Past Due.
Customers are still clinging to cash. How to get yours.

Kelly K. Spors
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Sure, the recession is technically over. But for many small businesses, getting paid by customers on time—or at all—is still a major achievement.

According to Sageworks Inc., which analyzes private-company finances, it took businesses three days longer to collect receivables in 2009 than in 2008. Not surprisingly, businesses took 3.5 days longer to pay vendors during the same period.

Many collections experts expect the tough collections climate to stick around through this year, especially for small and mid-sized businesses that often don't have the resources to strong-arm customers like larger corporations do. Small business owners often maintain personal relationships with their customers, and they worry more about customers taking their business elsewhere.

"Small businesses are less skilled in collecting—they just don't have the experience, they don't know the techniques, they haven't had the training," says Len Sklar, a collections consultant in Redwood City, Calif. "Also, they are psychologically less willing to push to get the money that's owed to them."

Many small businesses are reluctant to fork over money to hire a collections agency to settle their bad debt. But the bad economy is forcing many small businesses to be more proactive and aggressive in how they handle payment in-house, Sklar says. Many small companies have gotten savvier in the last year or two—out of necessity.

Here's a look at some ways small businesses are ramping up their collections, and how it's working out for them so far.

Write a Formal Policy

When the economy boomed, most small businesses had few rules or standard procedures for how they collected money. But more business owners are realizing they can speed up their collections time—and improve cash flow—by hashing out payment and collections procedures ahead of time, and having customers sign a dotted line acknowledging the policy. It's a simple and cheap strategy, but for some small businesses, it's enough to do the trick.

Kimberly Martinez, co-founder and chief executive of Bonitas International LLC, a Newbury, Ohio-based fashion accessories wholesaler, always required her customers to pay within 30 days of invoicing—a policy that worked well until the economy tanked. But in early 2009, Martinez noticed a worrisome uptick in late payers. Several independent retailers her company sold to filed for bankruptcy protection.

Martinez and her business partner decided they needed a more aggressive and formalized payment and collections process. The first step was designating someone at the 17-employee company to monitor collections on a daily basis and oversee payment and collections procedures. The company also joined Credit Collective, a fee-based online community of about 200 specialty manufacturers that swap credit information about retailers with whom they deal. The collective also offers other collections services, such as pre-collections letters and business credit checks.

Bonitas International’s first-time customers are now asked to sign a personal guarantee when they place an order that contractually obligates them to pay their bills, even if their business fails. New customers are also required to put their first payment on a credit card, which is billed after shipment.

Having a formal procedure for checking credit histories and those personal guarantees have helped ensure the company takes only qualified customers. The company has also become more aggressive about calling late-paying customers right after they miss payment, rather than waiting a week or two. If a customer is more than a month or two late, Bonitas turns to a collections agency.

The aggressive policy has paid off, Martinez says. The average time it takes customers to pay has fallen to 43 days, down from an average of 80-plus days a year ago. “These are all things we should have been doing all along,” she says. “We really think this process will help us as the economy gets better, too.”

Upfront Advantage

One way to assure payment, or at least part of it, is to require customers to pay a portion in advance.
In late 2008, Tim and Stacy Peterson, NFIB members and husband-and-wife owners of Affordable Transmission and Auto Repair in Byron Center, Mich., grew frustrated as more and more customers dropped off vehicles for repair but couldn’t pay the bill when they picked them up. The couple ended up holding several vehicles in their lot—and paying fines to the township because of the crowded lot conditions—until customers paid. Even then, several customers wrote bad checks.

The Petersons decided to start requiring customers to pay 50 percent up front for repairs more than $200. The shop also stopped accepting personal checks.

Tim was a little nervous that customers would balk at having to pay up front, but only one customer outright refused, Stacy Peterson says. Most understood why the shop needed the new policy. It ensured that customers only brought in vehicles when they had the money to pay for their repairs. The couple also began offering a credit repair program to help customers get approved for financing. “Now we see people who tell us they are saving their money so they can afford a repair they need,” Stacy Peterson says. “It’s made a huge difference.”

This strategy can be applied in different ways. Businesses don’t necessarily have to charge a particular portion up front. Some may want to spread out the payments in installments while the work is being done, or they can bill customers on delivery rather than waiting for them to mail in a payment 30 days later.

Lisa Wolfington, an NFIB member and owner of The Wolfington Group LLC, an advertising, marketing and public relations firm in Chester, Md., last year began requiring her regular clients to pay for services at the beginning of each month, rather than after the work is completed. She charges them the minimum expected balance for the month and tacks any additional charges onto the following month's bill. "It keeps everything running smoothly, so I don't have to worry whether or not I'm going to get paid," Wolfington adds.

Going Electronic

For a long time, many small businesses only allowed their customers to pay via cash or personal check. But as the economy tightened, more small businesses expanded their payment options and encouraged customers to pay via quicker, more convenient modes. Credit cards are one option—besides guaranteeing payment, they can "streamline the purchase process" for both the customer and business owner, says Raghav Lal, head of global small business at Visa Inc. in Foster City, Calif.

Outside of credit cards, some small businesses are adding electronic payment, such as PayPal, while others have set up automatic bill pay. "The more options you give customers, the more likely they'll purchase your product or service," says Brian Bickel, vice president of sales at payment processing company Solveras Inc. in Franklin, Tenn. Solveras has also noticed an uptick in small businesses setting up recurring payment options for customers, to ensure they'll get paid on time.

Some businesses have found they can give customers an incentive to pay by rewarding them for paying early—or penalizing them for paying late. The idea: Customers will prioritize your bill over someone else's if they can save. Some businesses give their customers a discount if they pay immediately or within 10 days of service. Others charge penalties when bills are late.

Elizabeth Rosenberg, president of LOFT Marketing & Communications in Los Angeles, decided when starting her business in 2008 to charge late fees and to formalize collections. After an initial 30 days, clients are charged a 10-percent penalty for each additional 30 days outstanding. She sends a reminder of the charge seven days before the due date. Payment that doesn't clear gets an extra 15-percent penalty.

Her policy, which she lays out in advance as part of her contract, has so far worked marvelously, she says. "To date—after 19 months of running my own business—I have yet to have a late or bounced payment."