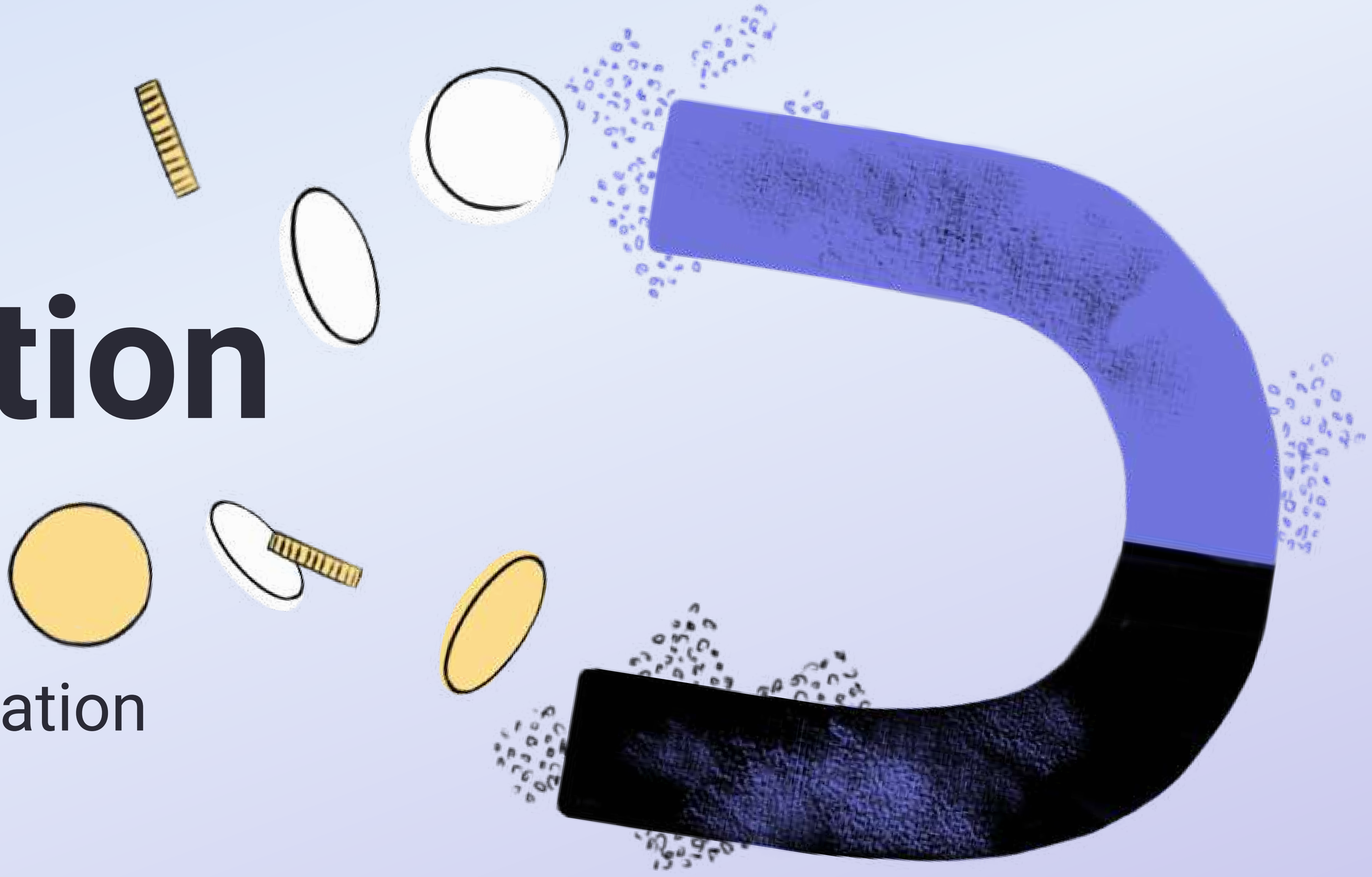
tovie ai

UK Debt Collection Industry:

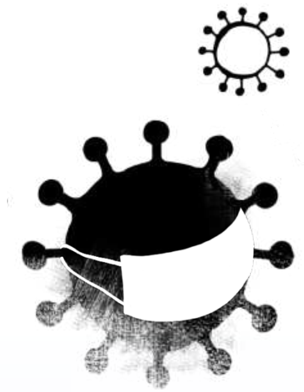
Stats, Practices and AI-powered automation



January 2023

Intro

The following report represents statistics gathered to get an insight into the current state of the debt collection industry in the UK and the technologies that allow debt collectors to minimise risk and successfully manage debt recovery processes during times of uncertainty.



The spread of Covid and the actions taken to contain it have greatly impacted UK households. The crisis has hit incomes and employment opportunities despite a huge degree of public policy support. The cost-of-living crisis that came on the back of the Covid-19 pandemic and lockdowns has worsened its effects on low-income households.

UK households are facing this crisis due to sharp price rises and falling real household incomes. The key drivers of the increase in the UK inflation rate were increased energy prices, increased petrol and diesel prices, and increased food prices. The reasons for these increases are a mixture of the UK and other major economies emerging from the lockdown restrictions and global demand for resources increasing and outstripping global supply chains. This coupled with the disruption of wheat and gas supplies to European countries from Russia due to the war in Ukraine has increased the wholesale price of both further.

There are several factors that make debt collections problematic during times of crisis. There's the question of ethics and empathy. With many debtors experiencing a sudden decrease in wages and some perhaps being laid off entirely, country-wide disruption of businesses often results in periods of grave uncertainty – not something that sits well with debt repayments, which thrive on consistency. Debt collections software provides a lifeline for banks and collectors in times of uncertainty. It has already helped countless collectors through some of the most severe natural and economic disasters of the last few years. Over the past couple of years, debt collection has been disrupted by Artificial Intelligence. AI is enabling companies to use advanced analytics, behavioural science and machine learning to their advantage. It allows companies to seamlessly automate debt collection strategy, and drive average days sales outstanding down, while also staying within the ethical framework and providing the human approach.

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Consumer debt of the UK citizens

The consumer credit growth rate and borrowing of mortgage debt by individuals have increased and remained above their 12-month pre-pandemic average.

UK households are facing a cost-of-living crisis. In July 2022, the annual rate of inflation reached 10.1%, the highest since 1982, and it is expected to peak at 13% in early 2023. The government rolled out a zero-interest loans scheme aimed at helping thousands of people across the UK struggling to put food on the table.

The cost-of-living crisis is reducing access to affordable credit, as lenders decline more loan applications. It is harder to assess loan applications because the applicant's circumstances and behaviour are more fluid and unpredictable. The nature of demand and lending is changing with a shift to smaller loans to cover living costs. Lenders are experiencing pressures on cost and income, which poses an existential threat for some lenders and is manageable for others.

Over 7m people in the UK risk being excluded from accessing affordable financial services because of flaws in credit scoring and are forced to rely instead on expensive options such as subprime lenders. In March 2022, The Centre for Social Justice (CSJ) reported that they thought 1m people in England were borrowing illegally, including involvement into money mules, identity theft, heavy use of Buy Now Pay Later and some evidence of continued doorstep lending from unlicensed lenders – so-called parallel lending.

Creditors' voluntary liquidations are in their history high, and individual insolvencies have mixed dynamics through the last years. The overall increase in company insolvencies in Q2 2022 was driven by a rise in CVLs, the highest quarterly number since 1960. The UK Government in response has extended its Recovery Loan Scheme for businesses for two extra years and has introduced a Debt Respite Scheme (Breathing Space) for individuals.

Statistics on money and credit

These monthly statistics on the amount of, and interest rates on, borrowing and deposits by households and businesses are used by the Bank of England's policy committees to understand economic trends and developments in the UK banking system.

Net borrowing of the mortgage debt by individuals increased to **£6.1bn** in August, up from **£5.1bn** in July, and remaining above its 12-month pre-pandemic average up to February 2020 of **£4.3bn.**

Mortgage approvals for house purchases increased sharply to **74,300** in August from **63,700** in July. This is the highest level since January 2022 (**74,500**), and a notable rise following a downward trend over the previous several months.

The 'effective' interest rate – the actual interest rate paid – on newly drawn mortgages increased by 22 basis points to **2.55%** in August.

Consumers borrowed an additional **£1.1bn** in consumer credit, on the net, a little below the additional **£1.5bn** borrowed in July.

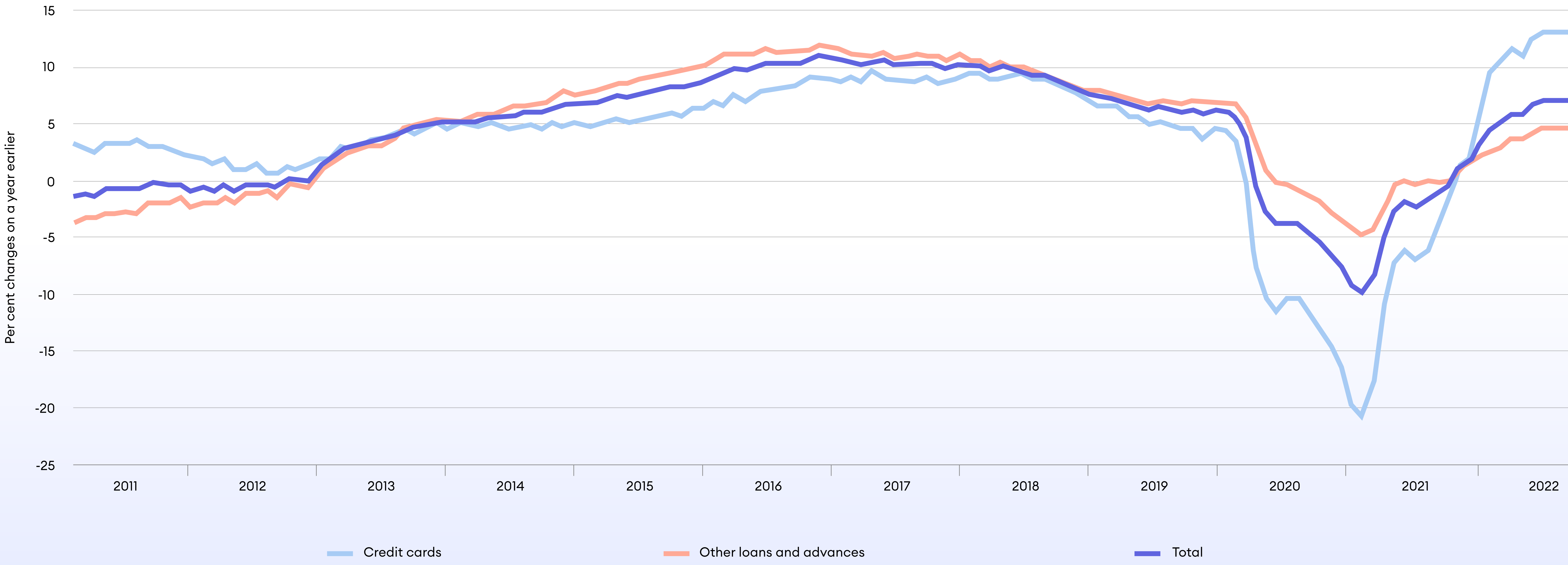
Non-financial businesses borrowed **£7.7bn** of bank loans in August, the highest flow of borrowing since April 2020. Private non-financial companies (PNFCs) redeemed **£1.4bn** in net finance from capital markets.

The net flow of sterling money (known as M4ex) decreased to **£4.0bn** in August, from **£17.2bn** in July. Households deposited an additional **£3.2bn** with banks and building societies in August, compared to **£3.9bn** in July.

The effective interest rate paid on individuals' new time deposits with banks and building societies rose to **1.94%** in August from **1.72%** in July.

Consumer credit growth rate

A common way to assess how quickly households are taking on consumer credit is to look at the annual growth rate, as shown here for total consumer credit and its components:



Challenges of the UK microfinance sector in 2022

The cost-of-living crisis

UK households are facing a cost-of-living crisis. In July 2022, the **annual rate of inflation reached 10.1%, the highest since 1982**, and it is expected to peak at 13% in early 2023.

In March 2022, the Office for Budget Responsibility projected that UK post-tax real incomes would start falling in quarter two of 2022 and not recover until the third quarter of 2024. Since then, inflation forecasts and the economic outlook has worsened significantly.

- **Millions financially excluded**

3.1 Million
use high cost credit

1.1 Million
use high cost credit to cover day-to-day living costs

13 Million
lack buffer for drop in income

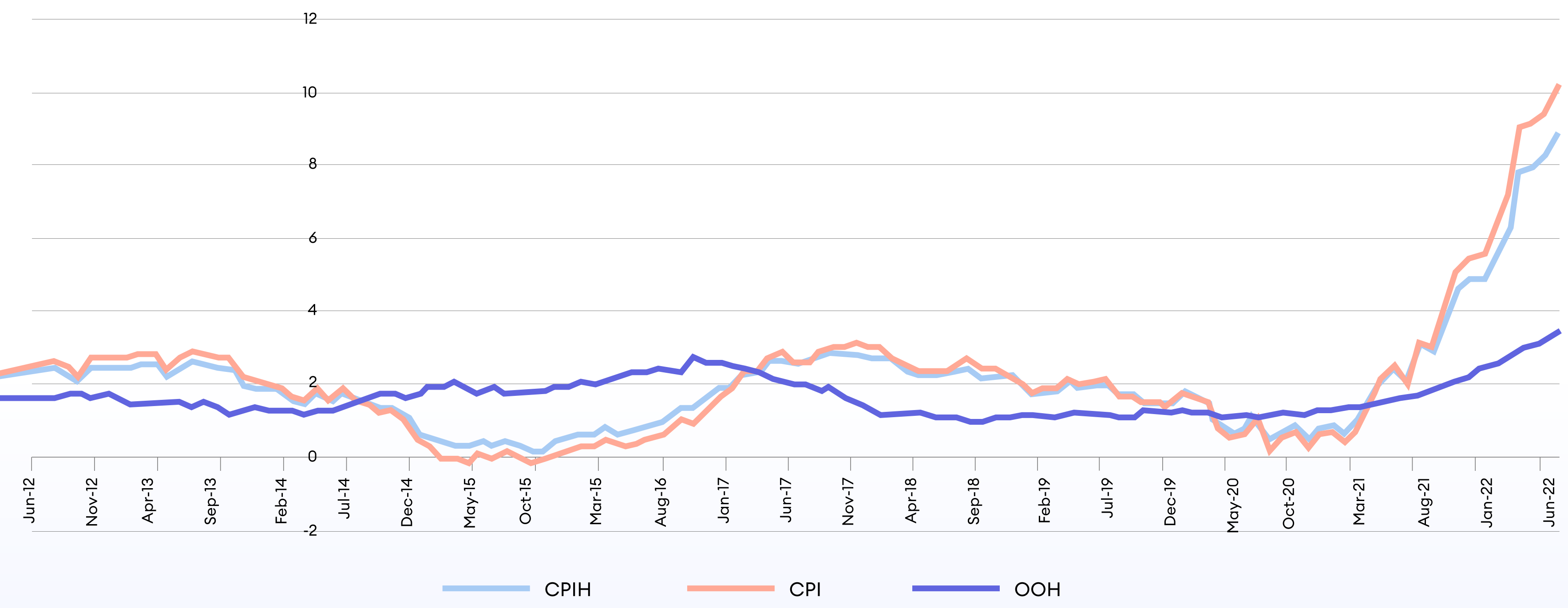
- **High cost credit users pay premium of up to £540 annually**

Reduced disposable income & spending in local economy

The cost-of-living crisis

UK households are facing a cost-of-living crisis due to sharp price rises and falling real household incomes.

The consumer price index increased by 10.1% in July 2022 up from 1.6% the year before:



The key drivers of the increase in the UK inflation rate were:

Increased energy prices

There was a 46% increase in energy prices between March and April 2022, as Ofgem increased the cap on energy prices by 54% in April 2022.

Increased petrol and diesel prices

These prices increased by nearly 33% in the 12 months to May 2022.

Increased food prices

The price for food and non-alcoholic beverages saw an 8.7% increase in the 12 months to May 2022.

The reasons for these increases are a mixture of the UK and other major economies emerging from the lockdown restrictions and global demand for resources increasing and outstripping global supply chains. This coupled with the disruption of wheat and gas supplies to European countries from Russia due to the war in Ukraine has increased the wholesale price of both further. There is great uncertainty concerning the magnitude and duration of future price rises partly due to the war in Ukraine.

Nevertheless, the **rate of inflation is expected to continue to rise, peaking at around 13% or possibly as high as 15% later this year**, early next year.

The cost-of-living crisis

The Bank of England expects inflation to slow down in 2023 and fall close to 2% in around two years. Energy prices are set to increase significantly in October and throughout 2023. It is difficult to predict the exact price increase, but energy prices for an average UK household are likely to be well in excess of 40% in October.

The fact that the cost-of-living crisis comes on the back of the **Covid-19 pandemic** and lockdowns may exacerbate its effects on low-income households. A third of UK households experienced a job loss or lower pay due to Covid-19, with people in precarious forms of employment (nonfixed hours, zero-hour contracts), self-employment, and sectors affected by the pandemic (hospitality, leisure) being the worst hit. Low-income households were disproportionally affected because they came into the crisis with higher unsecured debt levels, fewer savings and lower or unchanged real income.

A report 'Impact of the cost-of-living crisis on the UK affordable credit sector' conducted by Community Finance Solutions provides key findings:

- Cost-of-living crisis is reducing access to affordable credit, as lenders decline more loan applications.
- It is harder to assess loan applications because the applicant's circumstances and behaviour are more fluid and unpredictable.
- The nature of demand and lending is changing with a shift to smaller loans to cover living costs.
- Growth in savings is falling or is lower than projected, as members withdraw more savings and deposit less.
- Lenders are experiencing pressures on cost and income, which poses an existential threat for some lenders and is manageable for others.

It is too early to say something conclusive about the effect of the cost-of-living crisis on the affordable credit sector and its customers. The cost-of-living crisis is still unfolding and evolving with further price rises expected later in 2022 and 2023. There is great uncertainty about the global factors affecting inflation, such as the war in Ukraine, as well as future government responses and policies. It is uncertain if the effects of the cost-of-living crisis on households, especially those on lower incomes, will be short-lived or if they will significantly affect their financial circumstances in the long run.

Key takeaways

The combination of rising living costs, long-term financial precarity and Covid-19 has pushed many customers into, sometimes severe, financial difficulties. Credit union members are saving less and withdrawing more savings, part of which they are using to cover basic living costs. Consumers, including repeat customers, are more likely to be declined by affordable credit providers than before the crisis. Although not universal, some groups of borrowers are increasingly likely to miss payments. The cost-of-living crisis has magnified the effects of Covid-19 and disrupted the financial juggling act of many low-income consumers. Credit, especially BNPL, has often exacerbated rather than relieved the financial difficulties of many consumers.

The impact on lenders is more uncertain and uneven, but the cost-of-living crisis, especially coming on the back of Covid-19, poses a potentially existential threat to some lenders. Many factors potentially influence the impact on the bottom line of lenders, including financial starting point, size, target market, scope, and capacity to move upmarket, and the impact of Covid-19. Well capitalised lenders with large loan books, scope to lend to lower risk consumers, and surplus to invest in and recruit staff seem well positioned to weather the crisis. Many lenders are externalising the impact on customers by not lending to riskier, worst affected segments. However, the combination of a reduced loan book to generate (future) income, greater loan losses, and increased staffing costs pose a potential existential threat to some lenders.

Company insolvency statistics for England and Wales – Q2 2022

There were a total of 5,629 company insolvencies in England and Wales in Q2 2022, including

4,908
creditors' voluntary liquidations (CVLs)

368
compulsory liquidations

320
administrations

32
company voluntary arrangements (CVAs)

1
receivership

! Total company insolvencies in Q2 2022 increased by 13% from Q1 2022 and by 81% from the same quarter in the previous year.

The overall increase in company insolvencies in Q2 2022 was driven by a rise in CVLs, which accounted for 87% of all company insolvencies. These increased by 13% from Q1 2022 and by 74% from the same quarter last year. The number of CVLs was the highest quarterly number since the series began in 1960.

In the 12 months ending Q2 2022:

- 1 in 228 companies were liquidated
- the company liquidation rate was 43.9 per 10,000 active companies in England and Wales
- the company liquidation rate was higher than in both the 12 months ending Q1 2022 and the same quarter a year ago

Legislative frameworks concerning the provision of microcredit in the UK

Regulation of lending activity

In the UK, there is no specific regulatory framework for microcredit. Non-bank lenders, such as community development finance institutions (CDFIs)1 and credit unions, are allowed to lend directly to individuals and businesses. CDFIs operate under the Consumer Credit Act while credit unions are regulated by several laws. Given the diversity of the microfinance sector, the implementation of a voluntary European Code of Good Conduct for Microcredit Provision is one of the ways for regulators to promote best practices within the sector. So far only two institutions in the UK have complied - Fredericks Foundation and BCRS Business Loans Limited.

Incentives and support

There is limited support for microlending activities since there are no funds at the national or regional level to support microcredit provision in the country. However, individuals that offer financial support for microcredit provisions receive tax incentives.

Supervisory framework for non-bank lending

The Financial Conduct Authority (FCA) supervises the lending activities of CDFIs for credit offered to individuals and business. The responsibilities of FCA include:

1. Ensuring consumer protection by regulating how firms treat their clients;

2. Assessing the affordability of their lending; and,

3. Assessing the soundness of financial institutions.

Credit unions are supervised by the FCA and the Prudential Regulation Authority (PRA). Although CDFIs and credit unions are not obliged by law to share client data with the national credit

bureau, they can freely access the national credit bureau data.

Products

CDFIs and credit unions are allowed to disburse both business and personal microloans. CDFIs are also allowed to disburse social enterprise loans. In terms of business and personal microloans, CDFIs are allowed to disburse loans with a 100% interest rate cap for short-term loans (less than 12 months). Credit unions have an interest rate cap of 42.6% on business microloans. For both CDFIs and credit unions, there is no maximum loan amount on microloans.

Development of the existing framework for non-bank microcredit provision

A policy programme has been developed to advocate for a national support fund for microlending activities. The current challenge confronting the sector is to adapt regulation originally designed for large banks that do not proportionally apply to small non-bank lenders. As a reaction, the policy strategy should focus on a common lobbying front advocating for a proportionate regulation and building evidence of the negative impact that regulatory burdens imposed on microlending and its social impact.

Inclusive entrepreneurship and microenterprise development

The UK has a simplified administrative procedure that ensures the smooth registration of businesses and the existence of a welfare bridge for entrepreneurs out of employment. In addition to these provisions, the government subsidies business development services to support entrepreneurs and create awareness on the various initiatives of inclusive entrepreneurship. However, the British government is yet to include entrepreneurship education in the secondary school curriculum. The current initiatives to support inclusive entrepreneurship include the government "Start Up Loans" programme and the "New Enterprise Allowance" programme, which serve as the biggest government entrepreneurship programmes. These programmes are designed to provide business support and finance to unemployed people, empowering them to become self-employed by starting businesses. These programmes are often delivered through non-bank lenders.

UK debt collection industry overview

State of the industry

There are 555 Debt Collection Agencies businesses in the UK as of 2022, a decline of -2.2% from 2021. The number of businesses in the Debt Collection Agencies industry in the UK has remained steady over the five years between 2017 - 2022.

The Debt Collection Agencies industry in the UK has a medium market share concentration and the four largest industry players - Metis Bidco Ltd (Lowell), Cabot Credit Management Ltd and Arrow Global Ltd - are forecast to account for 40.3% of the market.

North West (18 businesses), London (17 businesses) and South East (14 businesses) are the regions with the most number of Debt Collection Agencies businesses in the UK.

The Debt Collection Agencies industry in the UK is labor intensive which means businesses are more reliant on labor than capital.

The highest costs for business in The Debt Collection Agencies industry in the UK as a percentage of revenue are Wages (26.2%), Purchases (48.3%), and Rent & Utilities (2.6%).

UK debt collection market context and trends

The debts relate mainly to consumer credit, but also include other consumer debt.

Debt collection services are increasingly being used in other areas where there are significant consumer debts, such as telecoms and utilities, as well as in areas of the public sector such as council tax.

Debt purchase remains primarily focused on consumer credit although it is also used to some extent for other areas. Lenders or other creditors have a choice whether to use a collection agency to work on debts on their own balance sheets, or to sell the debt to a firm that will then collect on its own behalf. Since the FCA assumed responsibility for consumer credit in 2014, regulation has had a significant impact on the market, leading to substantial changes to the industry structure. Debt collection procedures for consumer credit are now tightly regulated requiring significant investment in systems and training.

Many firms have left the market and others have consolidated. This has imposed costs on the industry but has been helpful for the larger debt purchase groups in particular, as they have the scale to invest in developing and implementing compliant processes and can therefore expect to benefit from the increased barriers to entry created by the new regulation. Alongside these direct impacts on debt collection, FCA regulation has led to a decline in high cost short term lending (including payday lending) where debt collection services and debt sales have been regularly used.

Competitive landscape

The following groups are considered to be the market leaders.

Cabot (including Orbit and Westcot), PRA, Lowell (including acquired Hoist), Arrow Global and Moorcroft. Moorcroft is the largest of the pure debt collection agencies which do not purchase debts remaining independent.

Several others have been acquired by debt purchase groups with a long tail of smaller collectors, many focusing on specific niches, still operating. The leading debt purchase groups active in the UK are Arrow Global (UK), Axactor (Norway), B2 Holding (Norway), Cabot (UK), EOS Europe (Germany), Kruk (Poland), Intrum Group (Sweden), Link (LCM) Europe (UK) and Lowell (UK).

Leading players continue to make better use of data to improve their collection success and to enable them to offer higher prices to improve their success in purchasing portfolios. Most are now part of European-wide groups, looking for higher growth outside the relatively mature UK market.

! **A key focus for all is an investment in technology to reduce operating costs, improve service levels and demonstrate compliance with regulations.**

Macroeconomic trends affecting the industry

Post-pandemic delays in the resumption of non-performing loan (NPL) sales are limiting debt collectors' near-term revenue growth. Economic dislocation typically creates opportunities for debt collectors by increasing the levels of NPLs available to purchase. However, government support for consumers during 2020 and 1H21 temporarily slowed the rate at which new NPLs developed, limiting collectors' ability to replenish their books, and also speeded up collections on NPLs already held. Receipts from acquired portfolios are typically greatest in the early years, so the combination of payment acceleration and slower portfolio replacement makes 2020 and 2021 high collection benchmarks for future comparison.

Credit use in Q2 2022 was the highest it has been since the early months of the pandemic.

More than a quarter (27%) of Brits don't have the ability to save money due to their financial situation and over one in five (22%) revealed that they have mental health difficulties directly caused by money.

Key trends affecting the industry

1. Increased corporate focus on the cash collection cycle

Accounts payables and cash collection which were taken for granted until the Covid-19 crisis are now the top priority for businesses looking to effectively manage their working capital levels and remain liquid.

2. Greater digital transformation

COVID-19 forced businesses to make bold moves forward with their digital agenda, especially in the modernization of the credit and collections process. The global accounts receivable automation market size to grow from USD 3.3 billion in 2022 to USD 6.5 billion by 2027.

3. Greater automation

Manual Dunnings letters, emails and excel spreadsheets are mostly in the past as machine learning enables the automation of repetitive tasks and allows the human workforce to focus on the areas where they can really add value.

4. Improved customer segmentation

The ability of modern collections software systems to capture data on customer payment behaviours and patterns enables customers to be easily segmented based on their risk of default and delivers them personalised communication increasing the debt recovery and satisfaction rates in a cost-efficient manner.

5. Rising importance of the customer

Delivering positive customer outcomes has become an increasingly important metric for credit and collections teams. This is a reflection of the overall global change in the customer relationship landscape – driven for the most part by the meteoric growth of social media.

6. Greater adoption of omnichannel collection strategies

Collections industry follow where the marketing industry has led and seen the widespread adoption of omnichannel collections strategies which enable them to contact the right customer through the right channel at the right time.

7. Increased volume of commercial debt

8. Increase in outsourcing

- debt collection companies are more often becoming both providers and consumers of outsourced services within the industry.

Traditional debt collection measures, such as aggressive calls, door-to-door collections, and invoice reminders, **have all failed**. Inefficient collection procedures based on flawed tactics and models raise operating costs and have a negative impact on liquidity.

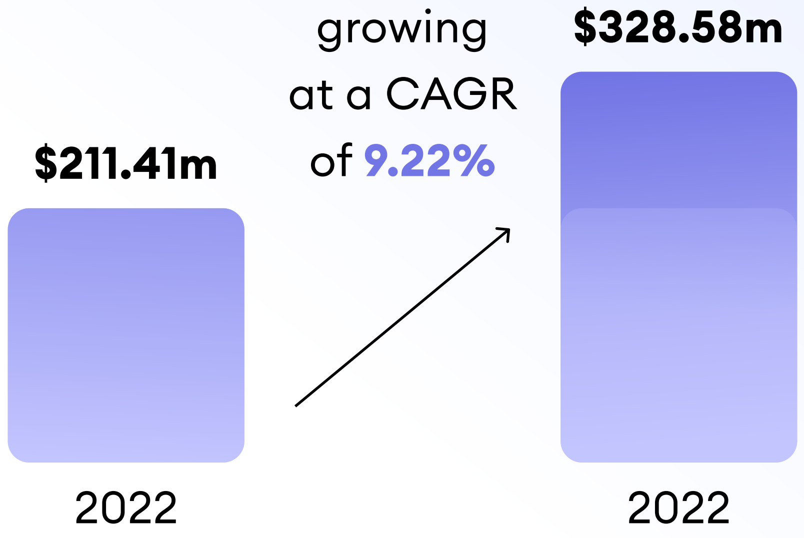
Debt collection software allows banks to automate their collections activities, which is projected to promote software adoption among banks. However, due to rising patient costs and bad debt in the healthcare industry, the healthcare industry is predicted to increase at the fastest rate. The expansion of debt collection software in the healthcare business is fueled by a surge in demand for technologically enhanced systems to reduce bad debt and speed and automate the revenue cycle.

Debt collection software market

The UK's Debt Collection Software Market is estimated to be $211.41m in 2022 and is expected to reach $328.58m by 2027, growing at a CAGR of 9.22%.

As the market dynamics impact the supply and demand curves, decision-makers aim to determine the best way to use various financial tools to stem various strategies for speeding growth and reducing risks.

A debt collection software discovers, prioritizes and recovers debts by overcoming the Data, Process and Technology challenges and maximizes debt recovery.



Here's a list of benefits that debt collection software brings in:

Optimization

The debt collection software eliminates the need for working on minor tasks of lead management, preventing human agents from mundane tasks. This ensures operational automation and saves resource time.

Customer segmentation

A debt collection software empowers agents with a Single View of a Customer and ensures automated segmentation of the customer base on factors like delinquency, credit history, demographic, account age, etc. This categorisation helps collection agents to approach different customers with the right tone of communication to deliver a personalised experience.

Progressive collection

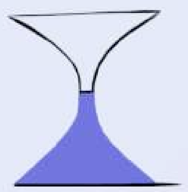
Collection agents are loaded with the arsenal of debt collection tools that automates their dialling strategies and intelligently identifies the best time to connect. Thus the agents are able to target the customer using the right method which will help in an incremental and speedy collection

AI in the debt collection industry

Agents spend too much time on the same types of conversations. **Over 70% of all debt collection calls** are of a pre/soft collection

With rapidly changing technology, regulations and demographics, debt collection agencies face a wide range of challenges. Debt collection is a time-consuming and extensive task. For example, the client may require frequent support, which can take a lot of time and effort and the costs will be extremely high.

In addition, debt collection needs a great deal of legal attention. It requires verification of each defaulter, the reason for non-payment, confirmation of promise-to-pay dates, etc. Having meaningful and error-free conversations with debtors every day is an unrealistic task for most call centre agents.



A call centre agent spends on average about **30% of the working time making calls**

While **70% is spent on research, the call itself and a long break** after an exhausting conversation

Equally important is the fact that agents should be sensitive to the personal situations in which clients may find themselves. The middle ground between debt collection and empathy for customers is a balance that can be difficult to find.

AI-powered automation

The automation of the collection process plays an important role and is already becoming an integral part of the default management process. Voice bots are not only more convenient but are also more cost-effective than a team of agents.

Reduced burden on collection agents' duties

The debt collection process usually begins with the agent sending an initial notice to the client with the arrears. If no response is received within a set time frame, follow-up messages will be sent. Agents spend hours sending messages, making calls and picking up the right phrases.

A single 24/7 operating collections bot can replace an entire contact centre. Designed specifically for a variety of debt collection practices, it has script samples and debtor status lists.

Bots can remind a debtor of unpaid debts via **WhatsApp, email, SMS, Telegram or simply by calling.** You no longer have to allocate an agent who will constantly chase clients until they pay

Improved debt repayment performance

In everyday practice, debt collection agents try to make as many calls as possible to contact debtors. However, this does not always mean that a needed rate of the debts will be recovered. In the worst cases, this approach can breach the requirements of the FCA and CSA regulators.

Clients with arrears are usually reluctant to talk openly about their debts, ignoring messages and calls from agents. Knowing they're chatting with a robot, customers will feel less pressured. The automated collection bot is impersonal and non-judgmental, so the embarrassment factor is reduced.

Debt collection bots also simplify customer interactions, making conversations more efficient and personalised. Using customer data from the CRM, bots provide answers to questions in real time with no chatbot-to-human handoff.

Automated customer coverage

Debt collection is becoming increasingly efficient through the introduction of automation. More than 50% of the customer interaction process can be completed by an AI assistant which can handle most of the simple issues such as identification, notification and confirmation of promise-to-pay dates.

With AI bots, agencies can automate the whole collection process by creating custom call flows. This will help make decisions based on the data collected by the bot, getting results in real time.

Effective debt collection strategy with AI

Implementation of a digital strategy is a customer-oriented approach, which is crucial for clients. Bots allow debtors to free themselves from the guilt associated with talking about their debts and instead discuss better payment options. In addition, by analysing the debtor's emotions, the bot can emphasise and respond in a more convenient way.

A collection bot can replace an entire contact centre. Such a bot is able to make up to a million calls and texts a day, showing an 80% increase in debt recovery. Such AI assistants can send out regular reminders and offer the debtor different options to choose from.

The Debt Collections Bot by Tovie AI is a conversational AI solution that can be easily implemented in any existing default management process. The bot automates the debt collection process, saving up to 50% on agents. That way, organisations get a higher conversion rate and extra revenue.

About Tovie AI

At Tovie AI, we set ourselves a goal to make an interaction with a robot, virtual assistant, or a simple bot to be as natural as possible.

Our comprehensive tool ecosystem, end-to-end solutions, accurate NLP engine, and customized analytical reports enable our users to test the market and get the most out of their investment.

We offer solutions and technologies that help bring to life conversational AI projects of any complexity: from basic to advanced. Our technological capabilities allow for deep customisation, as well as integrations with all popular business systems. Powered by the trailblazing hybrid synthesis technology, our voice bots sound as human as possible.

For more information, visit tovie.ai or contact us at contact@tovie.ai

Sources

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