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When, why and how small businesses turn to collection agencies

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By Deborah L. Cohen

CHICAGO (Reuters.com) -- When the economy takes a turn for the worse, bills take longer to get paid. Established companies have been here before, but start-ups that rode the wave in recent years are in for a painful lesson.

Many may be dealing with a pattern of past due receivables for the first time in their history.

Jeff Nolin, an Atlanta-based vice president of commercial services for NCO Financial Systems, among the largest U.S. collections agencies, says he has seen a slow-down in the pace of collections. "It's enough where it's certainly noticeable," says Nolin, adding that companies need to get on top of their accounts receivables earlier in the process. "It becomes a vicious cycle, if your customers aren't paying you on time, it becomes increasingly difficult to pay your vendors on time."

Kaulkin Ginsberg, a Rockville, Maryland consultancy to collection agencies and debt purchasing firms, forecasts that if a recession continues into 2009, recovery efforts of past due receivables will become increasingly difficult.

The Kaulkin Ginsberg Index, which tracks conditions affecting the management of accounts receivable, is down 1 percent in the first quarter to 1240.4, and off 16 percent from its high of 1477.7 in October 2006. The index takes into account macroeconomic factors such as the federal funds rate, outstanding consumer credit and bankruptcy filings, among other variables.

"More small to mid-sized businesses are finding themselves outsourcing collection efforts to third party collection agencies who can assist them," says Mark Russell, a director with Kaulkin Ginsberg. "It's more cost effective."

Some businesses worry the use of a collection agency will sever their relationship with longstanding customers and they try to avoid them, favoring a more cautious approach to whom to do business with in the first place.

"A collection agency - that destroys the relationship between you and the client forever," says Cliff Zugay, who runs a boutique direct marketing firm in Chicago. Instead Zugay, who used to get a fair amount of work from mortgage companies, now steers clear of the financial services industry altogether. "I've tried to be careful in getting at least enough money... to cover the up-front costs," he adds.

Still the draconian stereotypes associated with collection agencies don't necessarily hold true anymore, says Rozanne Andersen, executive vice president and general counsel for the Minneapolis-based American Collectors Association, a trade group representing collections agencies. Rather than giving customers an ultimatum, agencies are often charged with working out more flexible terms, so that everyone gains.

"The name of the game now is that debt collectors are more in the business of assisting people with arranging a payment plan," she says. Collection agencies must adhere to a host of strict practice guidelines set by individual states, and depending on the type of account, by the federal government.

If they're going after a consumer account, for instance, they are governed by the Fair Debt Collection Practices Act. Fees vary, but most often third-party collection services call for the client to give up a percentage of the face value of debt from the company's customer, contingent upon payment. That amount depends largely on the time spent pursuing the account, but often ranges from 20 to 30 percent, according to

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Andersen.

USING COLLECTION AGENCIES

Early on in the past-due cycle, they can be enlisted as first-party agents, acting as an extension of the company to assist with reminder calls, letter-writing campaigns and other softball efforts to gently encourage delinquent accounts to pony up.

In the case of debts running several months or more past due, the collector may then take on the better-known role as third-party agent, identifying itself as an outside firm intended to go after the outstanding debts.

Agencies also offer related services such as skip tracing, which involves tracking the location of a delinquent account whose whereabouts are unknown.

For solo practitioners with limited budgets, pre-packaged software solutions, such as "Bill Collector in a Box," which was developed by a California-based collections agent, might offer a more affordable alternative. The software, which retails for \$49.99, includes templates for creating letters to past due accounts, and as-needed fee-based services such as ability to report a customer to a credit bureau.

Andersen stresses the need to find an agency that is a good match for a company's culture, its line of business and employees, and advocates taking a hands-on approach to the agency's work. Her trade association website, <http://www.acainternational.org/>, is one place to begin a search. "You control the relationship between the collectors and the customers," Andersen says. "You are the driver."

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