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When Good Customers Become Bad Bill Payers

By CAITLIN KELLY

When credit markets seized up more than a year ago, many small businesses were caught flat-footed. Their clients were not paying, or were paying more slowly, and the owners were left emotionally stressed and financially damaged.

But after the initial shock wore off, those owners have come up with a variety of ways to make sure they do get paid.

The National Federation of Independent Business, which has 350,000 members, signed up 200 members for a Web seminar on collections, said Karen Harned, executive director for the organization's small-business legal center. "This is always a big issue for small-business owners."

Arne Salkin, an account executive with Transworld Systems, a 39-year-old national collections agency, said the problem was felt by owners in an array of businesses. "Our clients include cigarette wholesalers, pest management companies, nursing homes and private day schools," he said

With 150 offices and 75,000 customers across the United States, Transworld sends out customized demand letters, he said. Its customers, most of them small businesses, pay $750 for a series of five letters asking for payment, each escalating in intensity. Typically, they are sent out every two weeks, matching a standard pay period.

This system worked, in one instance, for David Neal, assistant corporate controller for Hoover Treated Wood Products, a lumber wholesaler in Thomson, Ga., when a client owing $15,000 paid the entire amount after receiving two letters. "I was shocked," Mr. Neal said. "We were very surprised that it worked."

But another client — a longtime customer, Mr. Neal said — was in arrears for $45,000, ignored all five letters and then went out of business in late October. "It will have to be written off," he said.

That is painful for a low-margin industry like his, which typically bills within 15 days and in which 95 percent of clients pay promptly, Mr. Neal said. His firm typically has $4.5 million a week in receivables, he said, and payments started slowing in November 2008.

Geoffrey Wilson, owner of 352 Media, a 10-year-old Web development firm in Gainesville, Fla., lost $165,000 in early 2008 when three clients did not pay. The three firms were start-ups, he said, two in Florida, one in Michigan.

"It was devastating," he said. "It damaged our cash flow and really hurt us." The company, with major companies like Microsoft and American Express, did not have to lay off any of its 40 employees, but the experience left scars, Mr. Wilson said.

"It makes you really angry," he said. "These were clients we had extensive interactions with over several months, sometimes with as many as 50 meetings. It felt very personal. Suddenly you have to threaten them, sue them."

Today, Mr. Wilson is much more cautious about accepting new clients and is clear from the outset about payment terms — 33 percent upfront, raised from 25 percent in August 2008. Clients are now classified as standard or preferred, the latter being firms with 15 employees and at least two years in business. Standard clients must pay in full before material is delivered, and the business owner will be asked for a personal guarantee, he said.

Some customers are newly candid about their own financial woes, "which we'd never seen before," he said. "They've become very truthful. As a business owner, I really appreciate their honesty. It allows us to better plan our situation. I need an accurate understanding of what's coming in instead of having a client simply go silent."

Lisa Brock, head of Brock Communications in Tampa, Fla., is taking a personal approach to managing late payers, recently visiting the chief executives of two local clients to negotiate payment. Now, more than ever, Ms. Brock said, she wants to know whom she is dealing with before entering into any business deal. A free consultation allows her to decide if a client's values match hers. If so, she delves deeply into their references. "We've done more of this recently than in the 14 years we've been in business," she said. "There are a number of ways to check people out: annual reports, a Dun & Bradstreet report, ask for personal and professional references."

Cindy White, whose 11-year-old company manufactures knitted ribbon jackets that are sold in 40 high-end boutiques nationwide for $800 to $1,000, has been owed $5,000 for six months from several clients, forcing her to lay off employees. She has also fallen behind in the rent on her Phoenix design studio. "I have a lot of stores out there who owe me money, but they're my bread and butter. You don't want to upset them by suing or sending out collection letters."

The decision whether to hold back or escalate demands for payment was made for her recently after a seven-year client, a store that closed, refused to communicate with her and did not pay for the jackets she had shipped. "I was furious," Ms. White said. "This was a store I had a longstanding relationship with."

Ever since, she said, "I have been on the phone every few days with all the stores that owe me money, just keeping tabs and making sure they are still viable." She said she is hopeful that the economy will come back, and "I am willing to work with them because they are my lifeblood."

Such attentiveness is necessary, agreed Ms. Brock. "I look at our profit and loss statements biweekly." She advises scrutinizing client lists to predict potential trouble spots. "Even having two slow payers is significant."

When a client refuses to pay, last-ditch options include hiring a collections agency — which typically recoup in full only 11 percent of the time — hiring a collections lawyer, who may claim one-third of what they recover, or filing a case in small-claims court. Joshua Friedman, a collections lawyer in Beverly Hills, Calif., said his business had been booming since last fall, with clients coming to him "in every field you can imagine."

"Sometimes people can't pay. Sometimes it's a matter of straight-out fraud, where buyers are not doing enough due diligence. People are desperate to do the deal," he said. Mr. Friedman takes on only cases worth more than $10,000.

"I try to resolve everything without filing a suit," he said. His success rate is still only 20 percent, he warned. "My clients know better than I do if the client is really likely to settle."