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Turnips can bleed: The Portfolio Recovery story

NORFOLK

This is how debt collection sounds:

Cheers from a group in one corner of the call center. The clack of a spinning noisemaker in another. A jingling tambourine. Every five to 10 minutes, the clamor signals that a consumer somewhere agreed to pay money owed.

“She just made her goal,” a supervisor boasts of one of her collectors. “She got a payment for $4,400.”

That payment caps a process that Portfolio Recovery Associates has refined into a fast-expanding business. At its headquarters in an office park off Military Highway, the company buys portfolios – pools of consumer debt – from banks that no longer want them, paying pennies for each dollar left on those accounts. Through letters, phone calls, lawsuits against debtors or claims filed in bankruptcy court, PRA tries to recover a few cents more per dollar on that debt.

All those pennies added up to a $126.6 million profit last year – 10 times what PRA earned a decade earlier. And its investors expect more growth.

They’ve bid shares of the company to record highs this year and to a stock market value of $3 billion.

In Hampton Roads, that supports about 1,400 jobs, out of a companywide total of more than 3,300.

Many people picture debt collectors as money-grubbers, relentlessly hounding people in financial trouble. Some consumers accuse PRA, the nation’s biggest publicly traded debt buyer, of pushing too hard. But its executives insist that the company doesn’t owe its success to pressuring debtors.

Instead, they say, the key is restraint. Specially designed software helps the company pinpoint the consumers who are worth the expense to pursue and go after them when the time is right.

Almost everyone else, PRA leaves alone. It owns more than 33 million accounts but, in any month, brings in payments from just 2 percent of them.

“Let’s face it,” says Steve Fredrickson, the company’s co-founder and CEO, “if you’re a consumer that’s in dire financial straits and you can’t pay us anything, I don’t want to talk to you, and you don’t want to talk to me.”

The former bankers who founded PRA in 1996 seized an opportunity created by a credit-hungry society that left an increasing number of spenders deeper in debt than they planned.

The company's growth shows that businesses don't need to make anything or even sell a service to become enormously successful. PRA simply applies innovation to reap rewards from others' financial troubles.

The company's edge is its embrace of computer processing power, says Bob Napoli, an analyst for the William Blair investment bank who has followed PRA for more than a decade. "Yes, it's a debt collection company," he says. "But with the technology they've built, it's really a technology company."

PRA rides economic surges and slumps. In good times, more people can afford to pay their bad debt. And when times are rough, that bad debt is cheaper to buy because there's more of it.

Only about 7 percent of U.S. borrowers fail to pay their debts on time, according to federal statistics. That's the territory PRA mines, knowing that only a tiny fraction of the folks in its database will ever pay the company a cent.

It has mastered the art of finding the needle in a financial haystack. In doing that, it could build itself into Hampton Roads' next Fortune 500 company.

"We have a fleet of really smart math guys sitting just over there," says Neal Stern, PRA's executive vice president of operations, gesturing from his window-walled office into the company's nerve center.

Stern came to PRA from Target, where he worked for 10 years and ran the collection operation for the retailer's credit card business.

Stern, Fredrickson and Kevin Stevenson, the company's other founder and chief financial officer, seem a relaxed bunch, more than willing to speak with candor about their widely detested industry.

To them, debt collecting isn't personal. It's basically a game of numbers.

In a building next to its Norfolk call center, PRA's headquarters look like any other cubicle-divided, computer-dominated office. The analytics team works there, crunching data and studying software to figure out, first, how much to pay for the debt it buys and, second, which consumers are worth pursuing.

PRA buys portfolios of accounts that creditors have "charged off" – taken as a loss after customers have skipped payments for typically 180 days. PRA and other debt buyers see samples of the accounts but otherwise are like the bidders for the contents of units on the TV show "Storage Wars," guessing the value a portfolio might bring.

In its 17 years, PRA has shelled out $3.1 billion to buy $75.2 billion in account balances – or an average of 4.1 cents for every possible dollar of collection. It pays more, maybe 10 cents on the dollar, for accounts that banks have recently abandoned because newer debt is easier to collect. As a rule, the company aims to collect twice as much as the purchase price, Fredrickson says.

About one-eighth of the accounts PRA buys today are in bankruptcy court, which prohibits the company from contacting the debtor. The collection process for bankruptcy is relatively cheap; PRA files a claim and waits for a settlement.

The rest of the accounts become candidates for collection. PRA has call centers in Alabama, Kansas, Nevada and Tennessee, as well as those in Norfolk and Hampton.

Before collectors make those calls, computers scan the files sent by the banks that sold PRA their accounts. The data are "scrubbed" for specific information. For example: Is the person who owes the money deployed as an active member of the military? If so, federal law prohibits a debt company from pursuing collection.

Once scrubbed, each account gets a score, ranging from zero into the thousands. The higher the number, the more likely that someone will pay. The scoring system factors in the account balance and calculates an anticipated collection.

"You feed that into the statistical software, and it figures out what correlates to payment," similar to the way underwriters determine insurance premiums, explains Mark Anderson, vice president of strategy and Stern's right-hand scoring man. He's the kind of guy who can talk about numbers for hours.

A consumer who has a job and owns a home usually will get a high score. An unemployed person with no home, no car and no other assets will score low.

Every account is recalculated each night, and its score drops every day it gets older. That is, unless something changes to indicate the debtor's prospects have improved. When an unemployed mom gets a job or signs up for a cellphone contract, for example, her score goes up. PRA pays to access data from credit reporting agencies, among other sources of information.

"When something does change, you want to be the first one to get them on the phone," Stern says. "They probably owe five or six other people."

PRA's accounts are organized by score into 20 categories, which the company calls "tiles" – from those with the greatest potential for collection to the least. Every month, Stern gets a chart showing how much money PRA tallied from each tile. He wants to channel the bulk of expenses – labor costs, phone bills, legal fees – into the tiles that bring in the most cash.

"For the vast majority of accounts, the most important thing for me to do is to not fool with them," he explains. "If I make a phone call or send a letter or I do anything, all of that costs money. If I'm spending money and not collecting anything back, that's a good way for me to get in trouble."

PRA can wait a long time, even more than a decade, for the right moment to pounce. The only ticking clock is each state's statute of limitations. After a certain period – typically three to six years – a collector cannot take a debtor to court.

"The key to success is patience and timing," Stern says. "We'll wait for someone to get on their feet, get a job, get out of whatever problem it is."

Most consumers have never heard of Portfolio Recovery Associates until they get that call.

"It's the MasterCard account with Capital One," a PRA collector in Norfolk tells a debtor on the phone.

"I'm calling about your auto loan," says another.

About 440 collectors work in the Norfolk center in small cubicles, wearing headsets and casual clothes and facing computer screens. Papers cover the fabric cubby walls, listing the rules and language they must follow in each state. That leaves little space for personal photos or decoration. One worker keeps a placard in front of her screen that reads, "I'm all about my money. Keep it positive."

When consumers hear from PRA, they often start by responding, "I don't have any money," says Julita Long, an account executive who has worked for the company for five years.

"I ask them what was happening when they stopped paying," she says. "A lot of times, they lost their job or had health issues."

Collectors earn a yearly salary starting around $25,000 plus a bonus – a commission on each payment – depending on their level of seniority. They start on the floor as a "rep" and move up to account executive as they rack up payments, setting a personal collection goal for each month.

An operations manager, who might get on the phone when a consumer needs a push for payment, oversees a team of 14 and stands at the end of each row of cubicles on an elevated platform, like a conductor looking down on the orchestra.

"All right, team," one operations manager shouts to a surrounding group. "We need some more money, team."

PRA collectors' calls are largely unscripted. On their screens, they might see instructions allowing them to accept a settlement for less than the balance due or a monthly payment over a certain time period. If customers give them new information, they can submit it, and that gets calculated into the account score.

About three-quarters of the time, the consumer hangs up on her, Long says. "If they're still on the phone, you know it's most likely they want to pay their bill."

Some people express gratitude when they hear from her; they can put their debt behind them, she says. She also tells consumers they can clean up their credit reports by paying off their balances.

When debtors resist, Long persists: "I can get you on a payment plan that'll fit right in your budget."

Payment plans have helped PRA work with consumers since the economy sagged in 2008, when the average payment size dropped, Fredrickson says. Since 2011, payment amounts have leveled off, though they haven't come back up, he says.

Vicki Payton, a former schoolteacher and an 11-year PRA veteran, says a collector needs patience and a thick skin. "We know what we want to make, and we know what we have to do to get to that point."

Only a few of Payton's calls each day end up combative, she says. "If they're angry that we've called, we just try to win them over," she says, softening her voice to illustrate: " 'I'm trying to help you resolve this.' "

Banks used to try to collect overdue debt themselves or through an agency that they paid a commission or fee. During the savings-and-loan crisis of the late 1980s, a federal bailout program successfully auctioned off failed loans, encouraging other banks to sell delinquent debt.

A new niche business emerged: companies that specialized in buying overdue accounts. By giving banks an outlet for unloading unwanted debt and reducing their risk, these companies help keep the cost of borrowing low. Even regulators agree that debt buyers are a crucial cog in the national wheel of consumer credit.

In the early 1990s, Fredrickson was working in Chicago for Household International, helping that finance company figure out how to price and sell its bad commercial loans. He moved to Virginia Beach to lead Household's new consumer-debt-selling division, which never took off, he says.

Fredrickson, though, saw opportunity. He and Stevenson, a Household colleague, launched PRA with four employees in Virginia Beach. They moved the headquarters to Norfolk in 1999. The company went public three years later.

Last year, Fredrickson earned total compensation of about $3.5 million, according to a PRA filing with the U.S. Securities and Exchange Commission. His PRA stock holdings are valued at nearly $15 million. Stevenson's 2012 salary, bonuses and other awards totaled almost $1.8 million, and he owns $2.8 million worth of stock.

They and their company have grown richer partly because of competitors' missteps. Fredrickson says some early large rivals paid too much for the debt they bought or grew too fast, hiring inexperienced workers who were inefficient or broke the rules.

PRA has managed to stay mostly on the right side of government watchdogs, who recently have sharpened their focus on debt collection, a top source of consumer complaints to both federal and state agencies last year. PRA has tried to distinguish itself among its brethren as the best-behaved child. Company executives say they invest extra money to keep on top of or ahead of the rules.

Collectors undergo background screening that includes drug tests and credit checks – not the practice of most companies, Fredrickson says. PRA records all phone calls. Voice software listens for required phrases or picks up unwanted language or tone. Mistakes can lead to a cut in a collector's bonus pay or, at worst, termination.

Analysts and others in the debt business say PRA's strictness makes smart business sense. "They do a great job of minimizing complaints," says Bruce Klinger, who runs a small debt collection business based in Virginia Beach. "They do not want any type of negative image."

Tougher regulations, in some ways, have worked in PRA's favor. The new federal Consumer Financial Protection Bureau, which took on oversight of debt buyers and collectors last year, has put pressure on banks and other creditors that sell debt. It has pushed them to scrutinize buyers and their practices, holding them accountable for violations.

As a result, banks have narrowed the list of buyers that can bid on their accounts. PRA remains in good standing, partly because it doesn't resell the accounts it buys, Fredrickson says.

"We have preached to the banks for years that they should care who they're selling their debt to."

One of the biggest challenges for collection companies is changes in the way people communicate. More and more consumers are dropping landlines in favor of mobile phones. That's a problem for PRA because collection companies cannot use their preferred, and cheaper, automated dialing systems when calling a cell number.

Text messages and emails from collectors also are off the table. U.S. law prevents them from revealing a consumer's financial information to another person, and they can't ensure that someone else won't read that text or email.

"A lot of the laws on technology or rules on technology diminish contact," Stern says. He would like to see those rules changed "so that I could call people who live in our century, who have cellphones, who look at text messages, who read email."

No one likes to hear from a debt collector, and PRA has incurred its share of consumer ire. The Virginia Office of Consumer Affairs took 209 complaints against the company in the past three years.

Some consumer gripes seem to contradict the company's promise to back off its collection efforts when people aren't able to pay.

Justin Hartman, who lives in Clinton, Iowa, says he hasn't worked since 1999 because of a chronic illness and owes money to many creditors. In 2011, he started hearing from PRA over an outstanding balance of about $155 from U.S. Cellular, Hartman says. He closed that mobile-phone account in 2001 and never got another bill, he says.

PRA collectors called multiple times a day, says Hartman, who complained on RipoffReport.com.

After ignoring several calls, he finally responded to PRA that he had no intention of paying a 10-year-old debt and that the state statute of limitations to sue him for it had long expired.

“We can still harass you until you pay it,” Hartman recalls the PRA collector telling him.

He says he asked the collector for documentation. “They’ve still never provided me with proof that I owe this debt.”

PRA wouldn’t comment on Hartman’s situation or any specific consumer problem. But Stern concedes that PRA’s systems aren’t always perfect.

“We’re going to talk to 10,000 people today,” he says. “We’re going to get a couple of those wrong, I’m sure of it. We do everything under the sun to do the best we can on every one of those calls.”

In PRA’s realm, debt is inevitable.

“We live in a society where delayed gratification is a tough concept,” Stern says. “And out of that has grown a credit society. And out of that has grown my job.”

And the jobs of thousands of others. PRA plans to keep its collectors busy, and hire more if the business is there.

It has no shortage of opportunities.

It could venture into new frontiers of debt, such as student loans and defaulted mortgages, analysts suggest.

Or, it could look overseas. From Greece to Spain, Europe has plenty of consumers who are in over their heads.

PRA already is calling some of them. Last year, it took over another debt collection company – in Scotland.

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