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DEBITO TECHNOLOGIES: TAKING A DEBT MANANGEMENT App Abroad

Ladislav Tyll and Mohit Srivastava wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Tomáš Medřický started his debt management company, Debito Technologies s.r.o., in December 2014 to help creditors better manage their issued debt. The company provided a complete beginning-to-end service using a debt management application (app) that traced debtors by following their digital footprint. The whole process was managed with just the mobile app and had no upfront fee.

Medřický started this service in the Czech Republic by collaborating with a team of lawyers. In December 2017, with success in the Czech market, the company was considering expanding its operations abroad. To expand globally, Medřický needed to first select a country that provided excellent market potential and product fit, and then develop an ideal market entry. Medřický was finding it difficult, however, to narrow down a list of potential countries where he could launch his product. He was debating whether he should look only to European countries or if he should also consider an Asian market.

Typical Debt Collection

In a typical debt collection process, every creditor with an overdue claim had to send a collection letter (known as a dunning letter) to the debtor before launching an official litigation process. However, many unreliable debtors were unreachable because they rented virtual offices or flats and rarely responded to mail. Thus, it was a challenge for creditors to collect their debts. If the debtor refused to pay the debt even after receiving a letter, the creditor’s only remaining option was to pursue litigation. Using a lawyer was troublesome and expensive, and litigation took more time and money.

As an example, a creditor with an overdue claim of Kč5,000[[1]](#footnote-1) would spend an additional Kč1,000–5,000 to collect the debt. If the debtor was legally ordered to settle the debt, the debtor was also required to reimburse the creditor’s fees. However, even with a successful claim, there was no guarantee of success because the debtor could go bankrupt or disappear entirely. Given the costs and nuisance, many creditors elected not to pursue debt collection and instead focused on avoiding a similar situation in the future. This was particularly common if the creditors were private individuals and the debt did not exceed Kč10,000.

Another option for creditors was to hire a collection agency. The process was the same because collection agencies were required to follow the same course as individuals and companies. There was, however, one significant difference: collection agencies were specifically structured to collect debts. They had call centres and lawyers and were more familiar with the nuances of the process. Creditors were prepared to pay a premium for the service. Most collection agencies charged the service fee in advance. On the Czech market, there were over 30 agencies whose services were used by approximately 23 per cent of creditors with overdue debts.

A creditor’s final option was to find a factoring agency willing to buy overdue debts. The agency would purchase the debt at a discount, pay the discounted price to the creditor immediately, then pursue the outstanding debt. Factoring agencies usually imposed higher discounts for more dubious claims. The creditor was paid immediately, but the revenue could be only 50 per cent or less of the original debt.

Debito Technologies: Digital Disruption of the Business Model

Medřický, an information technology (IT) consultant at a local insurance company, was living with his wife and two children in a suburb of Prague. One day after work in mid-2014, two men from the executor’s office came to the house, wanting to confiscate some of Medřický’s property. Medřický was confused: he always paid his debts on time and never defaulted. However, the men from the executor’s office informed Medřický that he had an overdue debt—a fine he had forgotten to pay—that was more than two years old. It took a while for him to recall this specific debt. Although he did not intentionally fail to pay this fine, his disorderly approach to financial matters caused him to make a mistake. The consequences came as a surprise, and Medřický was worried that the possible legal action might tarnish his image in society and at the company.

This unpleasant experience led Medřický to think about a solution that could help creditors collect their debts by managing their financial records in one place. They would then know when debts were due, from whom, and in what amount. Medřický researched existing apps for debt management and was surprised to learn that most of the available apps provided more of a debt management process than a complete service for debt recovery. The solutions the apps provided were based on traditional methods of tracking and searching for debtors; their methods did not align with the standards of the new digital era.

As a result of the digital revolution, every private individual or corporation left a digital footprint. It was, therefore, possible to track debtors using web footprints left on Facebook, LinkedIn, Instagram, Skype, WhatsApp, Viber, Twitter, and many others. An app with an algorithm that enabled creditors to track debtors almost without human intervention would save creditors labour and costs. As well, the latest trends and developing technologies could be exploited to create an innovative app that managed debt better. Technologies such as machine learning, chatbots, and optical character recognition (OCR) could be very useful in this type of business model. Medřický realized that with these technologies, he could develop an app that would help both creditors and debtors. Creditors could find their debtors and collect what was owed to them, and debtors who were disorganized like Medřický could keep track of and pay what they owed.

Medřický knew that it would require more than part-time efforts to develop such an app, so he quit his job and started his venture. After a year of hard work, he had developed an app that was not only an interface for his clients, but also had an attached framework that reached out to and attracted clients. Using an application programming interface (API), Medřický even connected his app with those used by justice authorities and lawyers. These developments helped Medřický build Debito and provide a helpful service for clients with overdue claims, with just a small team of 13 colleagues and a few partnering organizations.

To use Debito’s service, clients downloaded the Debito app and uploaded evidence showing that their debt was overdue. Clients uploaded their evidence by taking a picture with their mobile phone and importing the picture into the app. Debito lawyers assessed the formal and factual requisites of the claim and determined whether the client was indeed entitled to recover the debt. OCR highlighted the most critical parts of invoices, contracts, and other documents, and digitalized and stored them for future use, making it easier and more efficient for the lawyers.

If the lawyers found the claim enforceable, details about the debtor were checked to determine whether the debtor existed and if there were other claims or executions imposed on the debtor that could lower the probability of success. If the odds of collecting the debt were low, clients were informed and advised not to proceed further. If the check was positive, the client was asked to sign a power of attorney, allowing Debito to represent the client’s interests, and the whole process of collection would start.

Debito looked for debtors by tracing their digital footprints. Once located, Debito sent a message to the debtor informing them that they had failed to make their payments on time. The dunning letter was sent automatically using pre-defined templates and claims details from the scanned documents. If the debtor was reluctant to pay their debts, Debito submitted a request to the court to issue a payment order. Again, this was all done automatically using an API to communicate with the court. If the debtor defaulted on the court’s payment order, an immediate execution process was launched. If the debtor still failed to pay their debts, the execution was imposed (see Exhibit 1).

During the whole process, clients were updated about their claims through the Debito app. The clients’ interests were represented by Debito’s partnering lawyers, who did not charge Debito fees for their service; rather, the court and legal fees were billed to the debtor. Once the debt was collected, Debito took its remuneration, which was 20 per cent of the collected amount. Compared to the traditional methods of debt collection, Debito significantly reduced the additional investment clients would have had to make when claiming and collecting debts. And Debito’s practice of only charging a success fee appealed to clients, who would otherwise have likely written off their bad debt.

OTHER REVENUE STREAMS AND MARKETING THE SERVICE

Debito was co-operating with external lawyers who acted on behalf of Debito’s clients. Because Debito served these partners with new clients and automated paperwork, Debito charged them a commission of 80 per cent of the legal fees, which were usually guaranteed by law and paid by the debtor. This revenue stream represented the most significant portion of Debito’s revenues (see Exhibits 2 and 3).

The Debito app was provided as an online service. Thus, it seemed logical that advertising would be mostly online using Google or Facebook campaigns. However, most clients learned about Debito from radio advertisements. Only after hearing about the service would they search the Internet to learn more about the company and its app.

Because Medřický’s approach to charging his clients a success fee mattered to him, he sought partners who would have the same attitude to the business. Fortunately, he came across a multinational radio network company that agreed to charge Debito based on commission collected from their clients. The commission was set at 25 per cent of Debito’s accumulated fees (excluding commission from partnering organizations). The radio company offered the same scheme to Debito if it entered other markets where the radio company operated. This might include France, Poland, and Hungary. Debito would also invest in online advertising, but Medřický believed that a combination of traditional mass media and an online channel was an excellent strategy.

Besides a purely business-oriented approach to its clients, Medřický also tried to extend free services to aid vulnerable customers, such as single parents whose ex-partners did not meet their legal commitments. To have better access to Debito services, Medřický was planning to install tablets loaded with the Debito app in local city and municipal halls, which were visited by parents to get their subsidies.

FUTURE PLANS AND INTERNATIONAL EXPANSION

The company needed to sustain a constant investment in upgrading its app. By mid-2017, Debito was developing a new version of the app in co-operation with an external partner. This major update, which was meant to be used for the next few years, was financed from operating cash flow. The major source of the operating cash flow was the commission from lawyers’ and executors’ fees and the portion of the commission from clients that remained after paying the radio company for ads.

Medřický decided he wanted to expand internationally based on Debito’s current operating cash flows. He estimated that every new market entry would cost about Kč30,000 to Kč40,000 to localize the app and adapt it to local legal requirements. In addition, Medřický anticipated other costs, such as fixed costs, salaries, and building costs.

Medřický also realized that with more data about clients and their debtors, he could create archetypes of individuals, which would subsequently help him to formulate a better approach to help new debtors more efficiently. This project could be incorporated into the whole business model.

FUTURE CHALLENGES

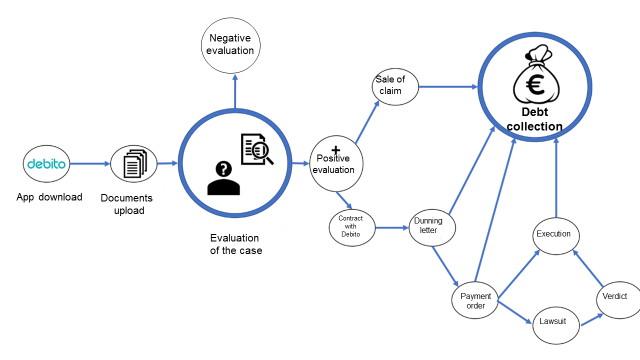
Medřický’s task for the upcoming year was to develop the new version of the Debito app, which would anticipate upcoming innovations in financial technology and persuade potential partners from that industry to start using the app. It was a big challenge since the industry incumbents were very conservative and had recently invested heavily in their own collection software, which was proving to not be very successful in collecting from debtors. However, having their own software allowed the financial technology companies to feel independent of others.

To expand internationally, Medřický had to decide which markets to start with and how to finance the expansion. If he elected private equity investment, which was popular, he would have to be prepared to sacrifice some control of his company in return for the potential of growth.

Medřický juggled the options in his mind, wondering what he would present in his global expansion plan at the next board meeting.

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Exhibit 1: Debt Collection and Management Process at DEBITO Technologies



Source: Company files.

Exhibit 2: Debito Technologies, Balance Sheet (in thousands of CZK)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2015** | **2016** | **2017 (Q1–Q2)** |
| Assets |  |  |  |
| Cash | 1 | 30 | 610 |
| Accounts receivable | 426 | 644 | 646 |
| Deferred income tax | 0 | 0 | 0 |
| Materials and supplies | 2 | 1 | 3 |
| Other current assets | 0 | 0 | 1 |
| Total current assets | 429 | 675 | 1,260 |
|  |  |  |  |
| Property and equipment | 0 | 0 | 0 |
| Other assets | 0 | 0 | 0 |
| Total assets | 429 | 675 | 1,260 |
|  |  |  |  |
| Liabilities and equity |  |  |  |
| Accounts payable | 468 | 494 | 76 |
| Current portion of long-term debt | 0 | 0 | 0 |
| Short-term debt | 261 | 0 | 0 |
| Other current liabilities | 0 | 0 | 0 |
| Total current liabilities | 729 | 494 | 76 |
|  |  |  |  |
| Long-term debt | 0 | 0 | 0 |
| Deferred income taxes | 0 | 0 | 0 |
| Other long-term liabilities | 0 | 0 | 0 |
| Total liabilities | 0 | 0 | 0 |
|  |  |  |  |
| Owner’s equity |  |  |  |
| Total stockholders’ equity | 2,000 | 2,000 | 2,000 |
| Retained earnings | −2,300 | −1,819 | −816 |
| Total stockholders’ equity | −300 | 181 | 1,184 |
| Total liabilities and equity | 429 | 675 | 1,260 |

Note: CZK = Czech Republic koruna.

Source: Company files.

Exhibit 3: Debito Technologies, Income Statement (in thousands of CZK)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2015** | **2016** | **2017**  **(Q1–Q2)** |
|  |  |  |  |
| Operating revenues | 3,615 | 6,322 | 4,330 |
|  |  |  |  |
| Operating expenses |  |  |  |
| Cost of goods sold | 0 | 0 | 0 |
| Selling expanses | 222 | 606 | 429 |
| General and administrative | 430 | 435 | 450 |
| Human resources costs, including compensation | 4,770 | 4,800 | 2,448 |
| Total expenses | 5,422 | 5,841 | 3,327 |
|  |  |  |  |
| Income from operations | −1,807 | 481 | 1,003 |
| Interest expense | 0 | 0 | 0 |
| Other income | 0 | 0 | 0 |
| Loss on disposal of subsidiary | 0 | 0 | 0 |
| Income before tax | −1,807 | 481 | 1,003 |
|  |  |  |  |
| Income taxes | 0 | 0 | 0 |
| Changes in accounting principles |  |  |  |
| Net income | −1,807 | 481 | 1,003 |

Note: CZK = Czech Republic koruna. The Debito app and other software were developed internally and were not recorded in the accounts; thus, there was no depreciation.

Source: Company files.

1. Kč = CZK = Czech Republic koruna; € = EUR = euro; 1 Kč = 0.036 EUR as of December 31, 2014. [↑](#footnote-ref-1)