

How to pick the right collection agency

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How to effectively and efficiently handle seriously past-due accounts is by far one of the most frustrating challenges confronting a business-credit manager. However, the level of competition in almost every American industry, current economic and other industry-specific concerns make bad debts a financial reality.

The most aggravating aspect of seriously delinquent accounts is that while a credit professional must spend an inordinate amount of time trying to find solutions to each delinquency problem, the total amount involved is only a small fraction of the total sales figures of a company. Due to a highly competitive business climate, and the accompanying narrow profit margins, the relatively insignificant amounts classified as seriously delinquent can reflect the difference between acceptable and unacceptable profits, or even year-end losses for a company.

Many business-credit grantors and credit managers accept bad debts as an inevitable part of granting credit. But recognizing the reality of bad debts does not mean that one must surrender to them. Two of the most valuable traits of a credit professional are the ability to identify those accounts which need special attention to minimize a loss, and to recognize (albeit reluctantly) when outside help is required to either collect the account or verify that the account is not collectible for legal or practical reasons.

‘If I can’t collect, then nobody can’

This statement either reflects a huge ego or a dangerous refusal to accept the reality that not all delinquencies can be resolved internally. A credit professional neither has the time nor, in many cases, the motivation to develop the specialized knowledge to effectively and economically collect a debt alone. After all, a credit professional still needs to be concerned about maximizing the profits from the 95 percent or more customers that don’t represent potential losses.

Specialists exist whose sole purpose is to assist you in minimizing the potential losses within your delinquent portfolio of accounts. So, collection agencies represent another practical and economic reality. They are in a position to dedicate the necessary time to a specific delinquent account.

And agencies do not carry the emotional baggage which the credit manager might harbor against the customer. An unemotional and impersonal analysis is necessary to objectively determine what, if any, actions and expenses are justifiable to collect. Agencies also represent both a level of psychological pressure on a debtor which cannot be duplicated by a credit-grantor and the last step prior to legal action to obtain payment without the debtor’s voluntary cooperation.

Placing an account for collection with an agency is a natural and logical action. Determining which agency or agencies to employ can also be a most frustrating decision.

‘I’ll employ the least expensive agency’

Any purchaser of collection services can be dazzled by collection commissions which appear to be very low. Although cost is a very important aspect of choosing or keeping the services of an agency, the agency’s commission schedule should be a

secondary consideration. The amount a collection agency collects has a much larger impact on the net amount returned to a company than fees do.

It is not true that an agency that charges twice as much as another agency must collect twice as much to return the same amount of money to a credit grantor. In fact, an agency which offers a 20 percent commission rate can give a creditor a larger net return by collecting only 5 percent more money than a “less expensive” agency that deducts a 10 percent commission on amounts collected.

The chart shows that an agency which collects 30 percent of the accounts placed for collection with a 10 percent commission will return no more to a credit grantor than an agency which collects 50 percent of the accounts placed with a 46 percent commission. Yet, the immediate reaction of any credit professional to a 46 percent commission structure would be less than positive.

No agency can guarantee the net return. There are simply too many variables that might not be known in advance by an agency, and are beyond the agency’s control to suggest a guaranteed return.

GROSS % COLLECTED ON \$1 MILLION PLACED FOR COLLECTION

	30%	35%	40%	45%	50%
Gross \$ Collected	\$300K	\$350K	\$400K	\$450K	\$500K

NET \$ RETURNED (& COLLECTED LESS COMMISSIONS)

Commissions Rates					
10%	\$270K	\$315K	\$360K	\$405K	\$450K
22.9%	\$231K	\$270K	\$308K	\$346K	\$386K
32.5%	\$202K	\$236K	\$270K	\$303K	\$338K
40%	\$180K	\$210K	\$240K	\$270K	\$300K
46%	\$162K	\$189K	\$216K	\$243K	\$270K

‘Have I got a deal for you’

It is a common practice of many collection agencies to offer a “carrot” in the guise of low commissions.

With the proper auditing procedures in place, it is fairly easy for a credit professional to decide which agencies to continue to use and which to drop based on the net return analysis. But, how does a credit manager select an agency without being blinded by seemingly low commissions? The selection process can be logical and relatively simple, if the analysis of the agency is predominantly based on potential net recovery.

Confidence in the potential ability of an agency to collect should be a reflection of a credit grantor’s perception of how much will be returned, not how little will be charged if a collection is made. An argument can be made that an agency’s incentive to collect decreases as the commissions decrease; or an agency’s motivation and sense of responsibility to perform increases as the commissions increase. Some factors which can

impact the agency's potential and which can help a creditor determine which agency (agencies) to use are:

- **Length of time in business.** If an agency cannot perform, the likelihood of remaining in business is low. Offering "cheap" rates is only a short-term method to attract new business and does not significantly contribute to the long-term financial stability of an agency.
- **Long-term references.** The ability of an agency to keep clients implies that the net return is acceptable.
- **Staff stability.** Excessive turnover in collection personnel creates an inefficient atmosphere. The greater the amount of time a collector has to know a creditor's company policies and credit procedures, the more effectively the collector can perform. Continuously "reteaching" an agency is an unnecessary chore of a credit manager. Staff stability also implies that the collectors are compensated fairly, increasing the possibility of ever-improving performance.
- **Insurance protection/bonding.** An agency handles money, a creditor's money. Sufficient insurance should be carried by an agency to protect its clients from theft. Additionally, liability and indemnity coverage further reflect a high level of responsibility which an agency wants to communicate to its business customers.