collective wisdom®
MEDIA COLLECTION PROFESSIONALS szabo
SZABO ASSOCIATES, INC. VOLUME 23, ISSUE 1, MARCH 31, 2008

Dear Friends:

The news on the economic front these past few months has been about as depressing as a blizzard in springtime. At the same time, some of our clients have allowed the troubled economy to compromise enforcement of their payment terms, extending the time they permit receivables to age before beginning formal collection efforts.

Taking action on past-due receivables is key to maintaining your organization's health until the economy rebounds! This issue's feature offers some thoughts about the current slowdown and tips to minimize its effects on your bottom line.

Our late-spring calendar takes us to the Broadcast Cable Credit Association/Broadcast Cable Financial Management annual conference, May 13-15, in Dallas, Texas; the Georgia Association of Broadcasters summer convention, June 5-7, in Marietta, Georgia; the International Licensing Industry Merchandisers' Association, Licensing International Expo 2008, June 10-12, in New York, New York; and the International Newspaper Financial Executives annual conference, June 21-25, in Las Vegas, Nevada.

Best wishes for a terrific spring,

Robin

C. Robin Szabo, President
Szabo Associates, Inc.

Accounts Receivable Management More Challenging During Economic Downturn

The late economist John Kenneth Galbraith once said, "We have two classes of forecasters—those who don't know and those who don't know they don't know." Certainly we have been able to appreciate Galbraith's sentiment over the past months as Wall Street and government analysts sliced and diced the latest statistics and opined on the current and near-future state of the U.S. economy. "This could be the 'big one,' the likes of which we haven't seen in 25 years," stated one. "The economy, if not at a halt, is very close to it," said another. "This is not and will not become a recession," offered a third.

Amid all the uncertainty and disagreement, businesses and consumers share a growing concern about the current downturn. When news of the sub-prime mortgage crisis first hit the headlines last year, the economic quake, at whose epicenter were the banking and investment industries, sent shock waves that reverberated much farther than most people expected. As reported in *The Wall Street Journal*, the latest quarterly survey (fourth-quarter 2007) of industrial manufacturing executives by PricewaterhouseCoopers found that only 29% held an upbeat view of the nation's economy, less than half the level of the 2006 fourth quarter and the lowest since the firm began conducting the survey in 2003.

The Commerce Department reported a fourth-quarter slowdown in economic growth as consumers cut spending, new-house construction fell, and business inventories declined. The department also reported that the gross domestic product grew only 0.6% at an annual rate in the fourth quarter, a sharp reduction from the 4.9% reported in the third quarter. GDP growth totaled a mere 2.2% for the entire year, the lowest since 2002. The Federal Reserve responded to the report by lowering its short-term interest rate for the fifth time in four months, for a total of 2.25 percentage points, and hinting at the possibility of further cuts in the near future.

So what really gives? Are we in a recession or aren't we? And what impact does the downturn have on accounts receivable management? In the face of increased uncertainty, it may be useful to review what we know for sure and what the practical implications are for credit and collection managers.

Is it Recession?

One of the most popular definitions of a recession, used by businesses and Wall Street alike, is a period when real (adjusted for inflation) gross national product has declined for at least two consecutive quarters. By

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that definition, the last time the U.S. experienced a real recession was in 1990-1991, with real GNP having declined between the third and fourth quarters in 1990 and between the fourth quarter of 1990 and the first quarter of 1991.

The two-consecutive-quarters definition of a recession, however, does not always work well, according to Geoffrey Moore, the director emeritus of the Center for International Business Cycle Research at Columbia University. One reason Moore cites is that the definition fails to provide monthly dates that a recession began and ended. Additionally, a major decline in economic activity in a given quarter can indicate a serious problem, even if the GNP in the subsequent quarter does not decline.

The National Bureau of Economic Research (NBER), the think tank whose chronology of recessions is widely accepted, defines a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real gross domestic product, real income, employment, industrial production and wholesale-retail sales." According to Moore, the NBER takes into account three dimensions of the decline in aggregate economic activity—its depth, duration, and diffusion across industries. The 1990-1991 downturn qualified as a true U.S. recession according to NBER criteria as well.

One problem with the NBER formula is that it takes six to 18 months after a recession begins to determine and announce that it exists. This is why analysts study and compare all relevant monthly data, including labor statistics, to make their best guesses. For example, the jobs report that came out on February 1st indicated shrinking payrolls and a falling aggregate hours index, additional indicators of economic poor health.

At the time of this printing, we were not yet in a recession, as defined either by the two-consecutive-quarters rule or by NBER's pronouncement. Some optimistic forecasters believe that the Fed's aggressive actions and fiscal stimuli will put the brakes on the slide toward recession. Others, including former Treasury Secretary Larry Summers, ex-Federal Reserve Chairman Alan Greenspan, and some influential Wall Street investment firms, are convinced that a recession is imminent if not already here.

Implications for Media.

Whether we are experiencing a true recession or simply an economic slowdown, the implications for accounts receivable management are largely the same. In difficult times, accounts are more perishable and collection recovery of past-due receivables decreases. If we are indeed in a recession, which is more far-reaching and longer-lasting than a downturn, it is even more critical for organizations to acknowledge these realities if they are to successfully weather the dark days ahead.

The reason accounts are more perishable is reflected by yet another sobering statistic—the higher-than-average percentage of business failures. Although bankruptcy statistics are rarely mentioned in discussions about the current state of the economy, credit and collection managers have long appreciated the correlation between the number of bankruptcies and the level of difficulty in recovery or liquidation of bad debt. It is interesting to note the number of business failures that occurred in the years 1990 and 1991 (our last true recession). Business failures increased a whopping 51.3% in 1990 over the previous year, and 46.3% in 1991 from 1990. (See *Collective Wisdom*, March 31, 1992.)

According to data reported in the *Dow Jones Daily Bankruptcy Review* and compiled by AACER (Automated Access to Court Electronic Records), a private company that tracks bankruptcy statistics, all types of business bankruptcy filings rose to 42,755 in 2007 from 29,993 in 2006—an increase of nearly 43%. The company reported also that bankruptcy filings of all types, including consumer filings, increased by 40% in 2007. Filings in 2007 numbered 826,578, up from 590,568 in 2006.

As the number of bankruptcies increases, pressure on media to make quota also increases, and media become more inclined to accept marginal accounts. Additionally, many media companies, during economic downturns, extend the time they will allow an account receivable to age before they engage in formal collection efforts. Failure to engage in timely collection efforts on accounts, some of which are higher-than-average risk to begin with, can have a severely negative impact on a company's cash flow and bottom line.

The longer an account languishes on the books, the more it costs to keep it there and the less likely it is to be collected at all. Even if the account is collected in-house, its value continually drops due to the cost of maintenance. Every dollar on the books that is written off requires four dollars in new sales just to replace its value.

According to a recent survey of members of the Commercial Collection Agency Association of the Commercial Law League of America, the probability of full collection on a delinquent account drops dramatically as the delinquency period lengthens. After 90 days, the probability of collecting the account is 69.6%; after 180 days, the probability is 52.1%; and after one year, the chance of collecting is only 22.8%. These percentages represent a significant decrease in probability from the CCAA survey results of several years ago, as reported in the March 2001 issue of *Collective Wisdom*.

With new and marginal accounts in particular, failure to collect on a timely basis exacts an additional cost that is difficult to quantify. If an account believes that payment terms will not be enforced, it may establish a pattern of delinquency simply because it is allowed to do so. The cost to media of repeated delinquencies over the life of the business relationship can be enormous.

Because receivables are more perishable in times of economic downturn, it is critical not only to adhere strictly to your company's collection procedures and timetable, but also to "keep your antennae up" and prepare to respond quickly at the first sign of trouble. Here are a few tips to help your organization maintain a healthy cash flow in these difficult times:

1. Monitor troubled industries. Recessions are defined, in part, by their diffusion across industries, measured by the percent of industries with declining employment. Some industries and some areas of the country are invariably hit harder than others in difficult economic times, recession or not.

When we think of industries that are the most beleaguered right now, the housing industry immediately comes to mind. Home loan defaults pitched mortgage lenders and many consumers into bankruptcy, and housing starts fell 38% this past year. The auto industry has also taken some heavy hits and is largely responsible for the business inventory drop reported in the fourth quarter. Business inventories decline during periods of extreme uncertainty. In this case, manufacturers are uncertain that consumer demand will soon rebound and spur sales.

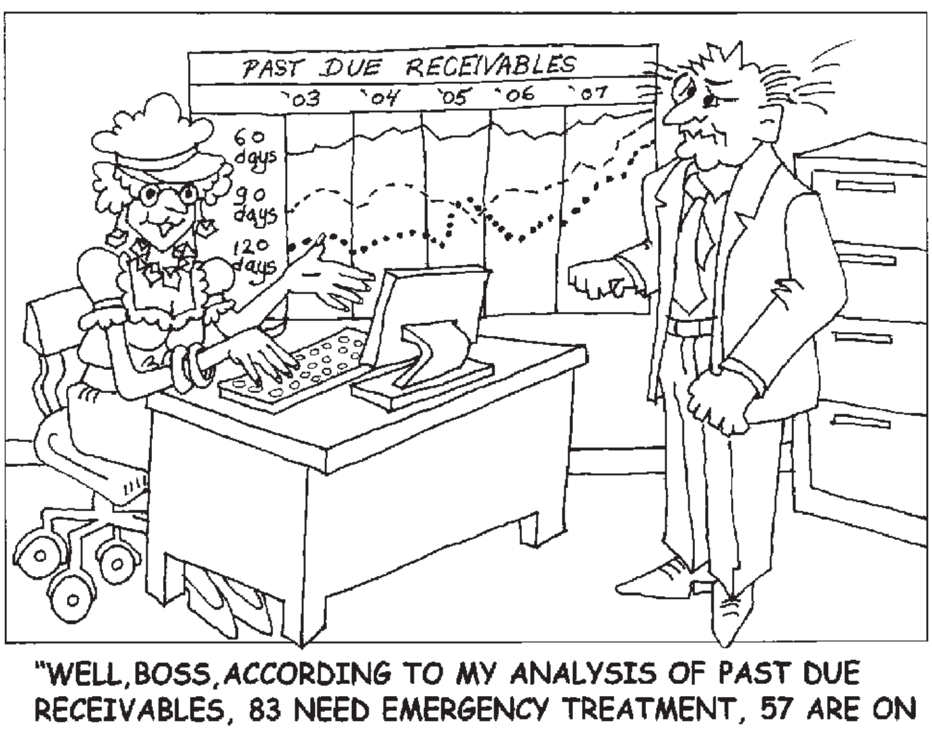
While monitoring industry trends is wise even in good times, it is imperative during difficult times. A prolonged credit crunch and decline in consumer spending can quickly change the profitability of businesses that were little affected at the start of the downturn.

Regularly review financial magazines, newspapers, and financial websites to help you stay abreast of industry developments. Meet frequently with staff members to exchange information and to ensure they are aware of the economic interdependencies that exist among industries.

2. Watch for "red flags" that can signal potential collection problems. We all have witnessed businesses in troubled industries that remain healthy and businesses in relatively untroubled industries that fail. Changes in markets, operations, or management can quickly affect a company's health and stability.

Observing a customer's behavior is one of the best ways to recognize signs of trouble early on. Have the customer's paying habits changed? Has the customer requested a hiatus during an advertising schedule? Has the customer attempted to cancel an existing contract? Has the customer defaulted in any way? If the answer is "yes" to any of these questions, procure an updated credit report and discuss the problem with the customer immediately.

Watch for delaying tactics. Does the customer repeatedly ask for documentation that has already been sent? Are there disputes or discrepancies that could indicate cash flow



"WELL, BOSS, ACCORDING TO MY ANALYSIS OF PAST DUE RECEIVABLES, 83 NEED EMERGENCY TREATMENT, 57 ARE ON LIFE SUPPORT, AND 42 ARE WEARING TOE TAGS."

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problems? Does the customer mention a dispute only after you request payment? Does the customer fail to pay after the allegation of a dispute is proved groundless? If so, it is time to place the account with a third-party collector.

3. Form a partnership with a third-party collector. It is impossible to totally eliminate overdue accounts and bad debt. Any organization that claims to have done so has probably been overly cautious in extending credit and, as a result, has missed some valuable opportunities. A good collection agency can improve your bottom line by maximizing recovery on past-due accounts while preserving your relationships with your customers.

Choose a collection agency with which you want to form a long-term partnership. It not only should reflect your company's ethics and standards but also should have extensive experience in your particular medium. A superior agency will also be actively involved in organizations and activities that keep it abreast of the latest developments, rules, and regulations in both the collections and media industries.

Turn over accounts to your third-party collector when they are 90 to 120 days past due, depending on how perishable they are. Accounts in more volatile industries should be turned over at 90 days, while those in more stable industries may be allowed to age longer. Under no circumstances should an account age longer than 120 days before turning it over to a third party.

This Too Shall Pass.

Some good news amid all the bad is that recessions in the past 50 years have had a shorter duration (11 months on average) than recessions that occurred before that time. Since the Great Depression of the 1930s, the government has intervened during times of trouble, providing unemployment insurance, reducing interest rates, and increasing credit availability. Additionally, service industries, which historically maintain their stability better than manufacturing industries, have become a more important component of the economy.

At the time of this newsletter's publication, it is quite likely that the Fed, hoping to mitigate the risk that the economy will continue to spiral downward, will have reduced rates once again. Whether this aggressive approach to easing the credit crunch will have its intended effect will be the subject of continued debate as we approach the mid-point of 2008. Most economists agree that the economy will turn around, as it always has, in the not-too-distant future. In the meantime, media can best meet the challenge by acknowledging that accounts are more perishable now, monitoring industries and accounts closely, and responding quickly at the first sign of trouble. ♦

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