The 6 Archetypes of Debtors

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We Help Credit Managers and Financial Controllers to optimise B2B debt recovery through insights into their SME debtors.

Which Mr Men character is your Debtor?

Mr Men is a series of children's books created by Roger Hargreaves. We grew up reading Mr Men books so we have used the characters from Mr Men books to make our analysis of the debtor archetypes more memorable. The B2B debtor archetypes that we have identified through research include:

1. Mr Muddle (Chronically insolvent)

One day Mr Muddle went fishing with a fisherman named George, and did the wrong things and didn't catch any fish. This debtor is chronically insolvent and there will be an appointment of an insolvency practitioner. Usually there are prior indicators of insolvency before this appointment.

2. Mr Forgetful (Incomplete evidence to support claim)

Mr Forgetful has a short memory and forgets to pass on a message to a farmer about sheep loose in the lane. This is where our Client has incomplete evidence to support the claim and therefore it is difficult for our Client to properly demonstrate the claim to the other Debtor or the Debtor's representatives.

3. Mr Nonsense (Phoenix activity)

Mr Nonsense lives in Nonsenseland, in a boat on top of a tree. This Debtor has engaged in phoenix activity and because of this something just doesn't add up. There is evidence the Debtor is avoiding service or has continued trading through a different entity to the detriment of creditors.

4. Mr Fussy (Genuine dispute to claim)

Mr Fussy keeps his hair combed, his moustache trimmed, his shoelaces tied and his house very neat. This Debtor has a genuine dispute to the claim and there is evidence that supports the contention that the quality or quantity of the goods or services did not meet specifications and therefore the price claimed may need to be adjusted.

5. Mr Quiet (Business exit)

Mr Quiet lives in Loudland, where everybody and everything is too loud for him. Because it is too noisy Mr Quiet closes his business without settling all of his affairs. The Debtor's business has closed but there is no insolvency appointment or evidence of chronic insolvency.

6. Mr Slow (Payment delay)

Mr Slow takes so long to do everything. It took him until New Year to open his Christmas presents and until Easter to write his thank-yous. This Debtor is simply delaying payment. There is usually payment of the debt after legal action is commenced and there is no evidence of any of the above key factors such as insolvency, business exit or a genuine dispute to the claim.

TAKE-AWAYS FOR CREDIT MANAGERS

Credit Managers and Financial Controllers that offer credit to small-to-medium sized enterprises (SMEs) need to manage the risk of non-payment. Our research and experience has given us insights to categorising business-to-business (B2B) debtors into six debtor categories. By correctly placing debtors into one of these categories our Credit Manager and Financial Controller Clients are able to accurately predict their prospects of recovery and optimise their legal expenditure. If a Client chooses to continue legal action against a chronically insolvent debtor, it may be for policy reasons rather than an expectation of recovery.

Methodology

We conducted research into B2B debt recovery claims that involved SME debtors over a four year period and we used statistical and qualitative analysis to gain insights to benefit our Clients. All claims were business-related (B2B) and the quantitative data included the date of invoicing, date of legal action, date of recovery, level of legal action, date of appointment of an insolvency practitioner (if applicable) and the payback to the client (or failure to recover). The time period for the research stretched over the Global Financial Crisis and included debtors located in NSW, Victoria and Queensland.

Findings

Regression analysis showed a negative relationship between the number of days between invoicing and the commencement of legal action. This means that the longer the delay in prosecuting claims, the less pay-back at the end. Secondly, there was a clear positive relationship between a debtor providing a personal guarantee and the percentage of the claim recovered. If a debtor (assuming the debtor is a $2 company) provided personal guarantees through its directors and proprietors, the chances of recovery significantly increased.

We were able to divide all the debtors into the following categories by identifying recurring qualitative factors and linking them to debtor categories:

1. **Chronically insolvent** – There is an appointment of an insolvency practitioner and there was prior evidence of insolvency.

2. **Incomplete evidence to support claim** – There is a problem with demonstrating the claim to the other party's representatives.

3. **Phoenix activity** – There is evidence that the debtor is avoiding service or has continued trading through a different entity to the detriment of creditors.

4. **Genuine dispute to claim** – There is evidence that there is a genuine dispute such as a quality or pricing issue.

5. **Business exit** – The debtor's business has closed but there is no insolvency appointment or evidence of chronic insolvency.

6. **Payment delay** – There is a payment of the debt after legal action and no evidence of any of the above key factors.

Other research

The Productivity Commission released a report in 2000 (Business Failure and Change: An Australian Perspective) that found that each year 7.5% of businesses leave their industry (i.e. business exit) whilst only 0.5% of businesses have a catastrophic failure (i.e. chronic insolvency). Therefore, the key risk to our Clients is not likely to be a chronically insolvent debtor (i.e. Mr Muddle) but a debtor that exits the business without resolving outstanding affairs (i.e. Mr Quiet).

Using these insights

The categorisation of Debtors helps Credit Managers and Financial Controllers to take appropriate action to recover debts and write off the debts that aren't recoverable. Legal action may be delegated to a suitable lawyer or mercantile agent that acts in the best interests of their client. Bad debts should be seen as a symptom of a problem with a business process (i.e. credit management).

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