A Study of the Non-Profit Credit Counseling Industry

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ABSTRACT

This study adds to the emerging body of research on the nonprofit credit counseling industry. We believe this is the first study that examines the industry metrics affecting the business model aspect of the nonprofit credit counseling sector. Extracting data from Form 990's for 36 of the largest organization in this industry we develop financial/operational ratios to determine the operational efficiencies and growth characteristics of the firms. Further, we establish the relationships between firm revenue streams and macroeconomic variables. Finally, we examine aspects of the growth in revenues in this industry by comparing merger generated growth to organic growth. We find that in general when the economy declines the revenues of credit counseling industry increases. Further, a change in revenues in the credit counseling industry lags a change in the economic indicators by one or two years. We also conjecture that there is significant room for growth in the industry.

INTRODUCTION

This study adds to the emerging body of research on the nonprofit credit counseling industry. The extant literature focuses on the effectiveness of nonprofit credit counseling on subsequent client behavior and other psychological factors of the client behaviors or the general industry trends. However, we believe this study to be the first that examines the industry metrics affecting the business model aspect of the nonprofit credit counseling sector. We develop a ratio analysis for the largest firms in the non profit credit counseling industry identifying the industry leaders and analyze the sensitivity of industry revenues to macroeconomic variables.

A credit counseling firm(CCF) obtains "nonprofit" status from the Internal Revenue Service (IRS) as a 501(c)(3) firm on the basis that education is the main purpose of firm. CCFs offer a wide range of services, from educating clients on budgeting, house financing, and bankruptcy. These firms also offer seminars and produce financial literature. However, the primary source of revenue for these entities is the debt management programs (DMP). These programs offer a structured path to pay off unsecured consumer debt by establishing a contracted agreement with creditors to eliminate fees and finance charges. A credit counselor will determine a single monthly payment rate that the client will pay to the firm, who will in turn pay the client's creditors. These generate a significant amount of revenue for firms through monthly maintenance/service fees and through Fair Share payments from creditors, which come in the form of either a lump sum grant or as a percentage basis of payments made to the creditors.

The objectives of this study are as follows: (1) to define the current state of the nonprofit credit counseling industry through examination of historic trends in the industry and determination of trends and relationships between economic and other indicators and the industry; (2) to predict future trends in the industry; and (3) to determine industry metrics that will allow firms to better understand their place within the credit counseling industry.

HISTORY OF THE CREDIT COUNSELING INDUSTRY

The billion dollar (Treasury, 2006) US nonprofit credit counseling industry has its origins in the establishment of the National Federation for Credit Counseling (NFCC) in 1951 (Stanley, 2001). The NFCC, the majority of whose members operate under the name of Consumer Credit Counseling Services (CCCS), had a virtual monopoly on the industry until the early 1990's. during this time period the NFCC had extremely close ties with the credit card industry until 1994 when a class-action antitrust lawsuit[1] resulted in their forced separation. These ties helped to spawned two other credit counseling industry association, the non-profit Association of Independent Consumer Credit Counseling Agencies (AICCCA)1993, and the American Association of Debt Management Organizations (AADMO). The AADMO began in 2001 and represented firms serving the debt management sector, including for-profit firms and third party vendors.

The NFCC's dominance of the nonprofit credit counseling industry eroded throughout the 1990's[2]. Many of the new market entrants had business models focused on revenue generation and profits rather than education and debt elimination. This represented a dramatic change in the credit counseling industry. This new entrants also contrasted with the NFCC model because these firms tended to be both large and national or at least supra-regional in focus, rather than the generally small and locally focused NFCC member agencies. The NFCC and AICCCA responded to these challenges by placing an even greater emphasis on accreditation and industry member standards[3,4] in an attempt to differentiate themselves from these aggressive, profit oriented firms in the eyes of both disillusioned consumers and increasingly concerned state and federal legislators.

This dramatic change in the size and nature of the nonprofit credit counseling industry had three significant impacts. First, creditors began reducing the Fair Share payments credit counseling agencies received from their DMP operations. The number of creditors willing to cooperate with the fast consolidating credit counseling firms declined and creditors became disillusioned with the credit counseling firms' screening of potential DMP clients. The second impact of this change was a string of nonprofit credit counseling industry mergers and acquisitions that started in the late 1990's and continues today. The primary motivation for this trend was the desire of firms to remain or become competitive in a dynamic, rapidly growing industry. A final impact of the change in size and nature of the industry was increasing consumer dissatisfaction and mistrust accompanied by increasing legislative and regulatory scrutiny.

All existing state and federal legislation and regulation regarding the nonprofit credit counseling industry hinges on a firm's status as a 501(c)(3) organization, as determined by the IRS. The IRS undertook no formal review of the industry after the late 1970's, until it became a primary focus in 2004 with the creation of the Credit Counseling Compliance Project[5], which, as of 2006, had resulted in the revocation of the non-profit statuses of 41 credit counseling firms, with 22 still pending[6], as well as clarification of qualifications for the granting of nonprofit status for credit counseling firms. The focus of this IRS scrutiny is whether "education" is the main goal of the firm, as determined by a variety of factors as discussed in a 2006 IRS memorandum[7] (2006 Memorandum).

Further, responding to mounting consumer complaints and evidence of abuse and profiteering, Congress passed legislation effective April 1, 1997, known as the Credit Repair Organization Act (CROA) that sought to protect consumers by compelling credit counseling firms to provide full disclosure and a written contract to consumers. This was followed by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005 which mandated pre and post bankruptcy counseling by a registered nonprofit firm, and in 2006 by the Pension Protection Act, which created new 501(q) legislation in the tax code which added new requirements for 501(c)(3) firms regarding fee policy, board of directors composition, and DMP revenues (Pension Q)[8].

The first major federal legal action against a nonprofit credit counseling company was the Federal Trade Commission's (FTC) lawsuit against AmeriDebt in 2003 (FTC Ameridebt)[9]. The events surrounding this lawsuit led to Congressional Hearings, the main result of which was that the FTC and IRS began a concerted effort to clean up the nonprofit credit counseling industry, with the FTC bringing "law enforcement actions against credit counseling agencies for violations of federal consumer protection laws" if it can establish that these firms are in violation of their tax-exempt purpose of education as determined by the IRS[10] (IRS Page). These agencies were joined in their regulatory duties by the US Department of Justice (DOJ) upon enactment of BAPCPA in 2005 in its role as licensor of mandated pre- and post- bankruptcy counseling firms.

Individual states have a patchwork of laws with varying degrees of stringency, all of which use IRS 501(c)(3) designation as a baseline for regulating the credit counseling industry. Many states have established more stringent standards, however. The National Conference of Commissioners on Uniform State Laws (NCCUSL) has drafted legislation that it proposes all 50 states adopt to regulate the credit counseling industry in an attempt to impose national standards and consumer protection. This legislation would greatly benefit consumers by providing more stringent consumer protections and nonprofit credit counseling firms by providing a single legal framework rather than a maze of 50 different sets of regulatory standards.

INDUSTRY ANALYSIS

We conduct an analysis of the industry using data for the years 1999 to 2007. We investigate 36 firms' series of Form 990 filings with the IRS obtained from the website of the National Center for Charitable Statistics[11]. Revenues from three primary sources, operations, grants and investment income was observed and catalogued. The top firms in the industry according to revenues have remained relatively stable over the time period examined. The top ten firms in revenues over the eight years examined include only 15 different firms. Three firms, Money Management International, Greenpath, and CCCS of Greater Atlanta appear in the top ten firms according to revenue in all eight years. Four other firms appear on the top ten list seven out of the eight years. Table 1 shows these firms and their respective revenues.

Using the data collected from the Form 990s we construct several financial ratios in an attempt to develop a financial operations analysis. Four of those ratios are presented in this paper, a profitability ratio, two efficiency ratios and a revenue breakdown ratio. The profitability ratio is the excess or deficit for the year as a percentage of revenue (Excess/Revenue)[12]. Table 2 shows the descriptive statistics for the Excess ratio. The average excess ratio dropped dramatically in the year 2001 and continued to decline for the next two years. It has increased since 2003 but has not yet reached it earlier levels. Because of the larger variability in the excess ratios across firms the median was also calculated. The same pattern is observed using the median of the excess ratio as well. The excess ratio establishes a profitability metric for the industry. The grand average of excess revenues over the time period examined is 3.84% and the grand median is 3.14%.

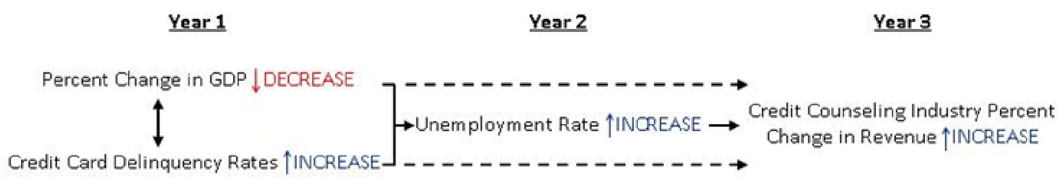
Since salaries and wages are the major costs in this industry two ratios were developed as a measure of efficiency of the firm. These ratios are salaries and wages as a percentage of revenues and officers' compensation as a percentage of revenues. Table 3 provides the descriptive statistics for the salary and wages as a percentage of revenue ratios. The average salary and wages ratio has remained relatively stable over the time period examined. The grand average is 33.79% with very little variation from year to year. The grand median salary and wages ratio is 35.99%. There are however large differences between the highest and lowest ratios; the average of the maximum ratios is 55.97% while the average of the minimum ratios is 5.8%. Figure 2 illustrates the fact that the average and median salary and wages ratio does not vary greatly from year to year.

The officers' compensation as a percentage of revenue shows are very stable pattern until 2005 when it increases significantly. Table 4 provides the descriptive statistics for the offers' compensation ratio. The grand average for this ratio is 7.43% and the grand median is 5.52%. There is great disparity between the grand average maximum ratio and grand average minimum ratio 35.49% to 0.67%. The data demonstrate that officers' compensation has been on the rise in this industry as a percentage of revenue since 2005. Figure 3 shows this that officers' compensation as a percentage of revenues was relatively stable at an average rate between 6 and 7 percent until about 2005 increase to more than 8 percent. This figure also reveals that officers' compensation increased to an average over 11 percent in 2007.

The final ratio that we investigate is the ratio of program services revenue to total revenue. This ratio reveals how much of revenue is being generated by the business operation of credit counseling. Table 5 presents the descriptive statistics for the program services revenue. The median of this ratio shows that this ratio was over 70 percent in the early years of the 2000 decade but started to drop in 2004. Examination of Form 990s reveals that Fair share contributions of creditors are included in the service revenues while lump sum grants from the creditors are included in grant revenues. The numbers indicate that creditors may have taken to providing grants to credit counselors rather than fair shares.

ECONOMIC TREND ANALYSIS

This analysis attempts to find correlations between the industry's revenues and various economic indicators. These indicators are the percentage change in GDP, the duration of unemployment and credit card delinquency. This analysis is intended to find leading indicators for the credit counseling industry performance. The preliminary findings are that first, percentage changes in industry revenues are lagged by two years to percentage changes in GDP this correlation is very strong and negative (correlation coefficient equal to -0.96). Second, average revenue of the top firm's in the industry is correlated to the duration of unemployment (weeks) lagged one year. Again, this correlation is very strong and positive (correlation coefficient is equal to 0.91). Finally, there is a positive correlation between credit card delinquency rates and the revenue of the credit counseling industry. This relationship is lagged by two years, this lagged correlation implies that consumers do not immediately seek help for their credit problems. The following time line illustrates the relationship between economic measures and the industry's revenue.



MERGERS AND GROWTH

Merged companies appear to generate the highest revenue growth rates in this industry. Looking to the larger mergers in the industry during the time period examined shows four firms have engaged in merger/acquisitions activities they are;

- MMI 2000,2001,2002,2003,2004, 2005 and 2006
- CCCS Central Ohio 2000
- Clearpoint FS Inc. 2003
- CCCS Greater Atlanta 2006

These firms had an average growth rate of revenues in the year of the merger of 44.79 percent. For the two firms where data was available it was found that organic growth (growth occurring in non- merger/acquisition years) averaged 4.55percent and -0.85 percent compared to an industry average annual growth rate of 5.16 percent. These facts indicate that the strongest growth opportunities for the credit counseling industry are related to mergers and acquisitions.

CONCLUSION

An industry analysis is conducted for the non-profit credit counseling industry over the years 1997 to 2007. Data was obtained from the Form 990s filed by the 36 largest firms with the IRS. Economic trend data was used to test the relationships between several macroeconomic variables and aggregate industry revenues. Financial /Operational ratios were developed and investigated to determine the operational efficiencies and growth characteristics of the firms.

In general, the findings indicate that when macroeconomic variables declines the revenues of the credit counseling industry increase. Further, a change in revenues in the credit counseling industry lags a change in economic indicators by one to two years. The investigation of the financial/operational ratios show that the leaders in the industry changed very little over the 10 year period studied. There also is a persistence of merger activities in this industry. Indeed, merged firms generate the highest levels of revenue growth over the period. The authors believe that there is significant room for growth in this industry.

We would like to extend the data set back to at least 1990. This will allow us to examine more than one economic cycle. Also, we are attempting to obtain firms' DMP data. This will help us refine the efficiency estimates of the firms as it would provide valuable information concerning operational revenues. Further, this information would help provide answers to the following questions. How many DMPs does the firm generate per number of contacts? How many of the DMPs are successfully completed? And how long is the average DMP?

Table 1: Top ten firms by revenue in the Credit Counseling Industry by years.

	ANNUAL REVENUE (in millions)								
Company	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**# of Years in Top ten**
Money Management International	$11.50	$12.50	$25.50	$36.60	$45.50	$51.30	$67.80	$79.20	8/8
Take Charge America	$24.10	$30.40	$32.00	$36.40	$38.90	$35.50	$30.80		7/8
Cambridge Credit Counseling Corp.	$23.80	$28.90	$53.80		$49.70	$33.60	$18.10	$13.90	7/8
Consolidated Credit Counseling Service		$12.70	$18.80	$23.00	$25.70	$28.00	$31.30	$35.90	7/8
Debt Management Credit Counseling	$31.10		$23.30	$27.70	$18.00	$16.30			5/8
Greenpath	$13.20	$13.50	$14.40	$14.00	$15.00	$16.90	$18.50	$27.70	8/8
InCharge Debt Solutions						$48.10	44	$38.00	3/8
CCCS of Greater Atlanta	$8.70	$10.10	$11.50	$12.40	$12.20	$13.40	$13.60	$20.50	8/8
Clearpoint Financial Solutions	$7.50	$7.20	$9.10		$14.80	$19.30	$16.60	$14.10	7/8
CCCS of Greater Dallas	$13.10	$11.50	$11.80	$12.00				$9.80	5/8
Lighthouse Credit Foundation				$9.00	$28.50	$27.90	$18.00		4/8
CCCS of Montana in Great Falls	$10.20	$10.40	$11.40	$11.20					4/8
CCCS of Central Ohio				$11.10	$12.30		$11.80	$13.20	4/8
CCCS of Maryland and Delaware	$7.60	$7.90							2/8
Garden State								$9.60	1/8

Table 2: Descriptive Statistics for the Excess ratio

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Average	12.93%	6.22%	0.08%	-0.96%	-0.82%	2.73%	2.50%	2.93%	8.95%
Maximum	96.98%	36.66%	18.13%	15.54%	11.99%	19.73%	16.07%	20.11%	29.36%
Minimum	-14.87%	-14.03%	-37.82%	-31.44%	-21.97%	-38.18%	-7.34%	-13.95%	1.09%
Standard Deviation	22.51%	11.63%	12.54%	9.77%	7.70%	8.91%	5.02%	7.00%	9.04%
Median	9.86%	5.15%	0.45%	0.19%	0.46%	4.35%	1.60%	3.12%	5.81%
Number of Firms	20	22	23	29	31	36	35	33	9

The Excess Ratio is (Total revenues – total expenses)/total revenues. This ratio is a profitability ratio.

Figure 1: Average Excess Ratio measured against the median Excess Ratio

Table 3: Descriptive statistics for Salaries and Wages as a percentage of Revenues. This ratio is an efficiency ratio for the CCI.

	1999	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
Average	***31.22%***	***30.45%***	***32.90%***	***33.32%***	***33.86%***	***32.98%***	***34.78%***	***37.96%***	***36.60%***
Maximum	***53.86%***	***54.46%***	***61.54%***	***60.92%***	***59.36%***	***48.25%***	***55.59%***	***55.13%***	***54.63%***
Minimum	***0.00%***	***0.00%***	***0.00%***	***5.96%***	***5.63%***	***6.73%***	***6.62%***	***8.67%***	***18.59%***
median	***34.12%***	***35.59%***	***40.70%***	***39.79%***	***39.98%***	***36.86%***	***34.59%***	***35.99%***	***32.78%***
N umber of firms	***20***	***22***	***23***	***29***	***31***	***35***	***35***	***33***	***10***

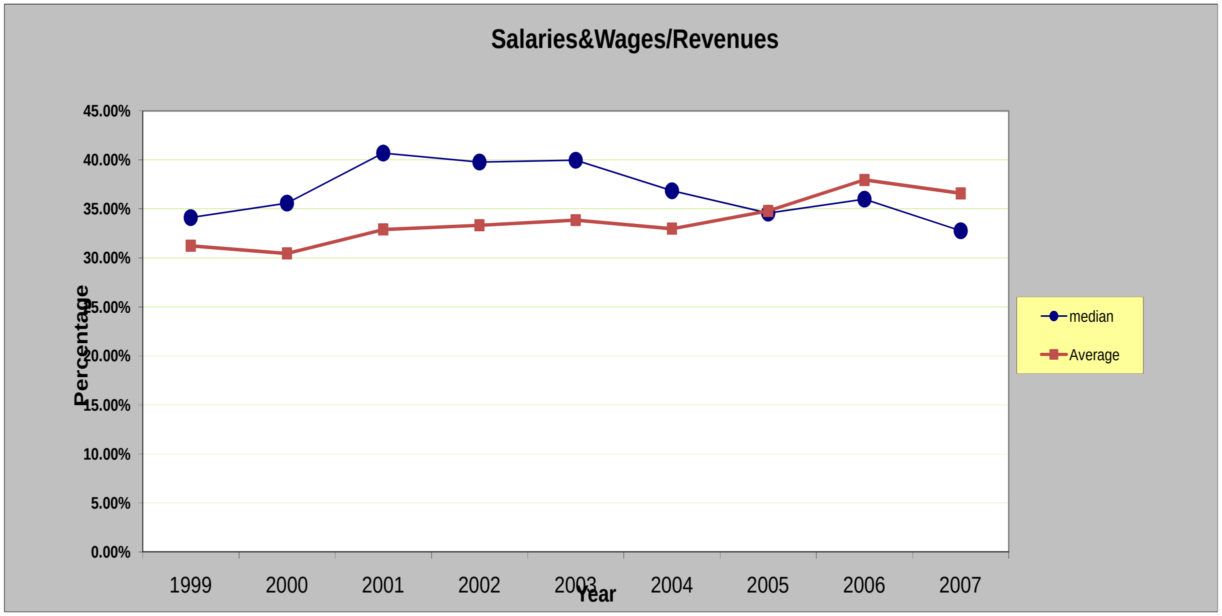


Figure 2: Average Salaries & Wages as a percentage of Revenue versus the Median Salaries & Wages as a percentage of Revenues

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Average	**6.69%**	**7.08%**	**6.25%**	**6.44%**	**6.12%**	**6.34%**	**8.56%**	**8.23%**	**11.16%**
Maximum	**32.70%**	**30.56%**	**21.80%**	**37.47%**	**38.60%**	**36.85%**	**38.47%**	**40.41%**	**42.58%**
Minimum	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.53%**	**0.78%**	**4.68%**
median	**4.76%**	**4.53%**	**3.56%**	**4.94%**	**5.09%**	**4.60%**	**7.02%**	**7.59%**	**7.59%**
Number of Firms	**19**	**22**	**23**	**29**	**31**	**35**	**35**	**33**	**11**

Table 4: Descriptive statistics for Officer's Compensation as a percentage of Revenues. This ratio is used as a measure of the firm's efficiency.

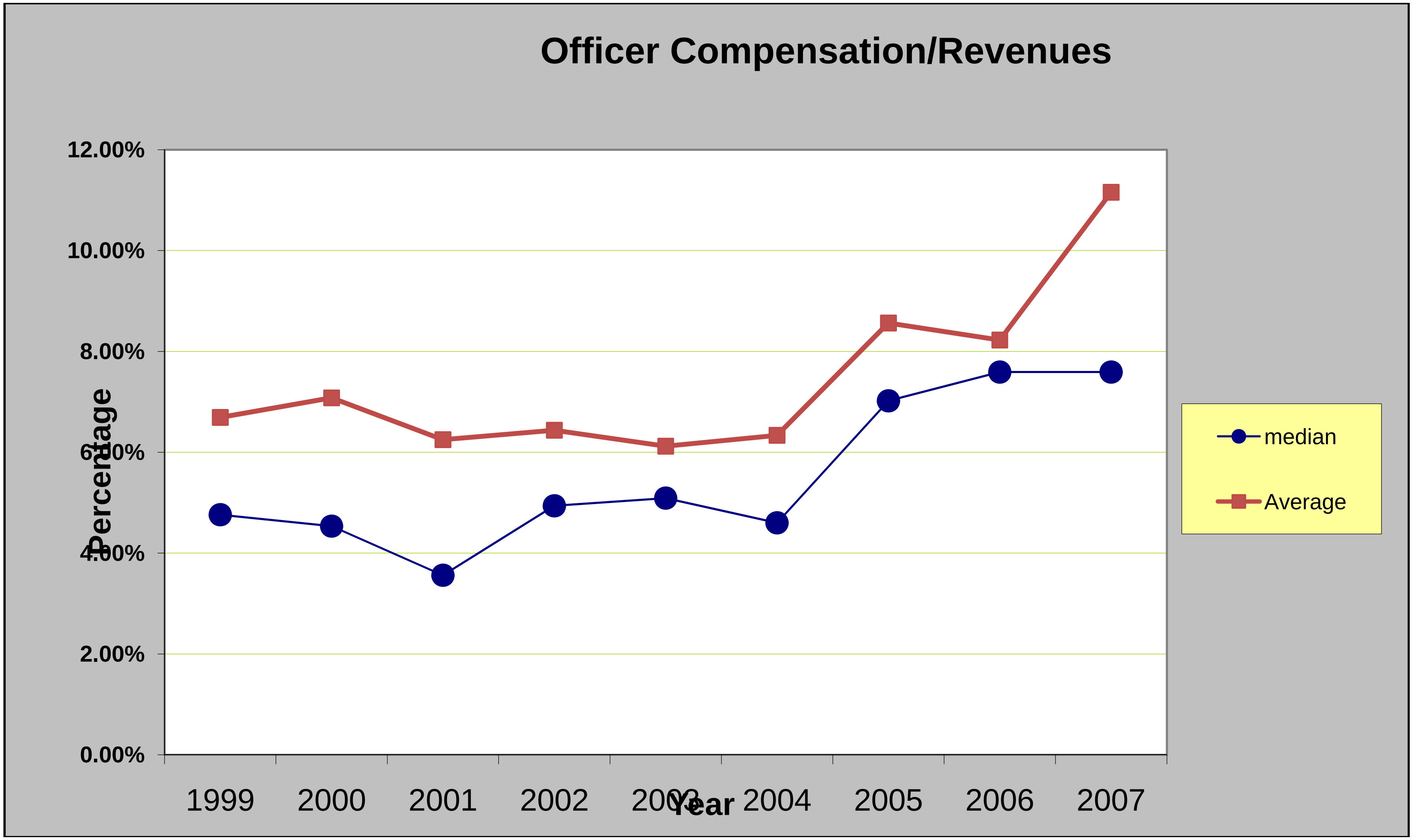


Figure 3: Average officer's compensation as a percentage of Revenue versus the median officer's compensation as a percentage of revenue.

Table 5: Descriptive statistics for the ratio of program services revenue to total revenue. This ratio serves to how much of revenue is derived from operations.

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Average	**56.27%**	**64.09%**	**64.34%**	**62.67%**	**62.44%**	**56.48%**	**58.40%**	**56.59%**	**51.43%**
Maximum	**100.00%**	**100.00%**	**100.51%**	**102.47%**	**100.00%**	**100.00%**	**101.45%**	**100.00%**	**99.76%**
Minimum	**1.41%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**
median	**52.54%**	**74.39%**	**71.68%**	**85.87%**	**76.36%**	**59.76%**	**62.47%**	**48.85%**	**41.56%**

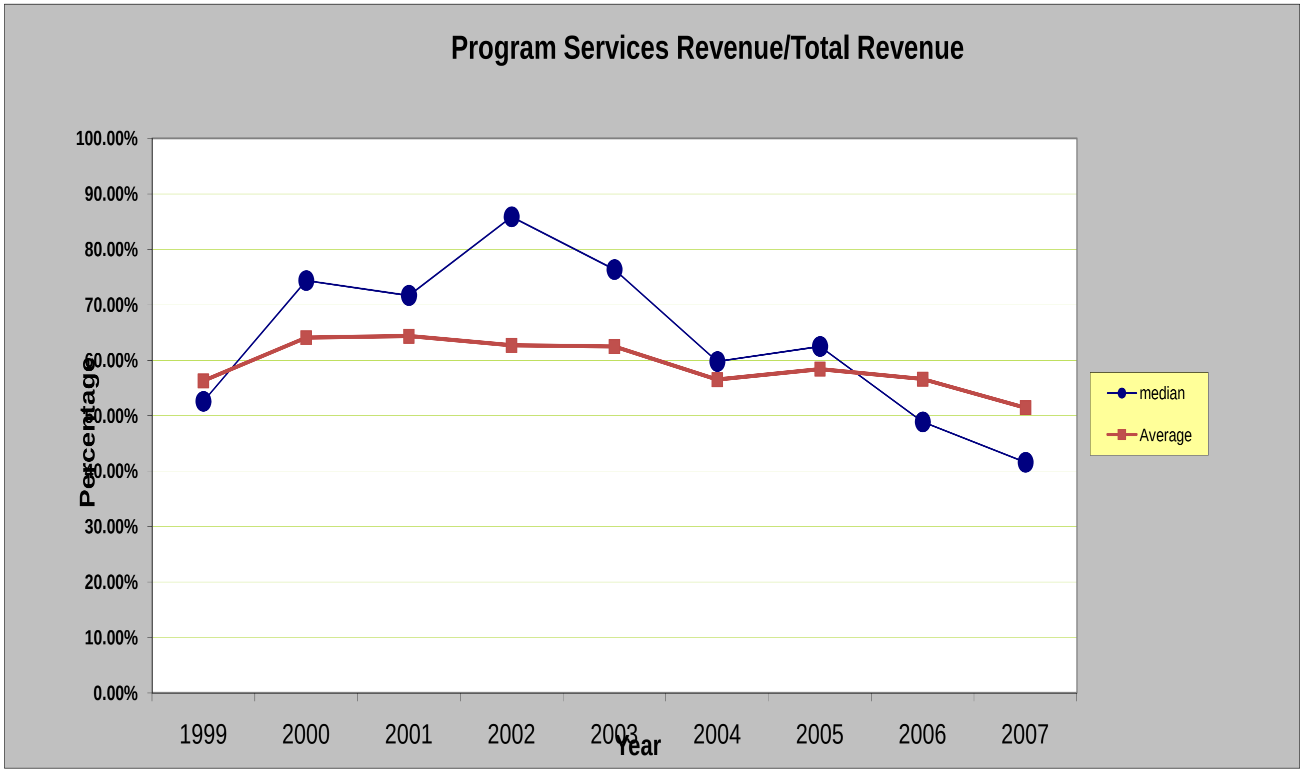


Figure 4: Average program services revenue as a percentage of total revenue versus median program services revenue as a ratio of total revenue

Credit Counseling Compliance Project.

Credit Counseling—Joint Federal Agency Resources

Pension Protection Act of 2006 Credit Counseling Provisions: Frequently Asked Questions

Written Statement of Commissioner of Internal Revenue Service Mark W. Everson Before the Permanent Subcommittee on Investigations Committee on Governmental Affairs United States Senate Hearing on the Role and Tax-Exempt Status of Certain Not-For-Profit Credit Counseling Agencies