How to Get Customers to Pay Up

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It's a tough discipline, especially in a recession, but bill collection can make or break a business — and in some cases, it can bring others down with it. After defaulting on $275 million in loans, Idaho's Tamarack Resort filed for bankruptcy protection in February and shut its doors March 4, leaving behind $22 million in unpaid bills from suppliers and contractors, many of whom had to lay off employees. And a French auto-parts maker recently sued Auburn Hills, Mich.-based Chrysler, claiming the car manufacturer owes $110 million for engineering and research costs.

To successfully collect payments on time, companies need a plan in place that includes more than just the threat of a bill collector calling six times per day. Here are three key steps to get clients to pay up in a down economy.

Things you will need:

- **Time:** Allow about three months to carefully craft, vet, and launch a new billing policy. Alert your customers to the changes and specify when the new policy will take effect.
- **Money:** Depends. If all goes as planned, collecting unpaid bills will add more cash to the company's coffers. But if customers don't pay up immediately, a plan B — such as debt settlement — could result in a loss.
- **Task Force:** Assemble a team of bright minds from legal, accounting, and public relations to refine a billing policy.
- **Key Message:** Be upfront about why your company is stepping up its collection efforts. Everyone knows the economy is in trouble, so go ahead and say it. Customers will be more accepting of any policy changes.

step 1

Use a Carrot and Stick

Goal: Encourage customers to pay on time by creating a reward-and-punishment billing system.

First, the carrot. Offer a discount if a client pays the debt early. The most common early payment discount is called the '2/10 net 30 rule': Customers receive a 2 percent discount on a bill that is due in 30 days if they pay by the 10th day.

By offering a discount, "businesses can make huge returns in this economy," that they otherwise wouldn't get, says Jim Ullery, president of the Center for Organizational Energy and a management consultant who specializes in bill collection. Those returns come from clients who are eager for any opportunity to save money. J.P. Morgan, which operates an electronic payment service for firms and their suppliers, recently reported that the economic crisis has spurred more companies to take advantage of early payment discounts. In 2008, one of J.P.

Morgan’s Fortune 500 clients in the telecommunications industry netted savings of $30 million in early payment discounts. A pharmaceutical customer captured more than $4 million in discount savings.

Now the stick. If customers face a mountain of unpaid bills and invoices, they need a good reason to pay your company first. Customers are more likely to cough up the cash if they know they will legally owe more money down the line. Here are a few ways to encourage payment:

- Start charging accrued interest on the day the bill is late.
- Include a clause in the service agreement or contract that says the client is responsible for all fees associated with bill collection.
- Require the business owner or principal to sign a personal guarantee.

Banks have a long-established practice of asking for collateral, such as equipment or property, when extending business loans. Companies should be no different, Ullery says. The reality is that “people pay banks and lenders who are going to repossess something first,” Ullery says. In this economic climate, a handshake won’t cut it; the only personal guarantee is one signed on the dotted line — with collateral attached.

What Not to Do

Surprise Customers

No one wants angry phone calls from customers slapped with unexpected late penalties. Clearly spell out every detail of the billing change in a letter, and include it with invoices: Does the 10-day period for the early discount start on the date of the invoice, or the day the customer receives it? What is the interest rate charged on late payments? Make new customers aware of the policy in a signed service agreement. Be transparent and explain why you are making the changes. Chances are, your customers are feeling the same pinch, and they’ll understand.

step 2

Strike the Right Tone

Goal: Express the gravity of the situation — without alienating the customer.

If the past-due date for a bill has come and gone, immediately send the first collection letter. “The day the payment isn’t there on time, establish an iron fist and a velvet glove,” Ullery says. He suggests a letter that is conversational, courteous, and specific — not full of legal jargon or generic statements. The tone of the letter is critical. Let the client know that it’s about more than just money — the business relationship is also at stake, Ullery says. And don’t be subtle, either. The letter must not leave any room for interpretation. Strike the line that says: “If your check has already been sent, ignore this letter.” That’s a wishy-washy sentence, and it’s also an out for the customer who may say that the check is in the mail, even if it’s not. One final tip:

Toss the standard white envelopes that will get lost in a stack of mail. Instead, send collection letters in an oversized priority envelope that screams, “Important!”

For Example

Watch Your Words

Here’s an adapted excerpt from one of Ullery’s collection letters that is polite and conversational, yet firm in its tone:

“In a few days, decisions must be made on accounts that are seriously past due. Your goodwill has always been important to us; that is why we are reluctant now to take any action that might jeopardize your credit standing and cause you added expense. Our contract stipulates that you will be responsible for collection and legal fees.

We have contacted you numerous times without response, and now we must consider the possibility of placing your account with our collection agents or a law firm. Still, I am hopeful that you will act promptly and forward us your payment in full, immediately. That is why I am going to suspend further action until (date)

It is important, however, that I hear from you by then. Otherwise, a decision must be made that I am sure neither of us wants.”

step 3 Negotiate New Payment Terms

Goal: Work with your customers directly — and turn to collection agencies as a last resort.

The knee-jerk reaction to an unresponsive debtor is to turn the bill over to a collection agency, sell off the debt, or write it off. But first, call the debtor and offer to set up a payment plan, says Mike McDerment, CEO and founder of FreshBooks, an online invoicing service. “Negotiate some of the terms to be more flexible,” he recommends.

Open the conversation by asking why the customer hasn’t paid the bill. These are extraordinary economic times, and a customer who paid bills promptly in the past may be faced with unprecedented business challenges. “Understand the situation they are in today,” says McDerment. “Stay in tune with your customers. If you can work with someone through their tough times,” he says, then that business relationship will last past the economic downturn.

Another option is a debt settlement. With the financial climate making it increasingly difficult to fully collect on a bad debt, more firms are offering to forgive a portion of the debt rather than send it to a collection agency or write it off. Major credit card companies like Bank of America have quietly started offering debt settlements to some customers. Even though settling a debt means taking a loss, it will be faster than going through a collection agency or litigation. Also, clients who didn't respond to other options may jump at the chance to settle.

If no other solution works, resort to a collection agency or litigation. "The longer you wait, the less likely you are to get the money," says Ullery, who recommends waiting no longer than three months before sending a past-due account to collections. But beware: Sometimes collection agencies can go too far to collect a debt. The Illinois attorney general filed a lawsuit in January against a collection agency that made false threats, including telling debtors that the state's child welfare agency would take away their children if they didn't pay up. That's an extreme case, but it underscores the importance of knowing what kind of agency you're dealing with. Familiarize yourself with the Federal Trade Commission's Fair Debt Collection Practices Act to make sure the collection agency is doing things by the book.

Nitty Gritty

Avoid Difficult Customers from the Start

Clients who already have plunked down a chunk of cash are more likely to finish paying their bills than those who haven't paid anything, so try to weed out the non-payers before they jeopardize your bottom line. Consider requiring new clients to make a down payment of at least 25 percent — ditto for a long-time customer who is in obvious financial trouble. "Businesses want the next order so desperately that they become more vulnerable to being taken advantage of by deadbeats," especially in a recession, says Susan Schreter, managing editor of takecommand.org and a professor of entrepreneurship at the University of Washington's Foster School of Business. Even if requiring a down payment drives off a few potential customers, it's worth the saved collection headaches.