



# Construction Industry **COLLECTIONS TIPS**

*zlien*

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# Introduction

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There is a lot of information out there to help credit and collection professionals decrease their DSOs, work on aging receivables, and generally improve their receivables portfolio. All of that advice and information, however, is nearly irrelevant for those professionals working in the construction industry.

The construction industry presents complex and unique circumstances that exasperates the challenges of getting paid.

Some examples of circumstances unique to the industry include:

- Retainage rules
- Contingent payment provisions, like *pay when paid* and *pay if paid* clauses
- Bonding requirements and lien rights
- Subcontractor default rates
- Payment chain problems

Most industries must brainstorm how to deal with a specific customer when faced with a non-payment situation. Those in the construction industry, however, are most likely faced with a more nuanced situation, such that the customer's customer or someone else in the payment chain is causing the payment problem.

This ebook will analyze the unique reasons why getting paid in the construction industry can be challenging, and then will provide you with concrete guidance on what remedies and tools are available to you to turn the corner on problem accounts and get paid.

Let's get started!

## Why Customers Don't Pay and What To Do When It Happens

Businesses of all shapes and sizes are confronted with two challenges: (i) Getting more and more business; and (ii) Losing less and less money.

It's funny, but running a successful company really boils down to doing these two things well. Your company probably has something it produces, and if the customer pays for it your margins are set up so that you'll pay your bills and turn a small profit. That's the easy part. The difficult part is getting people to want it from your company and then getting them to pay for it. Right? Easy.

Getting people to want your product or service is outside the scope of this ebook. Let me direct you to some other vendors for that. You may be, for example, interested in a great blog from our friends at [Construction Marketing Ideas](#), or the [Construction Marketing Association Blog](#).

Getting people to pay for it, however, is right up our alley. This article reviews why customers don't pay for things, and what to do when it happens.

### Why Customers Don't Pay Their Bills

[Google "Why Customers Don't Pay"](#) and you'll get 1.8 *billion* results. This is an obvious worldwide problem. The top search results to this query offers a lot of advice about what you can do to collect from customers who don't pay – which is an interesting answer to the "why customers don't pay" question (see, for example, [here](#) and [here](#)).

Shouldn't there be more of a focus on the reasons why your customer isn't paying?

I think so.

It's incredibly important to understand the reasons why your customer isn't paying in

order to fix the problem, and perhaps more importantly, avoid the problem from happening in the future.

Of all the search results, the best came from a novel company called Zencash, and the blog post was aptly titled: [Dissecting The Reasons Customers Don't Pay](#). Here is a list of their reasons:

- Billing Surprise (no communication about bill or fees)
- Invoice lost (invoice doesn't get to the customers door)
- Customer can't pay (they don't have the money, credit, solvency)
- Forgetful (customer forgets about the bill, and there are no reminders)
- Dispute about what was performed (they think your work sucked)

I think this is a really great list. In the construction industry, however, there are a few specialized reasons why you might be in a non-payment situation:

- Money is misappropriated somewhere up the contracting chain
- There is a dispute about the percentage of work completed on the project
- Everyone's different payment terms results in payment delay on the project
- Someone else's workmanship is in dispute clogging payment from reaching you
- Bigger companies may be exerting leverage over smaller companies
- Dispute exists about change orders and scope of work requirements

### How Much A Non-Paying Customer Costs You

Everyone wants to ignore a non-paying customer. Dealing with the issue is just difficult, and we hate to look at our books and see losses. Nevertheless, it's a fact of business and your going to go down in flames if you

don't understand the true cost of a non-paying customer.

This is something we've addressed frequently on our *Construction Credit Journal*.

Recently, in fact, we wrote an that really tied together a lot of the data on the cost of [bad debt](#) and deadbeat customers. That article was "[Credit Management: How Did Your Books Look Last Year? This Year?](#)"

The Readers Digest version of this article is that a *tiny* bit of bad debt has a huge impact on your company's bottom line. This is especially relevant in the construction industry where profit margins are slim. If you have a 5% profit margin (which is huge in the building supply industry – 5x the average, in fact), you'll need \$200,000 of revenue to make up just \$5,000 in bad debt. What a burden! As funny as it may sound, a non-paying customer is the most important customer in your business.

## What To Do When A Customer Doesn't Pay

Okay okay. You understand *why* a customer doesn't pay and you understand *how bad* it is to your business. So, what do you do when a customer doesn't pay the bill?

Alas, we get to the bulk of the Google search results to our query. Let's start, therefore, with some of the results and the basic suggestions on what your company can do to recoup its payment. I particularly like the suggestions in a post from [Global Talks Business](#) (never heard of the site otherwise), which offers:

- Remind Your Customer (Remember one of the reasons customer didn't pay? They weren't reminded, they forgot, etc.)
- Make payment convenient and inform them about the options
- Get serious with them and threaten suit (inform them you *can* sue them, sometimes they don't realize it)

Another great blog article on this topic comes from the Business.com blog. This article is a lot more focused on developing *processes* to handle these problems instead of one-off tactics. I strongly agree with the need to develop these processes. Here is the article: [Debt Collection Strategies For Customers Who Don't Pay](#).

## Special and Effective Solutions To Non-Payment Problems In The Construction Industry

While those in the building material supply and construction industry must employ these standard credit and collection procedures within their business, the mechanics lien laws provide an entire suite of unique collection and credit tools to them. These tools have the potential to turn the industry's credit problems completely upside down and make it one of the most secure industries in the nation.

What should you do, therefore, if you're in this industry and you have a customer not paying? Threaten a mechanics lien!

A mechanics lien is a very, very effective weapon in a non-payment situation. Take a look at our blog article from last year titled the [17 Ways A Mechanics Lien Works To Get You Paid](#).

Liens have a huge impact and will get money loose on the project. Liens press all of the right buttons to attack those reasons *why* the customer isn't paying, and in fact, it lets you leap frog over your customer and get to the deep pockets on the project.

And here's a secret: While filing a mechanics lien is great and is something you may eventually need to do, you can get a lot of mileage by just threatening to file the lien. Sending a "[Notice of Intent To Lien](#)" document may be enough to get the right attention and get your debt paid.

## Collections: An Overview

A collection policy is an important piece of a complete credit policy. In fact, a good collection policy, coupled with a thorough lien policy, may save a business some of the time and expense of ever getting to the litigation portion of their credit policy.

While some collectors and collection agencies have rightfully gained a less-than-stellar reputation, a good in-house or outsourced collection program can benefit a business's bottom line.

### What Is A Collections Policy?

A collection policy is the set of procedures a company uses to ensure payment of accounts receivable. Similar to the credit policy as a whole, the collection policy should be written and strictly followed. Also similarly to the credit policy as a whole is that the written collection policy serves as a sort of window into the company zeitgeist in terms of how credit and debt are treated. Further, strict compliance with the collection policy as written allows the business to be more streamlined, with no time wasted on deciding when or how to respond to a certain debtor situation.

Generally, a collection policy systemizes the steps taken to recover amounts due prior to litigation. This includes when a customer should be contacted, how they should be contacted, how disputes are resolved, when internal or external "collectors" are used to step-up collection efforts, and ultimately when and whether to turn the account over to litigation or write-off the debt.

### Deciding on a Collection Policy

Once the decision has been made to formalize a collection policy it must be decided whether the policy will be formulated from scratch or whether the disparate pieces of the business's current collection structure can be melded into a cohesive outline.

Just like a credit policy as a whole, a collection policy should not be an off-the-shelf or one-size-fits-all product. Each individual business will likely want to treat the collection policy in a different way – some are much quicker to send a sternly worded letter or firm phone call upon late payment, and some will let the account simmer for a short period of time. As with many things in life and business, a moderate approach that balances the reality of the market with the need to get paid according to the terms of the credit extended is likely the best solution.

While strict adherence to the collection policy is generally best, to streamline the process and exercise oversight of the decision making processes, that doesn't mean that all clients must be treated the same under the collections policy. Some clients with whom a longer relationship has been established, for example, may be extended the courtesy of an extra phone call or letter or two before the account gets placed with an outside collection firm. Business relationships can easily sour over something like sending a delinquent account to an outside collections firm, so that knowledge is important in the crafting of a proper policy.

### In-House or Outsource Collection

The first part of any collection policy is generally in-house. The question is whether or not the collection policy should keep the whole process in-house, or if it should be eventually be outsourced, and when that point comes. Of course things like making a nice phone call before the payment is due in an attempt to ensure prompt payment, and even a stern letter after the debt becomes due are things that are easily handled in-house. There are certain things that an outside collection company can do, however, that would strain the time or resources of many businesses.

Outside debt collection agencies can be beneficial for several reasons, including experience specifically in debt-collection, notifying the debtor that the company has

## CONSTRUCTION INDUSTRY COLLECTION TIPS

escalated the debt collection process, spending time and resources to continually contacting the debtor with letters or phone calls and responding to and locking down promises to pay, reporting the debtor to credit bureaus, and more.

Clearly this must be balanced with the cost associated to use an outside collection agency compared to attempting to keep the process completely in-house. Some further discussion of the potential costs and benefits of an outside collections agency may be found [here](#), or [here](#).

The collections part of a credit policy can often be overlooked, but it is an essential part of a sound and comprehensive credit policy.

## Are Your Lien Rights The Best It Gets When Collecting A Construction Debt?

You are a subcontractor or supplier and you have an unpaid account on your hands. This can happen for a variety of reasons. Maybe your customer filed [bankruptcy](#), is being stretched because of a [pay when paid clause](#), or maybe they are involved in a construction dispute. Notwithstanding the circumstances the fact remains that your company isn't paid and it's hurting your bottom line and your quarterly numbers. What is the best way to collect?

### Alternatives To The Mechanics Lien

The title to this article questions whether mechanics lien rights are the best it gets when it comes to collecting a construction debt. If you are a reader of this blog you know that I believe the mechanics lien is the collections holy grail. I'm not the only one.

I recently came across two articles by Joe Virene of the Texas Subcontractor & Supplier Legal Guide Blog examining non-lien remedies for his audience. His comments in each of the two articles struck me.

In the first, about [Joint Check Agreements](#), he states "a joint check agreement is better than nothing, but it is not substitute for lien and bond rights."

In his second, titled "Adding Another Target: Personal Guarantees," he makes a similar comment: "[A personal guaranty is nice to have, but it is not a substitute for lien or bond claim rights.](#)"

This sentiment is repeated by another lawyer, Jeffrey Bellamy of Thrasher, Buschmann & Voelkel, P.C., who wrote an article in a recent firm newsletter titled: [Collection Strategies to Consider When Mechanic's Liens Won't Work](#). When collecting a construction debt, again, mechanics lien claims are at the top of the food chain.

If you don't have lien rights, have lost your lien rights or otherwise don't want to pursue your lien rights, there are other ways to collect in the construction industry. The above-cited articles discuss those methods in some detail, and we've done the same on this blog. Here is a quick summary.

### Personal Guarantees

When extending credit to a customer you're likely agreeing to terms with an organization. If the organization defaults, you'll have a much better chance at collecting the debt if you were able to secure a personal guaranty from one of the company's principals. When the individual's credit and assets are on the line, that prioritizes your debt above others.

It can sometimes be difficult to get personal guarantees from companies, with the difficulty of obtaining the guaranty increasing as the company you're doing business with gets larger. Furthermore, a personal guaranty is only as good as the individual signing it, and if their company is tanking, there's a strong possibility the individual is taking as well.

Nevertheless, these are good tools to have. Learn more about why personal guarantees are effective, how to create them and what can go wrong on our [Personal Guaranty Tag](#).

### Joint Check Agreements

Joint check agreements are a staple of the construction industry. While not a specific construction law document and available to other industries, because of how construction projects work they are almost exclusively found in construction.

These joint check agreements can significantly reduce the amount of financial risk borne by your company by obligating additional parties to watch out for your interests and pay your debt.

The trouble with joint check agreements, however, is that there is no clear form used everywhere. The forms vary greatly from



party to party and they can be written to very heavily favor one party to the agreement.

Plus, the laws interpreting joint check agreements can be a bit wormy (i.e. the [joint check rule](#)). We did an entire [blog series dedicated to the Joint Check Agreement](#), and especially like this article: [Joint Check Agreement Common Misunderstandings And How It Can Burn Your Company](#).

## Notice of Intent to Lien

You may not have mechanics lien or bond claim rights, but that doesn't mean you can't send your customer or the other parties at the construction project a notice indicating your *intent* to file a mechanics lien if unpaid.

[Notices of Intent are a great inexpensive tool available to anyone to get paid on a debt.](#)

These notices are highly effective at getting folks to pay a debt and avoid a lien situation, and they are effective even if you don't have an actual lien right. Sending these notices without any lien rights poses zero to minimum risk. In all my years of reading and researching lien laws and cases, I have *never* encountered a case where a company was sued for sending a notice of intent to lien without a lien right. It just simply doesn't happen, and wouldn't make much legal sense if it did.

## Giving Your Contract Teeth

This particular "alternative to mechanics lien" tool isn't something you can rely on when confronted with an unpaid debt. This is one of those things your company must do proactively to put yourself in a better collections position in the event of non-payment. To significantly increase your chance at collecting a debt you must give your contract *teeth*.

Last month I wrote an article titled "[Legal Tricks To Make Extending Credit Easier](#)." The first suggestion was to draft a credit application and credit agreement with care

and foresight, and to "include legal terms to give you leverage."

Almost every company will sign a contract agreeing to to pay non-payment penalties, interests and collection costs. Take advantage of this. When confronted with a non-payment situation, it allows you so much more flexibility to go out and collect, and can make the difference between a settlement in your favor and a settlement seeking to simply avoid the costs of litigation.

## Followup

I was going back and forth about whether to include this section, but it is so important and so overlooked I decided in favor. Followup on your debts.

As explored in "[How To Collect On An Overdue Invoice In The Construction or Building Supply Industries](#)," one of the most common reasons why an account is unpaid is because no one from the creditor's company is following up on the invoice. Followup on your invoices! This will do wonders to your collections success.

## Mechanics Lien And Security Interests Are The Gold Standard

Okay, we have reviewed the rest, but not let's make a quick comment about the best: mechanics lien and security rights.

As you've seen from the above discussion, many attorneys agree that mechanics liens are the gold standard in protecting a company against non-payment. In fact, it's so clear to attorneys and collection agencies that mechanics liens work, it prompted our own Nate Budde to write an article inquiring "[Why Aren't More Accounts Receivable Secured?](#)" This is a good question, especially considering the promise that mechanics lien and security interest rights can "[Eliminate Overdue Accounts Receivables](#)."

The short answer here is that mechanics liens are extraordinarily effective at getting

## CONSTRUCTION INDUSTRY COLLECTION TIPS

companies paid (See: [17 Ways A Mechanics Lien Works To Get You Paid](#)). Protecting your lien rights is affordable and possible, and [it's the right thing to do](#).

## Retainage Collection Best Practices

Last week we wrote an article about Retainage laws: [What Rules Apply And How Do You Get Your Hands On The Money](#). This article defined and debated retainage laws and practices, and enumerated how the laws operate across the country. It hinted at, but did not directly state, that these laws are negotiable.

In large part, however, this is true. Retainage is part necessity and part evil, and it's the evil portion of it that is left to negotiation within almost every contract with one party usually trying to squeeze as much as they can out of the other party to help their own cash flow.

This article discusses retainage "best practices" which can help your company with the negotiation process, but can also help your company simply accommodate the retainage challenges you'll encounter.

### Plan For The Cash Impact

Don't be silly. Know your numbers. The Construction Financial Management Association's 2007 Construction Industry Annual Financial Survey reported that the company's net earnings (before income taxes) for a specialty contractor was 2.9%. That's a lot less than the retainage percentage often held. Don't fool yourself into thinking you can float a project with 5% – 10% retainage when you're working on a 2.9% margin and don't have a mound of cash in the bank.

If you agree to a retainage percentage make sure it makes sense for your company. Otherwise, taking the project can be a lot more fatal than just not doing the job.

## Make Sure Retainage Is Fairly Passed To You And Pass Retainage Holdback Down The Contracting Chain – Fairly

Retainage is what it is. If the general contractor is dealing with 5% retainage with the property owner, than it's highly unlikely you're going to get a contract without at least 5% retainage withheld. However, you should fight to make sure the retainage percentage is "equitable," meaning it is the same percentage withheld up the chain.

Similarly, make sure you protect yourself by holding back retainage from your subs. Don't get clever – just be fair about it and push the same percentage down the chain as is being imposed on you.

### Examine Alternatives

Perhaps there is a way to offset the retainage requirement on the project. Owners, developers and general contractors may be willing to negotiate the retainage percentage if your company's reputation is good enough, or if you can offer some other type of security such as letters of credit, performance bonds, etc. I'll admit, however, this is really tough.

One possible area for negotiation, however, is interest. In some states it is required that retainage gain interest in favor of the party for whom the retainage is withheld.

## Mechanics Liens & Lawsuits: Get Serious If You Don't Get Paid On Time

Don't get pushed around with retainage. If you're entitled to payment and the contractor or developer is withholding retainage funds, the law is strongly on your side. Now, you simply need to harness its power.

You can do this in two ways.

First, we love mechanics liens here, and you should too. A [mechanics lien](#) filing is the most effective and inexpensive way to get your company paid on a construction project. Fight fire with fire on the construction project if confronted with a non-payment situation like this and get your mechanics lien claim filed. Deciding if you can file a mechanics lien for retainage can be a bit of a mind twister because of timing issues, which we've discussed in the past respecting [retainage](#) issues and [pay-when-paid clause](#) issues, but the bottom line is that you need to file your lien within the lien timeframe for the value of your work.

Second, know which retainage laws apply to your situation. If you're on a private project you are likely entitled to penalties, interests and attorney fees in the event retainage is being unlawfully withheld from you. [Do not, however, include these amounts in your mechanics lien claim.](#) You can include the *retainage* amount, because this relates to the work you actually performed, but it is highly unlikely that you can also include the ancillary debts (interest, penalties, attorney fees) in the claim itself even though you can recover these amounts in suit.

# A Platform That Fixes Liens

Mechanics lien rights and “staying in a secured position” is very valuable to construction industry participants. Does your company rely on fragmented and manual processes to manage these complicated tasks?

What if you could keep 100% of your A/R in a “secured position?”

What if you knew everything about your lien and bond claim rights on all projects, at all times?

What if you could automate your notice & lien processes?

**GET A DEMO**

