Part I:
Introduction

CHAPTER 1

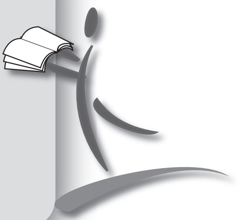
Did You Ever Think You'd Be Doing This?

Overview of the Credit and Collections Field

Promises make debt, and debt makes promises. – Dutch proverb

After reading this chapter, you will be able to:

- Recognize the importance of the collections department
- Learn the primary role of a credit professional
- Evaluate where to place the collections department within your organization
- Compare Asian and western collection environments



A Passion for Collections

Aren't you proud to be a bill collector?

If you had met me as a college student and told me that one day I would become a bill collector, I would have said, "No way, man." Of all the professions, bill collections would have ranked about 973rd on my list.

How about yourself? Did you choose collections or did collections choose you?

For most of us, I suspect the latter. Yet extending credit and collecting bills must be one of the oldest professions in the world. I bet humans have been borrowing things since the first harvest or the first hunt. And the lender probably received some kind of "promise" from the borrower.

Og	:	*Urg, can I borrow your spear for the winter mastodon hunt?*
Urg	:	*Og, I'm not sure I can spare it.*
Og	:	*Please?*
Urg	:	*No, I need it.*
Og	:	*Urg, if I get a mastodon, I'll give you a leg.*
Urg	:	*Deal!* (Followed by joint head banging as shaking hands was unknown at this time).

When I first began my career in collections it was a bit embarrassing. Friends, parents and strangers would ask, "So, what do you do for a living?"

That simple question caused all kinds of uncomfortable feelings within me. I didn't want to lie, but I sure didn't want to tell the truth either. It felt like I was holding a dirty secret. Eventually I mustered the courage to speak the truth, plus it's hard keeping track of different occpations if you lie and bump into the same person again.

"I'm a bill collector."

Their responses ranged from "You're joking, right?", to an uncomfortable, "Oh, I see." Dinner parties were the worst.

Nowadays, I handle that question easily. I give a one-two conversational knock-out punch. First, I answer the question confidently because I'm proud of what I do. I figure that if people feel awkward about my profession it's because they probably owe somebody money. Second, I follow up with a funny collection story.

I found it works. Soon small groups of people would encircle me wanting to hear more funny collection stories. Collections is indeed an interesting field. As my stories increased, so did the number of dinner party invitations.

Collections deals with life. We get our hands dirty. We hear stories. It's a job that allows us to interact with more groups within an organization than most other jobs. We deal with sales people to ensure the credit quality of their submissions is high. We share credit impacts with the marketing people before they roll-out new promotions. We meet with the I.T. department to ensure their systems allow us to touch more customers and process more money faster. We meet with the finance department to evaluate reports and statistics to forecast cash flow. We even contact our fellow employees for debts they owe the organization.

Senior management is concerned with our performance as it ties directly to shareholder performance goals. Chief Financial Officers are in regular contact to ensure the company is hitting its cash flow and expense targets.

By doing our job well, we give senior management something to brag about. We help them look good; which is the first rule in working for any boss. From their perspective, our role is to convert as many accounts receivable– which are simply "promises to pay"– into cash as quickly as possible.

"Collections" is Not a Dirty Word

People treat bad debts like a taboo topic. Although we know we have them, we would rather not talk about them, thank you. However, if we ignore them, we cause more problems. Ask businessmen about their gross sales and few hesitate to share this information. Ask them their bad debt percentages and often you will be greeted with strange looks. Either they don't know or they feel uncomfortable sharing such down-side information.

Mismanaging accounts receivable (A/R) causes companies to go bankrupt as cash returns are delayed. That delay is reflected in higher borrowing costs or worse – no one is willing to offer financing.

Tip:

A collections rule of thumb says you lose 2% of the value of the balance for every 30 days you let other people hold your money.

According to a study commissioned by the U.S. Small Business Administration[1] the major reasons why companies go bankrupt are "Financing" at 28% and "Inside Business Conditions" at 27%. "Financing" includes high interest expenses, loss of financing or lack of financing. "Inside Business Conditions" include mismanagement of accounts receivable. Not having cash, or mismanaging it, will cause companies to go bankrupt.

A similar study conducted by the U.K. based Association of Business Recovery Professionals found that some of the leading commercial causes for insolvency included lack of working capital / cash flow (11%) and bad debts (8%).[2]

Anyone who wants children needs to expect dirty diapers. The same is true for business. If you extend credit, expect bad debts. But, the nice thing about bad debts is, with proper credit controls, you can minimize them.

Bad debts don't get a lot of attention because they're not "sexy." Bad debts imply foreclosure, repossession, angry customers and nasty collectors. No one wants to get involved in such accounts.

Sales, on the other hand, are sexy. The word even sounds sexy: "Sexy Sales." Sales people have sales meetings, sales conferences and sales conventions. There are even sales "boot camps" where sales people go offsite to a resort and discuss sales techniques in between trips to the

1 Sullivan, Warren and Westbrook, *"Financial Difficulties of Small Businesses and Reasons for Their Failure"*, March 1999, <http://www.sba.gov> (4 June 2004), Office of Advocacy, U.S. Small Business Administration.

2 Association of Business Recovery Professionals, *"9th Survey of Personal Insolvency"*, 1999, <http://www.r3.org.uk> (3 July 2004), R3.

swimming pool. When was the last time you attended a "Collections Boot Camp"? In fact, when was the last time you ever attended any training in credit or collections?

Many sales people, like baseball players, are considered great if they get a "hit" 30% of the time. Whereas, if collection professionals achieved similar results, we would be off the team.

Sales and collections people have a lot in common. We both:

- Need many of the same skills to do our jobs effectively
- Ask busy people to part with their money
- Overcome objections while ensuring the overall experience for the customer or prospect was professional and pleasant

Both jobs aren't easy, yet they're similar.

Employees' Primary Role

What's the primary role of employees for the organization?

When I ask that question to a room full of supervisors or managers, I normally hear, "To make our companies money." But is it our primary role as credit professionals?

Look at the top 50 companies in the Fortune 500 list of ten or twenty years ago. Many of yesterday's most successful companies have disappeared. How did it happen? Who would have thought companies like McDonnell Douglas, RJR Nabisco, Airtouch, Digital Equipment, Enron, Allied Signal, and Rockwell International would either disappear or become merged by larger forces?

The primary role of an employee is to ensure their employer's survival. It makes sense. If you believe organizations are living things created and run by living beings with the intent to grow, thrive and provide sustenance for its members; then its ultimate goal – like in nature itself – is survival. Just examine the root of the word "organization." The credit and collections function is an important organ within any organization. Without the organ functioning properly, the organism dies.

Companies disappear when the management is preoccupied with making money. As our sport coaches tell us, "Never take your eye off the ball." As a manager, if you're following your secondary role (making money), and your competitors are following the primary role, guess who's going to lose the game? This is especially so in today's work environment where we face competition both domestically and internationally. Andy Grove, co-founder of Intel, sums it up well : "Only the paranoid survive."

Many companies focus exclusively on sales. They think that by selling more they earn more. Instead, the focus should be on helping customers because if you don't help your customers, they won't help you.

Sales people have a difficult job getting people to buy, but a sale isn't profitable until the money is collected.

So, let's go back to the question: Where do bad debts come from?

Extending credit and experiencing bad debts are facts of life for businesses. Organizations bear credit risks in order to increase sales and stay competitive. However, the risks are manageable with proper strategies and controls in place. The key group that sets the drivers for effective debt management is an organization's senior management.

It's easy for the senior management to set unrealistic bad debt targets while launching aggressive sales programs with easy credit terms. When the bad debt numbers inevitably increase, fingers are pointed at the credit or collections department. But pointing alone doesn't fix the problem. Until senior management takes a firm stance on combating bad debt, its bad debt targets likely will never be achieved.

If a company has a banner sales year, should the sales department take all the credit? Did the sales department do it all themselves? Or did the engineering department help by designing good products, or customer service by providing good after-sales service, or marketing by creating excellent promotions? In fact, it's a team effort.

The same holds true for bad debts. The credit and collection department alone can't take full credit or blame for a company's bad debt levels. The sooner senior management recognizes this, the faster organizations will take control of their bad debts instead of the other way around. David and Martin Sher[3] write in *How to Collect Debts and Still Keep Your Customers*:

> Collection departments alone don't cause bad debts – bad management causes bad debts. You can't blame the doctor for the number of sick and ailing patients. You also can't necessarily blame your collection department for the large number of sick and ailing accounts.

Organizational Disconnect

Many sales and credit professionals confide in me that the other party doesn't fully understand their business. Sometimes they will say that senior management doesn't fully understand the business, too. Usually, both the sales and the credit people are the ones who don't fully understand.

A customer-centric organization's top priorities should be (in order of importance):

3 David and Martin Sher, *How to Collect Debts and still Keep Your Customers* (AMA Publications) 1999.

1. Survival
2. Helping Customers
3. Earning Profits
4. Increasing Sales and Reducing Expenses

But often the focus of the sales and credit departments doesn't align with the organization's priorities:

Priority No.	Organization	Sales Department	Credit Department
1	Survival	Increase Sales	Reduce Expenses (bad debts)
2	Helping Customers	Increase Sales	Reduce Expenses (bad debts)
3	Earning Profits	Increase Sales	Reduce Expenses (bad debts)
4	Increase Sales and Reduce Expenses	Increase Sales	Reduce Expenses (bad debts)

Many sales and credit departments have only one priority. Is it any wonder there's a disconnect between these two groups and the organization? The sales and credit people point fingers at other groups for not knowing "what's really going on" when in fact they're the ones confused. It's at Priority 4 where sale's and credit's priorities are aligned with the organization's.

If your department's priorities are misaligned with your organization's, then you're missing the big picture. You're working in a silo.

Did you ever think that your top priority wasn't to collect money? Instead, concentrate your efforts on ensuring your organization survives, help your customers by providing excellent service, help your organization maintain profitability, and you will find yourself collecting more money than you have ever collected before.

Importance of the Job

Collectors are corporate doctors. We take unhealthy, nearly dying and sometimes dead accounts and try to revive them. In our society, doctors are valued. When I see layoffs announced in newspapers, the affected groups are usually factory workers, middle management, R&D specialists, and sales and marketing people. I have never seen a layoff where doctors (or nurses for that matter) were targeted. I also rarely see layoffs where collectors were the primary targets. Organizations silently value their collectors, but it's up to us to highlight our importance within our organization.

We're doctors and we're jewelers. We manage one of the most precious assets in any company's balance sheet: accounts receivable (A/R). For many companies, A/R is the largest current asset, for others it is the largest asset. A/R is the "crown jewel." How well you guard this jewel determines the profitability and continued survival of both your organization and your career.

Finally, while others departments read reports and memos of this asset, we actually touch it every day. In fact, we touch the two most valuable assets of an organization: customers and money. With the growth of Customer Relationship Management (CRM) – where the customer becomes the central focus of an organization-- our organizational value should increase.

If you haven't already guessed, my method of collecting debts is CRM-based. It's customer-centric. I want the customer to see me as a partner, not an adversary. Will today's global collections professionals survive collecting otherwise?

Where to Put the Credit Department?

In some organization's, the credit department is part of Finance or Accounting. In others, it's part of Customer Service or Marketing. In some, it's a stand-alone department.

There's no right or wrong answer; it depends on your business. If your organization is a consumer-based business catering to mass market consumers, like telecommunication companies (telcos), then perhaps Credit should reside in Customer Service. A company that wants to aggressively capture market share may put it in the Sales department. These are fine decisions, but I recommend against putting it in Accounting or Finance. These departments lack experience dealing with customers first-hand. They can cause customers to leave, and customers are our life-blood.

Senior management, with their overall understanding of the business strategy, is usually the most qualified group to determine the best fit for the credit department. Ideally, part of their decision-making process includes taking your views into consideration.

Dr. Barry Hutton, a professor at RMIT University in Australia, has written extensively on this issue. He suggests the credit department be a stand-alone department reporting directly to senior management, like an internal audit department. This way the department works cross-functionally to make its decisions wisely and impartially.[4]

4 Barry Hutton, "The Importance of Positioning," *Credit Management in Australia,* February 2003, 30-32; and "Are You Learning?", *Credit Management in Australia*, March 2003, 37-40.

Wherever your credit department is placed varies by an organization's needs. For me, I prefer the department residing with the sales or customer service departments. What other departments better understand customers?

Sales and credit are both part of the overall sales process. When I see credit and collections people in finance meetings, they often can't follow the conversation. They're unfamiliar with treasury's cash flow forecasts or the accounting people's problems with closing the monthly books, or the tax implications of purchasing certain assets. They're "fish out of water", but when credit or collections people attend sales meetings, they have plenty to say. Sales and credit departments are (like it or not) as the U.S./Canadian border reads: "Children of the same mother." We're both part of the sales process.

Tip:

If your organization places the credit department within the sales department, make sure both groups have joint KPI's (Key Performance Indicators). The sales people should have a component of their measurement determined by aging, bad debt and Days Sales Outstanding (DSO).[5] Conversely, the credit people should have a sales component added as a part of their measurement criteria.

Comparing the Collection Environments in Asia and the West

A large chunk of my working life has been spent in Asia, primarily South East Asia. I would like to share my experiences looking at both western and Asian collection techniques. Both cultures can learn from one another.

This desire to learn is seen every day from my new hometown in Kuala Lumpur, Malaysia. In Kuala Lumpur– or "K.L" as it's known locally–you see Asians wearing the latest western fashions like Armani suits and Dona Karan outfits; while western business people sport the local batik and silk garments. Each side emulates the other. Even the young are involved whether it's Asians dressed as rappers or western backpackers wearing sarongs and sandals. Both sides can learn from the other.

One concept that's differentiates Asia from other parts of the world is the concept of "face." "Face" is a powerful driver in Asian societies.

5 Days Sales Outstanding: the number of days it takes the average debtor to pay that organization's invoice. Calculated many ways, but calculated here as Total Receivables / Total Sales x 365 days.

People will do just about anything to gain "face" and avoid losing "face." Losing one's temper loses face. Smiling gains face. Face is about maintaining the dignity and respect of one another. As a result, if you share a lousy idea with an Asian, unlike a Westerner, they won't comment that's it's a lousy idea. They will hint instead. If you give incorrect information, often you won't be corrected. In Asia, you learn to understand hints.

"Face" is a powerful tool to collect money. Asian debtors absolutely do not want to lose face.

I hope you, the reader, benefit from understanding how collections is done in other parts of the world. Although the collection environments in both are different, overdue debtors share similarities the world over. Debtors in every country have similar payment excuses and objections, and the responses and strategies used to overcome these obstacles are similar.

Some of the collection techniques used in Asia are illegal in North America. I will highlight those suggestions by recommending you seek legal advice. At the same time, I don't believe grafting 100% of the U.S.'s FDCPA (Fair Debt Collection Practices Act) to another country. Asia and the West operate in totally different environments. The West has an extensive credit bureau system where up-to-date, confidential information is reported to creditors via centralized databases. In Asia, these databases are either non-existent or else limited to small data-bases sharing old, negative data to a small circle of creditors within the same industry (like banks).

In Asia, it's common for collectors and collection agencies to make site visits at debtors' homes or workplaces. Calling or visiting after 8:00 pm, on public holidays and weekends is common. This is partially due to a lack of fixed phone lines and the horrendous Asian traffic jams. In developing Asian countries, many debtors don't have work phones, and rural debtors lack home phones.

Another reason why site visits are so important in Asia is due to a lack of an effective skip tracing system. Collectors visit debtors' previous addresses to gather information from the neighbors to determine where the debtor has skipped.

Asian collectors also face large numbers of third party payment excuses, " Don't call me for money, call (third party) who's suppose to pay." This is particularly troublesome on car loans.

The U.S., due to its extensive credit bureaus, has some of the lowest Days Sales Outstanding (DSO) and bad debt levels in the world. According to the U.S.'s Federal Deposit Insurance Corporation, the banking institutions it monitors have a total non-performing loan rate of less than 1%[6]. Ciaran Walsh in his book, Key Management Ratios, writes that the

6 "Stats At A Glance", 31 March 2003, <http://www.fdic.gov> (5 April 2004), FDIC QBP.

U.S. DSO level is under 40 days, while in the European Union it's over 80 and in Japan nearly 60.[7]

Non-performing loan (NPL) rates in Asia are higher than in the West. According to the *Taipei Times*,[8] the NPL rates for the following Asian countries are:

Philippines	:	16-26%
Japan	:	40%
China	:	44 -55% of GDP
Taiwan	:	20-27%
South Korea	:	7 – 14%

In Malaysia, the NPL rate ranges from 6-7%.[9] The Central Bank of Indonesia reports Indonesian NPLs at 8%.[10]

America's bad debt losses and DSO levels are lower not because American debtors are saints, but because they're watched more. The credit "lights" are on longer and brighter. If an American pays slow or defaults on a bill, it becomes a negative mark on his / her credit record for up to seven years. In addition, good payment records are also captured.

If you visit Singapore, you will see one of the most orderly societies on the planet. There's no jay-walking, running traffic lights, toilets not flushed, spitting, and gum chewing. Singaporeans say, "Singapore is a 'fine' place." This is because the plain-clothes authorities pass out fines for these different transgressions. But observe Singaporeans once they cross the causeway into Malaysia and you will see a Dr. Jekyll- Mr. Hyde behavior change.

Ensuring the credit "lights" are on reduces overall delinquency rates and bad debt losses in any country.

Now, I would like to share brief views of the collections work environment in several selected Asian countries.

Collections Environment in Japan

Steven Gan is an American who ran a collection agency in Japan called Advance & Associates. He has lived and collected in Japan for over ten years. He finds that Japan has a similar collections environment to SE Asia. He shares these glimpses on collecting in Japan:

1. *"For some prompt paying debtors, we send birthday cards as a token of our appreciation.*

7 Ciaran Walsh, *Key Management Ratios*, (Prentice Hall Financial Times, 2003), 93.

8 Christopher Lingle, "*Balancing risks and returns in Asia*", 1 June 2003, <http://www.taipeitimes.com/News/edit/archives/2003/06/01/2003053537> (8 August 2003), Taipei Times.

9 *"Banking system remains healthy- Economic Report 2004/2005"*, 11 September 2004, New Strait Times, referencing data from Bank Negara Malaysia.

10 Central Bank of Indonesia's website at http://www.bi.go.id/bank_indonesia_english/monetary/banking_indicator/, (11 November 2004).

2. *Our collection manner is very polite (probably too polite). Sometimes I see the staff bowing to the debtors through the phone.*
3. *In Japan, we use a wide variety of collection letters and as much as possible try to customize the letter activity.*
4. *Legal action is almost never used as it protects mostly debtor rights.*
5. *There are approximately three credit reporting companies in Japan, but the data they supply is limited as not all companies contribute to it."*

Collections Environment in Singapore

Dominic Lee is a Singaporean and managing director of Credit Management Consultancy (Asia) Pte Ltd. – a full service credit company and collection agency (see http://www.cmc.com.sg). Prior to running his own company, he worked at Citibank for many years. He shares the following challenges collection agencies face in Singapore:

1. *"Singaporean creditors mostly outsource 180+ day accounts only. For the most part, creditors don't treat their agencies as strategic partners.*
2. *Singaporean debtors are 'face conscious'. Collectors must be very sensitive to this fact when making collections calls. However, for the extreme hardcore case, this rule is ignored.*
3. *Most collection agencies aren't technology driven. Our agency has the only predictive dialer in Singapore."*

Collections Environment in Taiwan

Jim Brown is an American running United Credit Services (see http://www.ucredit.com.tw). He is chairman of the Taiwan Financial Receivables Management Association – an association of credit agencies. He has this to say about the collections environment in Taiwan:

1. *"Consumer debt collection agencies in Taiwan tend to be large with eight or nine agencies employing between 150 and 400 collectors. There are over 40 registered companies providing full time debt recovery services—including field visits and legal support.*
2. *A major challenge we face here is strict data protection laws which prevent skip tracing or credit bureau support. In 2003, the Taiwan Financial Receivables Management Association (TFRMA) was established to promote a healthy collections environment, reduce complaints, and higher work standards among the agencies. The TFRMA members are to be ISO certified.*

3. *Commercial collections are generally handled by law firms, but there are no restrictions on the type of collections you do as long as your business is properly registered.*
4. *Debt portfolio sales have picked up recently with many banks selling off their NPLs (non-performing loans) to Asset Management Companies."*

Collections Environment in Australia and New Zealand

These two beautiful countries have their own unique collections environment. Neil Wood is a collections expert "Down Under". He also regularly travels around the Asia-Pacific region on business. He runs Global Credit Solutions Ltd. based in Australia (http://gcs-group.com/). He has this to say about the collections environment in his area:

1. *"The biggest changes I have seen in the past twenty years across Asia Pacific are the legislation under which collectors work. Privacy legislation and data protection legislation enforced in the West have spread globally and impacted Australia and New Zealand on the collectors' ability to locate debtors who do not want to be located.*
2. *What were previously considered sources of public records such as electoral rolls, credit databases, reverse telephone search engines, court records, drivers license and motor vehicle registration have been closed to collectors."*

Hey Asia, Want to Save a Ton of Money?

Asia could reduce its bad debt levels and make it easier to grant credit by implementing these next two recommendations:

❶ Creation of an extensive and accurate credit bureau system.

Western style credit bureaus that report both positive and negative payment behavior are less developed in Asia. Some countries have simple negative data-bases that report legal actions posted in newspapers, but many of the credit reporting agencies will expunge the record if the debtor satisfies the claim.

Some industries like phone companies and banks, share lists of charged-off debtors amongst others in the same industry, but not among outsiders.

One reason for Asia's lack of effective credit bureaus has to do with consumer privacy rights. Privacy rights, and especially the concept of maintaining "face", are strong.

The drawback in this thinking is that by protecting the poor paymasters from losing "face", the majority of prompt paying consumers suffer as they bear higher prices that vendors pass on due to higher than needed bad debt expenses. Good consumers also have difficulty getting credit as banks and other lending institutions are wary, thus loan sharks proliferate. Rarely will a month go by here in KL without a loan shark putting his business card in my mailbox, or car door handle, or under my wind-shield wiper. It's big business.

❷ Improve the efficiency of the legal system for creditors

In general, Asia's creditors need realistic protection. In the West, legal proceedings take a long time too, but in Asia it takes excessively long. As a result, many Asian creditors avoid the legal process, which the debtors take full advantage. Asian debtors, in general, are unafraid of legal action.

When I managed the collection department at a Malaysian company, my recovery rate on written-off accounts sent for legal action was 1%. The money recovered didn't cover the legal expenses. Still, it's important to send accounts for legal action as not sending them will send a more costly message to the market.

An exception to this legal inefficiency is Singapore. Singapore's legal system is automated and many of the forms can be downloaded and filed over the Internet.

Summary

- The field of collections is a noble profession and a critical function of any organization.
- The primary role for a supervisor, manager or any employee for that matter is to ensure their organization's survival.
- The best fit for your collection department depends on the needs of your organization.
- Although the collections field is similar in both the West and Asia, you can't graft 100% of one onto the other.
- Two recommendations for Asia to save more money and extend more credit are:

    1. Creation of an efficient credit bureau reporting system
    2. Improve the efficiency of the legal system for creditors