is taken, a common theme is the requirement for a clear performance framework. With Nissan Finance, this



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includes global objectives on debt management, individual targets and specific standards for each task. Additionally, competition is created between external agencies, with cases assigned based on recent performance.

Companies in trouble often have debts outstanding with multiple lessors. To maximise debt recovery, co-operation is essential. Broadcastle, for one, often volunteers to act as the front company. This means more work but a speedier and more effective process for all concerned.

The right staff

The legal and contractual complexities surrounding asset finance debt collection, and the involvement of multiple parties, result in a wide range of potential collection scenarios. Inexperienced staff often struggle to establish the best approach to debt recovery, and can be "bamboozled" by liquidators, insolvency practitioners and others highly conversant with the law, thereby reducing recovery values.

As a result, recruiting and retaining the right calibre of staff is extremely important. It's a point made both by Bassett, who believes that employing high quality people who can "move hard and fast" is essential, and Colin Taylor, chief executive of Gresham Financial Services, who highlighted the experience of his collection team and specifically its detailed knowledge of the industry as a competitive advantage.

Getting the workload right is also a key consideration. With increased caseloads, success rates are likely to decline. Like many elements of debt management, there is a clear calculation between staff costs and recovered debt.

Considering caseload size and the potential sums recovered, it is likely that many lessors overload their collectors, with a negative effect on business profitability.

Bizarrely, despite the

importance placed on high quality, knowledgeable staff, the recruitment market appears relatively dormant. According to Katherine Amin, recruitment director of New Leaf Search, there have been few advertised openings across the market in the last year, despite the availability of good quality candidates.

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Outside help

According to John Abbott, a partner at Silverman Sherliker, leasing companies commonly delay too long before initiating legal proceedings. "It's a standard problem with the industry. Everyone knows debts over ninety days are increasingly difficult to collect."

Like any debt collection activity, key to the process is information. Often, lessors provide only limited information when instructing their agency or legal firm. Full documentation, statements, copy default letters and history files give less opportunity for the customer to dispute the claim; details on house ownership, guarantees and bank accounts provide opportunities for effective debt recovery. Without these, the firm is forced to send standard letters and employ less effective recovery strategies.

As 90 per cent of cases operate on a success commission basis (typically 12 to 15 per cent, but from 5 to 20 per cent depending on circumstances), a simple model can be generated to determine the best recovery approach, using relative recovery performance, commission rates and "fixed costs" of an internal operation.

Specialist external agencies claim to outperform in-house operations, though evidence appears anecdotal. Gresham highlighted a recovery of up to 40 per cent on very mature

debt, typically seen in sub-prime portfolios of small business debt comprising some of the most difficult cases, DLA quoted 82 per cent on a much younger portfolio. Both had been worked by the finance company before outsourcing. Factors favouring the external specialist include a clear focus, greater exposure to best practices, specialist services and scale. Conversely, costs may be higher (in absolute terms, at least) and in representing the finance company, integrity and trust are essential. Reputable small agencies are likely to take more time and bring expertise to the table, suitable for small quantities of complex lease transactions; larger firms bring greater process efficiencies, driven by technology.

According to research by the Credit Management Research Centre, larger retail finance companies increasingly use behavioural scoring and predictive modelling to determine when to pass out the debt. Agency performance is benchmarked against internal collection teams, leading to an optimisation of resources and recovery techniques.

The market for asset repossession agents is particularly fragmented, with many small operators. Finding a good repo agent becomes extremely important when considering specialist, *in situ* equipment, ensuring value is achieved on resale and an effective search of customer premises takes place. Unlike debt collection agencies, repo agents usually require the payment of a daily rate and expenses to make a repossession visit.

The learning loop

Best practice dictates that arrears experience should feed back into new business acquisition and underwriting processes, using statistical and insight-based analyses. This may result in documentary amendments, process improvements or changes in

new business focus and underwriting standards.

With high volume retail portfolios using sophisticated credit scoring, refreshing underwriting standards is relatively straightforward and, as Denton highlighted, "makes a strong argument for end-to-end workflow and a single data model".

With some business lessor feedback only occurs after a major default or as one major lessor explained, in a report monthly management meeting. By comparison, Nissan Finance routinely analyses each write off, with information fed into the underwriting team.

Typically this means scorecard changes or additional training. Each quarter, the ten worst cases are reviewed by a specialist risk committee and policy changes made.

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John Abbott

Additionally, closer relationships between arrears management and marketing create opportunities such as insurance cross-sales, risk-based pricing and as a credit position improves, other sales opportunities.

Opportunities

The sheer breadth and complexity of the debt management process faced by leasing companies inevitably mean that the activities of each lessor are sub-optimal, at so point. There are clearly different approaches available with quantifiably different levels of success, suggesting significant value protection for those prepared to challenge their existing business model.

Peter Hunt is a director of Invisio, a specialist strategy, marketing & development consultancy.