

Debt valley

by Tiesha Higgins
Staff Writer

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Overdue bills strain creditors, but drive collections industry

When his catering business's customers don't pay their bills on time, Brian Gill turns to his last resort to make payroll: his credit cards.

Gill, president of Gill Grilling Co. in Lanham, sometimes asks his more reliable customers to pay in advance to help cover shortfalls from his delinquent debtors, usually larger companies with convoluted bill-paying systems.

It's an all-too-frequent headache for Gill, who has his own accounts payable to keep up with and a staff of 11 employees to pay.

"It's hard to deal with because your bills are [coming in] all the time," Gill said.

So far, Gill's customers have eventually paid off their balances, but not every company is as fortunate.



Susan-Whitney Wilkerson/The Gazette

Growing business debt is fueling competition among collection agencies. "You used to be able to buy debt for zero to 8 cents" on the dollar, says Susan Wilson, director of Asset Recovery Group LLC of Bowie, which handles debt acquisitions and helps small businesses pursue debts. "Now it's up to 5 to 15 cents."

However, this cloud does have a silver lining for some businesses: The debt collection industry -- the lawyers, agencies and bill collectors hired to track down debtors and get them to pay up -- is thriving. Nationwide, businesses lose billions of dollars annually just in unsettled judicial judgments. In 2000 -- the most recent year for which data is available -- Maryland had \$259 million in unsettled judgments, ranking it among the five lowest states, according to the National Judgment Network of Theodore, Ala., a trade association for judgment recovery professionals. That year, there was \$18.8 billion in unsatisfied judgments nationally, with \$387 million in Virginia and \$258 million in Washington, D.C.

According to data released by the Federal Reserve last week, the nation's business debt, including secured debt, totaled \$7.8 trillion at the end of 2004, up 4.8 percent from 2000.

"That is really the raw material for the accounts receivable management and debt collection industry," said Paul Legrady, director of research services at Kaulkin Ginsberg, a Bethesda strategic advisory firm specializing in accounts receivable management.

As business debt increases, so does the debt collection industry.

Agencies that collect debts in Maryland must register with the Collection Agency Licensing Board of the state Department of Labor, Licensing and Regulation. The board reports 1,210 agencies currently registered, compared with 58 when the board was established in 1978.

"The numbers grow by 20 to 30 companies each year," said Kelly Mack, a financial examiner with the board.

Growth in the debt collection industry usually means a slower economy, say industry experts.

"To slow down the economy means companies are having difficulty with their cash flow," said Emil Hartleb, executive director of the Commercial Collection Agency Association in Cedar Grove, N.J.

"If a creditor cannot get an account collected, they will think about turning it over to a collection agency," he said.

Placements for collections did decline for a while, Hartleb said, dropping 20 percent from 2003 to the last quarter of 2004. But then they started to increase, and 2005 will likely see a 6 percent growth in collection placements, he predicted.

When it comes to collecting debt, time is not on the creditors' side -- even with a court judgment. By the time an account is three months delinquent, there is only a 73 percent chance of recovery, according to the Commercial Collection Agency Association, an industry group. After six months, that drops to a 50 percent chance.

Creditors have several options to increase those odds, including hiring an attorney or collection agency to pursue the debtor and selling the debt outright to an acquisitions company.

Maryland businesses with a signed contract can also file a court claim against the debtor for a \$20 fee, but most companies don't have the time.

"They're so focused on doing their business, they just let this fall by the wayside," said Susan Wilson, director of Asset Recovery Group LLC of Bowie, which handles debt acquisitions and helps small businesses pursue debts.

Going to court

For Shawn C. Whittaker, a Gaithersburg collections attorney, the process begins with a letter to the debtor in hopes of avoiding court costs. Filing for a judgment is usually the last, least favorable option.

But winning a judgment does not mean the check is in the mail -- 80 percent of all court judgments are never paid off, according to the National Judgment Network.

"A judgment is just a piece of paper," Whittaker said. "That's not putting money in my client's pocket."

If a stiffed business needs more information on a debtor, it can seek a court order requiring the debtor to give a personal interview on his assets and liabilities. Discovered assets can then be seized for auction to pay off the debt.

The debtor may try to evade the judgment by hiding assets, changing addresses, using an alias or reopening the business under a new name.

Even if the money is never recovered, the creditor will have to pay attorney fees.

To stay afloat in the meantime, creditors running on a tight budget will have to raise their fees, take out a short-term loan or take other action to avoid defaulting on their own bills.

For example, Gill asks his more credit-worthy customers to pay early, in exchange for a discount. The arrangement helps, but that doesn't mean he is happy with it.

"You're losing [more] money because you need the cash flow because other customers don't pay on time," he said.

His catering company currently has \$30,000 in accounts more than 21 days delinquent.

Selling the debt

Most collection agencies operate on a contingency basis, keeping a percentage -- typically 25 percent to 33 percent -- of the debts they recover for a creditor. But for small companies such as Gill's, that can be too steep a price.

Another option: Companies can sell their debt for a few cents on the dollar to a debt acquisitions agency. As debt increases, so does the competition among collection agencies.

"You used to be able to buy debt for zero to 8 cents," said Wilson of Asset Recovery Group. "Now it's up to 5 to 15 cents."

Her company owns \$20 million in purchased debt, including \$5 million from Prince George's County businesses.

Public companies must write off debts after 18 months. "So if they bundle it up and sell it, it's automatically recorded as income," Wilson said.

Companies are becoming savvier in negotiating the sale of bad debts. For example, they will consolidate portfolios of debt owned by confirmed real estate owners to leverage a higher sale price from debt acquisition firms.

Avoiding bad debt

Many companies now apply statistical formulas, including credit scoring, when dealing with debt, said Lyle Wallis, vice president of the Credit Research Foundation in Columbia.

"Companies are looking at the stability of their clients' industry," focusing their collection efforts on the shakiest debtors, Wallis said.

"For example, US Air is in [financial] trouble, so you want to focus on US Air and let Southwest [Airlines] go," he said.

Despite an in-depth screening process, Legrady said, companies that excel at cash flow management know how to communicate well with their customers. "After a sale is made, they are in communication, making sure the sale does actually turn into cash," Legrady said.

Eugene M. Faison Jr., chairman and CEO of Equals Three Communications Inc., a Bethesda public relations firm, agrees. Besides using tightly written contracts, he stresses the importance of staying in touch with clients on troubled accounts.

Equals Three does not have many delinquent accounts, Faison said. Still, it has had to write off some debts at year's end; the largest he can recall was \$50,000. Currently, a \$20,000 account is 120 days delinquent. A diminished bottom line is not the only casualty of bad debt, he said.

"When you go into these relationships, you go into it with trust," Faison said. "When they don't pay you, it affects the relationship."