# The Collection Process

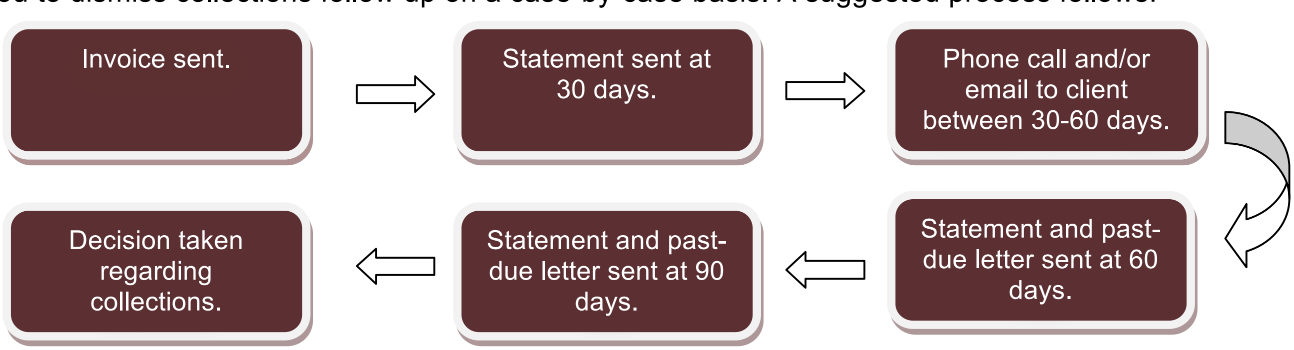
Spending or investing cash can be a fun exercise. Collecting cash, however, is often an undesirable activity for small business owners. Wearing the hats of sales agent, service provider, and bill collector might feel contradictory at times, but the collections process can be systematic and organized to enhance client relationships. It actually provides regular opportunity to be in touch with the client.

Prior to beginning an engagement, the payment terms should be clearly outlined in writing and agreed to. Clear payment terms need to be established up front in the price listed, contract, or engagement letter. Invoices should also indicate precisely what the terms are, including late payment fees and the timeframe for receiving payment. If it is a retail establishment, the refund policy should be clearly noted for all customers to see. The establishment of clear terms and timely follow-up should limit the amount of write-offs in your company.

It is important that invoices are both accurate and issued in a timely way. It is unfair to invoice 30 days late and then expect immediate payment. Timeliness in following up on outstanding invoices directly correlates to the amount that is collected. According to the Commercial Collection Agency Association, a company should expect to collect 90 percent of payments received 30 days late. The expectations of collection decrease to 70 percent at 90 days, 52.1 percent at six months, and 22.8 percent at a year late.[1]

A standard A/R policy makes dealing with collections fairly simple and includes a) credit approval checks on vendors; b) regular invoicing for products or services rendered; c) monthly statements having aging of balances due; d) regular reviews of the aging accounts; e) routine contacts with customers regarding payments when balances show over 60 days outstanding; and f) establishing reserves for non-payment (bad debts) after 90-180 days.

Systematic follow-up by sending monthly statements as well as letters indicating that the payment is past-due are important reminders. Phone calls are also powerful, as they are less easy for customers to avoid then mail. As an executive, be sure to review aging receivables and sign-off before staff make any collection calls as there may be a relational issue which causes you to dismiss collections follow up on a case-by-case basis. A suggested process follows:



*Collections Options:*

Many businesses at some point encounter long outstanding accounts receivable. After a receivable has been fully reserved for non-payment the company faces a choice of how to address the situation. Typically a letter of warning is sent indicating that if the invoice is not paid within a given period of time the account will be turned over to a collection agency, thus endangering the customer's credit reputation. Collection agencies are available to obtain outstanding payments on a contingency basis.

Regardless of the option chosen, when an account becomes uncollectible it is likely to lead to the end of the relationship with the debtor. The exception to this is if the debtor is serviced on a COD basis going forward and a repayment plan is put in place for past debt. There are various options that the company has regarding an outstanding account including:

1. *Write-off:* The purpose of a write-off is to ensure proper reporting of the account and the removal of it from the books. A small business might write off an account after six or twelve months.

2. *Collection Agency:* After following through with the standard A/R policy as mentioned above, outstanding accounts are turned over to a collection agency. The agency is paid a contingency fee on any accounts recovered. The business would sever the relationship with the account at the time that the collection agency takes it over.

3. *Sue:* In the ordinary process of collections (as outlined above), the collection agency would take over to recoup the outstanding payments and might opt to sue the company in order to collect. Another option is for the company owed to take the debtor to court directly.

4. *Restoration:* This option seeks to restore or maintain the client relationship and could lead to one of the following:
    a. *Forgiveness:* After attempting collections, a company could choose to forgive the debt and then cut the negligent payer off from any future business relationship.
    b. *Repayment:* The company could extend terms as needed (if financially possible) to the debtor and see that the debt is consistently repaid over the time agreed.

**Invoice Factoring:**
In order to supplement cash flow needs, many small businesses choose to factor their Accounts Receivables. For a certain fee, companies eliminate the need to implement a collection process. Factors often specialize by industry

In factoring invoices are held by the factor as collateral until full payment is received, often 60 or 90 days after receipt of invoice. Before agreeing to factor the invoice, the factor will review the credit worthiness of the client's customer. If the factor is not willing to process a particular customer, this should send a clear message to the client to be cautious of the risks involved in doing continued business with that customer.

In the factoring process the factor typically advances 80 percent of the invoice upon submission, sometimes as quickly as within 24 hours. This allows a small business the required cash to process the order and minimizes the risk of not being paid. The remaining 20 percent is paid out upon receipt of payment from the customer, less the fees charged by the factor. These fees are usually in the 2-5 percent range.[1] While previously companies were required to factor all receivables or at least held to a minimum sales requirement, there is a trend towards factoring on an invoice-by-invoice basis.

**Action Steps:**

1. Review your AR Collections process or create and implement one.
2. Review aging accounts on a monthly basis.

**Articles for Further Reading**

1. Lagorio, Christine. "Tips for Streamlining Accounts Receivable." 12 March 2010. http://www.inc.com/guides/accounts-receivable-streamlining-tips.html
2. Tabaka, Marla. "Poor Cashflow? Look at your Accounts Receivable." 4 May 2009. http://www.inc.com/marla-tabaka/2009/05/poor_cashflow_look_at_your_acc_1.html.
3. Dunn, Michelle. "Strengthen Your Credit Policy Today." http://www.entrepreneur.com/money/paymentsandcollections/collectionscolumnistmichelledunn/article203584.html

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*For more information, please visit Cathedral Consulting Group LLC online at www.cathedralconsulting.com or contact us at info@cathedralconsulting.com.*

[1] "Accounts Receivable Factoring Can Relieve 51 Percent of U.S. Small Businesses With Cash Flow Issues." http://www.marketwire.com/press-release/Accounts-Receivable-Factoring-Can-Relieve-51-Percent-US-Small-Businesses-With-Cash-Flow-1106071.htm. 22 Jan. 2010.