Bad Debts—
The Spin to Bankruptcy

There’s No Surefire Formula For Collections — but Careful Planning Beforehand Avoids Most Problems

By John W. Johnson

More than 1,000 construction firms failed during the first five months of 1974. And results for the last half of the year will undoubtedly show a significantly higher number of failures.

There are a variety of reasons for these bankruptcies, but one of the most common is bad debts. It is obvious that if you provide materials and services to people who don’t pay for them, it won’t be long before you don’t have the cash to pay your creditors.

That’s when they close in and take over your business.

How the Trouble Starts

Financial problems in the construction business, as in many other businesses, frequently start in similar ways. Here are some of those danger signals:

1. You are overly anxious to get the job

   When you are too eager to get a job or make a sale, you’ll do things that you normally wouldn’t do.

   For example, you’ll deal with a customer or a general contractor who you know is operating on a shoe string, or, just as bad, you’ll fail to find out how solid his financial base really is. This checking can be done quickly through one of several commercial credit reporting businesses or informally with some of your colleagues in the business.

   It’s better to know about a contract you’re about to sign than to put yourself in a position of giving substantial money out of your pocket to strangers. That’s exactly what you’re doing when you advance materials and services without knowing anything about that stranger.

   So, taking the extra time to learn as much as you can about your customer’s financial status—and particularly what assets or options are available to you should a collection problem arise—will help to keep your company off the bankruptcy rolls.

2. Integrity governs intentions

   The second thing you must know about your customers is whether or not they are honest. This doesn’t mean a little bit honest, or honest most of the time, but whether or not they’re just plain honest.

   There are many prospective customers who have plenty of money to pay but who can think of all kinds of ways to avoid doing so,
particularly in these times of expensive money. These ways might take a legal form through the contract you sign or might merely be stalls, delays, evasions, complaints and other tactics which will force you into legal action and perhaps even countersuits before you come out of it.

Don’t cut corners when learning something about the integrity of a prospective customer. And the bigger the job, the deeper you should dig before taking it.

Again, a credit check with a commercial reporting company will turn up much of the information you must have.

And so will other subcontractors. Chances are that if your potential customer has been around awhile these other contractors have had experience with him...good or bad...and will be happy to share that information, particularly if it’s bad.

3. Sometimes things go from good to bad

Almost every day the circumstances suddenly change for some companies and contractors who have been extremely good for their bills and you may find that they can no longer pay up.

One effective way for avoiding bad debt losses like this is to pre-collect every one of your accounts by assuming that they’re going to become bad debts. Take for granted the customer is not going to pay the bill voluntarily or willingly.

This will cause you to look at whatever tools you will have to work with and whatever assets are available to you. If you will just adjust your thinking to this one assumption, 99 percent of your bad debt losses will become more manageable.

For example, if you have a corporate customer with no assets, even though it’s owned by an individual with a lot of assets, you are on thin ice. But if that individual is a co-maker of the contract, things could be a lot brighter for you when the corporation without assets stops paying your bills.

Here’s where a good attorney can earn his fee over and over...before you accept the job.

4. Regular billing is mandatory

If you’re working on a construction project and submitting progress payment applications, these should be paid promptly. The minute a payment drags beyond the red flag date, you’re in trouble.

Letting that trouble simmer for awhile won’t make it any better. This is why it’s extremely important that you get on the telephone—or make some kind of personal contact—the day on which that payment is due.

Either get the check that day or you should know exactly why you are not getting it.

If payment is not made and you feel there is no real good reason for that failure, then you have reached the point where you should cease investing your money in the project. If you stick with the job and your bills are unpaid, you’re simply giving that customer more and more money out of your pocket.

These are the most common areas where business people, and particularly those in the construction industry, get into financial trouble as it relates to bad debts.

Another obvious reason includes the enormous interest costs today in construction financing. If periodic bills are not paid to you and you have to go to the bank for money to carry them, your profit can rapidly disappear.

This is why many contractors are including interest at the going commercial loan rate as part of any of their job agreements.

For any subcontractor, there is always the realistic problem of leverage and his ability to collect interest. But by using the going commercial rate, you can stay abreast of the swings in interest costs which are generally swinging higher rather than lower.

Take Action at Once

1. Time is the refuge of any debtor.

The more he gets of it, the less likely he is to pay the bill. This is why you should not wait even one day on any sizable bill or any bill which is not paid in accordance with a contractual agreement.

If you get to the place where you’re being merely stalled, recognize this immediately and take appropriate action. This can range from liening, to stopping work on the project, to getting professional assistance such as a collection service. When you select a commercial collection service, it should be a member of an organization such as the American Collectors Association. This is your guarantee that it has met a strict set of membership requirements, is in full compliance with state laws, and that you have the backing of the facilities and staff of the association should any special problems arise.

2. Interest charges are always added on to past due accounts.

Despite the difficulty in collecting interest, if you must carry any of your customers and at the same time have to borrow from the bank to maintain cash, flow then the customers should pay whatever you have to pay to carry them. You can always back down from your demand: so try.

3. Use the telephone to make your collection efforts.

Sending letters and statements may be all right if you have a large number of small balance accounts scattered over a wide geographical area:

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area. But if you have larger accounts and they are local, pick up the telephone when a payment does not come in on time.

The procedure to follow is simply to advise your customer that his payment has not been received as scheduled and that you want the check “now.” Where you go from there will depend upon the customer’s reaction, but don’t be too fast to grant an extension or terms other than those originally agreed upon.

Chances are he is already starting to juggle bills. If you let yourself be juggled to the bottom of the deck, even your good-natured partial agreement to better terms might be unmet.

At the conclusion of your phone call, make sure you’ve got it pinned down. Don’t let him get by with saying, “I’ll try to do something and will get back to you in the next few days.” If he gets you off the phone with that kind of statement, he’s just won... and you’ve lost.

You should expect to be paid. You might even need to work out a payment plan. But the critical point is to get positive results and have a plan of action in case the bill is not paid.

Bad judgement on your part—from the time of extending credit to collecting for it—can bring bad debts. And bad debts can bring bankruptcy.

So know how trouble starts, take action at once if it comes, and be sure the action you take is the wisest possible. Then it’s less likely you’ll be part of the bankruptcy statistics for 1974 or 1975 or any year in the future.