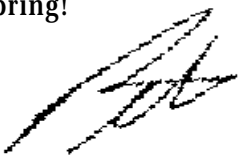**Dear Friends:**

This issue's feature continues our last newsletter discussion on collection industry trends that media properties should know about in order to best evaluate collection services. While our focus in Part 1 was on changes in the organization and business model, in Part 2 we look at technology driven change. And once again, we offer the Szabo perspective regarding these trends. Information technology can be a powerful support tool, but only if applied properly. In our organization, that means using IT to increase the value we deliver to our clients.

This spring's calendar holds several important conferences—the Broadcast Cable Financial Management Association and Broadcast Cable Credit Association annual conferences here in Atlanta May 16-18, and the International Newspaper Financial Executives and Newspaper Association of America's Newspaper Technology Exhibition & Conference (NEXPO) in Washington, D.C. on June 19-23. We look forward to seeing many of our friends and clients at these events.

Best wishes for a wonderful spring!

Pete Szabo, President
Szabo Associates, Inc.

Collection Industry Trends— And the Szabo Perspective: Part 2

In our last feature, we discussed how the changes in the global marketplace and technology have been driving intense competitive pressures across a wide range of industries. Media has certainly felt these effects, as has the collections business.

Generally speaking, trends in the collection industry fall into two broad categories: structural change and technology driven change. Last time we looked at industry mergers and acquisitions and the move towards outsourcing—not only call centers but even core business processes and customer-intimate activities. In particular, we focused on the relevance of these changes to the media industry as well as the Szabo strategy and philosophy regarding these trends.

In this issue's feature we pick up the discussion with part two, technology driven change. For the collection industry in general there have been a number of trends. We will focus on the several which appear to be generating the greatest interest.

Outsourced Call Center Integration

Call center integration is the technology flipside of outsourcing. When collection firms initially began to pursue cost reduction through outsourcing,

the focus was organizational. The equation was straightforward, or at least it seemed so: Capitalize on much lower labor costs outside the U.S. However, before long it became clear that there were significant unanticipated costs associated with migrating major functions as well as sustaining costs in areas such as increased management overhead, employee turnover, and customer satisfaction issues. These effects were amplified by the already present operational weaknesses due to the call center activities being segregated into functional silos. Consequently, firms were driven to invest in new application software and technology as a means to knit the call center together. While this has certainly resulted in productivity improvements, what remains to be seen is whether the recognized handicaps of outsourcing will permit gains as great as those realized by U.S. firms which had much earlier made such investments. For example, Szabo Associates' information technology architecture was not introduced to patch together already existing disparate systems, but rather was specifically designed from the ground up to drive business process improvement and

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standardization, provide a consistent data model, enable real-time access by any employee to all data needed to support the client, and to be quickly and cost-effectively enhanced as business needs change. This caliber of architecture can rarely be "back fit" onto an already implemented patch quilt of technologies and applications.

Application Service Providers

Application service providers (ASP's) are a recent development, which received a great deal of interest across industries about six years ago. They have since run into a lot of difficulty, caught between the pressures of economic recession and the significant challenges associated with what is a new and untested business model plus a large number of brand new operational requirements.

ASP's are essentially another form of outsourcing, and bear some resemblance to what was prevalent in the early days of data processing, the service bureau. Basically, the ASP "hosts" an entire hardware and software computing infrastructure. The key distinctions about ASP's are that the hosted software is a commercial package chosen and implemented by the customer (service bureaus provided very inflexible one-size-fits-all in-house developed applications), and the service fee is based on usage volume (rather than a flat rate service). This value proposition has particularly attracted small to mid size firms that cannot afford the costs of building,

implementing, and maintaining a computer center. These firms see ASP's as a means to level the playing field between themselves and their much larger competitors with deep pockets.

However, while for the smaller collection firm it is certainly much better to have automated tools, several compromises come with the ASP model. These essentially come down to having less flexibility and responsiveness. Using commercial software products means that the customer must fit business processes and practices around the software vendor's design. Because requests for changes in functionality are combined by the vendor with all others from its customer base, those requests may not be granted in the near term, if at all. Similarly, the vendor will queue up changes, usually until the next product release, which, on average, is every year or two. If the user feels a change is important to respond to new needs for clients, that capability will often simply have to wait. Hosting of the application and its underlying infrastructure by the ASP adds yet another level of control and reduced access to the application.

Recovery Scoring

Another technology change has captured a great deal of interest across the collection industry—recovery scoring. Recovery scoring is a computerized software technique that uses data models and mathematical formulas to "predict" behaviors. It is based upon statistics theory and uses a form of artificial intelligence.

The interest in recovery scoring accelerated considerably during this past recession. As financial pressures increased, many creditors slashed the fees paid to collection agencies

while also farming out more bad debt on a contingency basis. As a result, account scoring became a profitability issue for many agencies. Essentially, the same cost reduction drivers that led to the wave of outsourcing also drove the adoption of recovery scoring. In fact, what also has attracted firms' interest is the belief that recovery scoring can lower operating costs through reductions in personnel (which also indirectly mitigates high employee turnover) and lower staff development costs. For example, some firms have seen scoring as an alternative to negotiation expertise which requires more experienced—that is to say, expensive—collectors.

Early efforts at recovery scoring used generic models to determine if a debtor is likely to pay. Later these models evolved into predicting dollars to be collected. However, these models rarely indicated what the cost of recovery would be. All three of these factors are highly desired by many collection firms in order to determine how much effort to put into working an account. The objective is to create strategies that boost the overall recovery rate without raising recovery costs. Essentially, the tool is used to decide which accounts to liquidate, which to work aggressively, and which to work at a more modest pace.

Actually, scoring is not new. Credit reporting agencies have used a variant of "generic recovery scores" for quite some time to statistically determine creditworthiness. Who of us is not familiar with the consumer "credit score" that financial institutions now use to make lending decisions,

frequently with little or no direct interaction with the consumer? Recovery scoring is also extensively used by collection firms that represent consumer credit companies such as credit card issuers. For that matter, statistical modeling techniques have been used for years in the financial services industry as a marketing and business risk assessment tool.

What are the requirements for an effective recovery scoring model? First, there needs to be a very sound data model developed, which is not so much an event as it is a process that must evolve and improve over a period of years. That data model needs to comprise literally hundreds of data elements (pieces of information) about customers and transactions. Second, there needs to be a very large information repository of debtor experiences; thousands and thousands are needed for accuracy. For example, one

scoring services firm uses a model with more than 500,000 such "observations." Third, the repository needs to be continually maintained for accuracy and refreshed with the most current data. And fourth, there needs to be considerable computing power available, given the volume of data in the repository, the complexity of the models, and the need to have analytical feedback in real time. Clearly, the operational and technical prerequisites are not trivial.

The Szabo Perspective
Overall, Szabo is pleased to see the collection industry embracing information technology which, in all candor, the industry has been late to do. Szabo has been a pioneer in this respect, having seen in the late 1970's that IT can be a strategic enabler. This decision has paid huge dividends in collector productivity, business process re-engineering and re-invention, organizational and functional

integration, flexibility and speed in responding to client needs and industry shifts, and improved management review of collection files by facilitating self-critiquing while ensuring adherence to policy and procedure. In particular, IT has enabled Szabo to tightly tailor its operations to the highly unique and rapidly changing needs of the media community.

Szabo Associates does not use recovery scoring. As stated in regard to outsourcing, we would not debate the advantages of recovery scoring for some industries, for segments of the financial services marketplace, or even for certain firms with the general collection industry. Szabo does not, however, see recovery scoring as a good fit for media industry collections.

The effectiveness of recovery scoring—predictive statistical modeling—is directly proportionate to the quality of the data model, the size of the experiences repository, and the consistency and accuracy of the accumulated transactions. Experts in this field point out that it is desirable for the data model to use as many as 500 elements, and the preferred number of experiences are as many as a half-million accumulated over 5 or more years. Also, the model needs to be rather homogeneous, which means that the transactions are relatively similar in structure and composition. In simple terms, the accuracy of predictive modeling is dependent upon a very large volume of relatively similar data collected over an extended period of time.

It is easy to see why consumer goods purchases and revolving credit charges would be a good application for
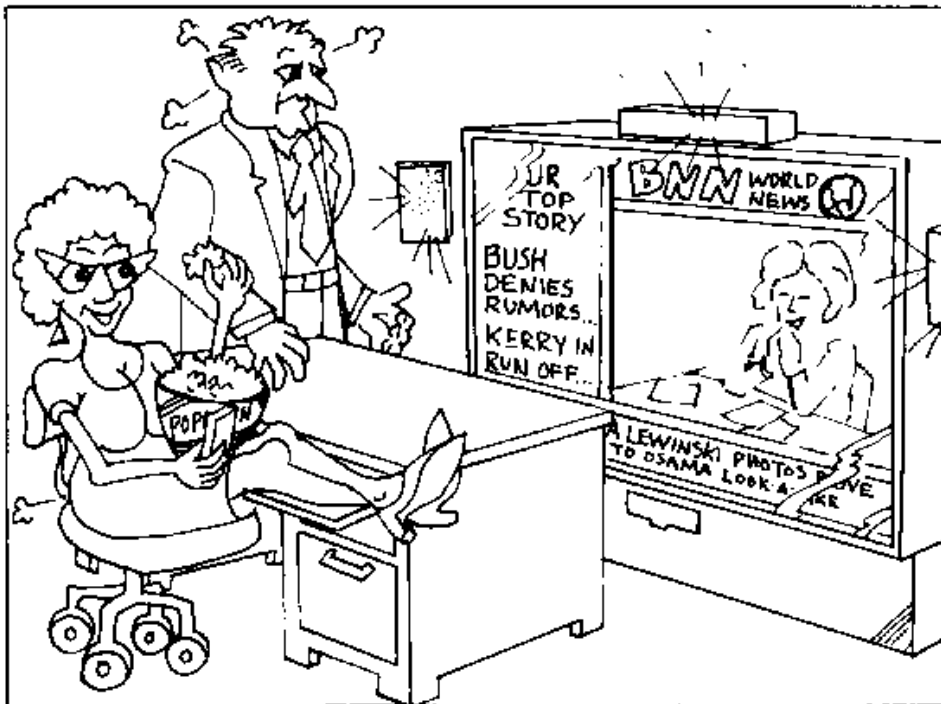
"NO NEED TO WORRY ANY MORE ABOUT USING THE LATEST TECHNOLOGY. THE TV SALESMAN TOLD ME YOU CAN'T GET ANY MORE HIGH-TECH THAN THIS!"

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recovery scoring. On the other hand, the media industry is different from other industries, most notably in the structure of business transactions and its rate of change. It is inherently dynamic—always changing, and not even remotely static.

Another concern regarding the applicability of recovery scoring to the media industry has to do with its value proposition to the customer. We at Szabo feel strongly that a media collection firm should make its operational decisions through the filter of maximum client value. We believe in a win-win value proposition. Recovery scoring is too often used solely for cost reduction purposes with the benefit flow-ing to the collection agency's bottom line rather than greater value back to the client. It shields the agency from having to invest in superior <u>human</u> decision making, such as by hiring, developing, and retaining the very best negotiators.

Additionally, the promise of IT is lost if misapplied. Having led the industry in IT for more than two decades, we understand how compelling the siren song of elegant technology can be. It is easy to succumb to the temptation to overly depend on technology. But when the decision support tool changes from an aid to something in effect making the actual decisions, it has lost its proper place, and can, in fact, be counter-productive. With such a powerful tool, over-simplification, ineffective use, or misuse, can translate into less, not more, value to the client.

At the end of the day, what technology investments must be about is increasing the value delivered to clients. More than 25 years of IT leadership has taught Szabo that technology, as useful as it is, must be harnessed as a tool—it must never become the main focus let alone an end in itself.

Looking ahead, it is clear that dramatic change in the global marketplace and technology is here to stay, and at an ever-faster pace. As new trends emerge in the collection industry, Szabo Associates will sustain its leadership by continually evaluating the merits of these developments through the prism of our core principle—delivering maximum net value to our clients. ♦

SZABO ASSOCIATES INC. **szabo**

MEDIA COLLECTION PROFESSIONALS