

# The 'Sell' or 'Recover' Debate:

## We examine how creditors can regain control after the recent market turmoil

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### The disappearance of the Debt Sale market

2009 was a landmark year for the recoveries market as it saw the dramatic close of five years of unprecedented growth in the debt sale market. By the end of 2008, growing concern over the economic climate translated into an increasingly pessimistic view on future recovery rates at the same time as market liquidity was reduced by debt purchasers' funding lines being restricted by the 'credit crunch'. The impact was immediate and dramatic, and by the end of 2008 prices for some debt segments had fallen by over 50% (see figure 1, over).

### Sell or keep? – The big question for 2010

Throughout 2009 creditors looked away from the debt sale market and towards investing in recovery infrastructure and the key question for creditors in 2010 will be what to do now with their debt.

TDX Group has already observed a marked improvement in the debt sale market in Q1 2010 and we forecast that by the middle of 2010 most creditors should once again find sale an attractive option from a Net Present Value (NPV) basis.

Some creditors, however, may be reluctant to switch back to sale after having experienced the painful process of the past 18 months investing in developing in-house capability and forging relationships with debt collection agencies.

### The value of outsourcing

For most creditors, the switch away from selling debt was not a strategic decision but one necessitated by market forces – the need to act quickly and decisively meant there was little time to evaluate or plan the investment needed to ensure long-term effectiveness and efficiency. For these reasons often, and despite best endeavours, the level of investment was far below that required to maintain that capability beyond the short-term.

Those creditors already using third party service providers, such as TDX Group and others, were largely sheltered from the impact because the increase in volume created by the reduction in debt sale volumes could more easily be absorbed by the flexibility of the panel management platform.

This flexibility is one of the key benefits provided by an outsourced "ready-to-go" platform and network of Debt Collection Agencies (DCAs). In addition, by accessing this service, creditors also avoided the need to invest in their own infrastructure, safe in the knowledge that they were benefitting from proven capability and performance.

### Choices for creditors in 2010

The aftermath of the recent market turmoil has left many creditors failing to extract the full value from their bad debt portfolios. The options open to creditors are clear, as can be seen in figure 2, over.



**Stuart Bungay**, Head of Capital Markets at TDX Group said, "Given that many creditors will have been conservative in their forecasting for 2010-11, most having excluded any proceeds from sales; any transactions could present an opportunity to deliver positive 'upside' to existing budgets".

Whichever option creditors choose, the decision regarding whether to sell or keep bad debts will remain a key one throughout 2010.

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Figure 1: Debt sale, market volumes and price

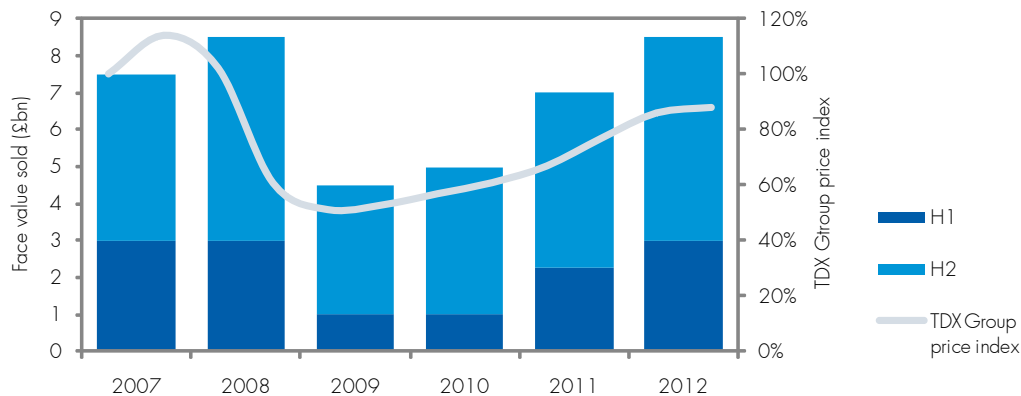


Figure 2: Creditor choices in 2010

1. Migrate back towards a sale-based strategy.

This would result in immediate sale benefits, would assist with balance sheet optics and would require little operational expense. However, there would be a risk of future exposure to asset sale market variations, no benchmarking of price vs. performance and this option would require investment in provisioning models.

2. Invest further in in-house recovery capabilities.

This would offer complete control over recoveries operations but is costly, may limit future flexibility and may leave a significant legacy backlog. Having made the investment, many creditors may find themselves subsequently reluctant to sell based on the cost they have sunk into infrastructure.

3. Outsource recovery operations.

The benefits for the creditor would include access to best in class infrastructure and capability, comparatively low costs and complete future flexibility, however, this option may involve the restructuring of existing resources.

4. Do nothing.

This option would have no incremental cost, but this must be weighed against the likely sub-optimal nature of the current process and the opportunity cost that would therefore be incurred in carrying on with the current infrastructure.



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