

# Use of controlling techniques in verifying contractors' credibility

## Introduction

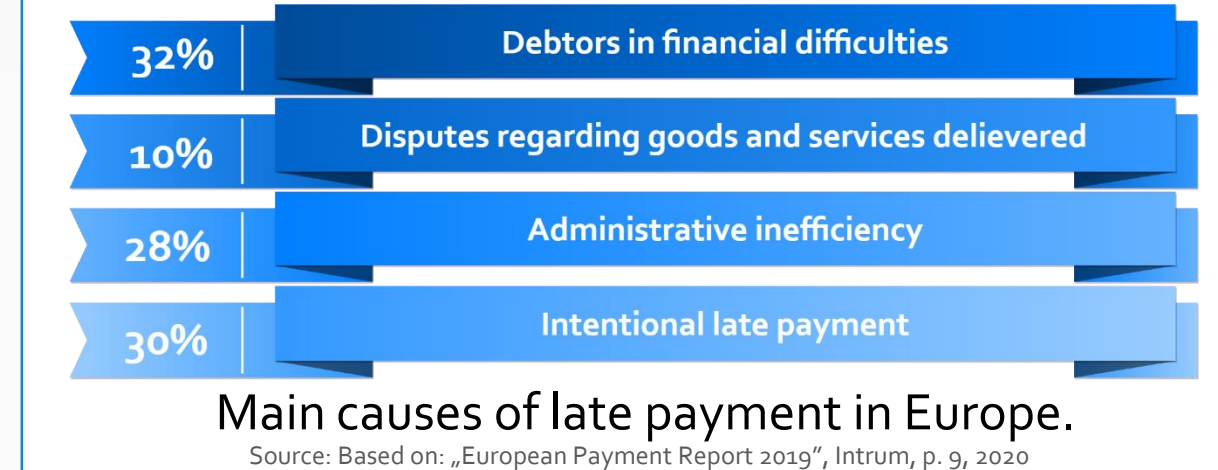
Credibility of contractors is of crucial importance for the processes of business management. It is not only a problem of management board of huge corporations, but also small business entities. Financially unstable contractors are a tremendous problem for entrepreneurs - in addition to the lack of payment for goods or services, the entrepreneur loses because of inevitability to pay taxes for these products. That is why it is worth spending time assessing credibility of the contractor before establishing cooperation. Counterparty verification is not only recommended before entering into the first business transaction, but should also be a continuous process. This will protect the company from dishonest contractors and minimize the risk of losing receivables.

## Influence of contractors

By the European Central Bank definition of 20 September 2011, contractors are defined as natural or legal persons party to a transaction. From the enterprises' perspective, the counterparties will be both suppliers and customers, i.e. key entities belonging to the so-called enterprise micro-environment. The literature of the subject characterizes entities belonging to the micro-environment as those which determine the conditions for functioning of enterprises and development in a particular sector or area of a market. Cooperation with an unreliable contractor has a significant impact on the company condition, ranging from breach of contracts, financial problems, to insolvency leading the company for even bankruptcy.

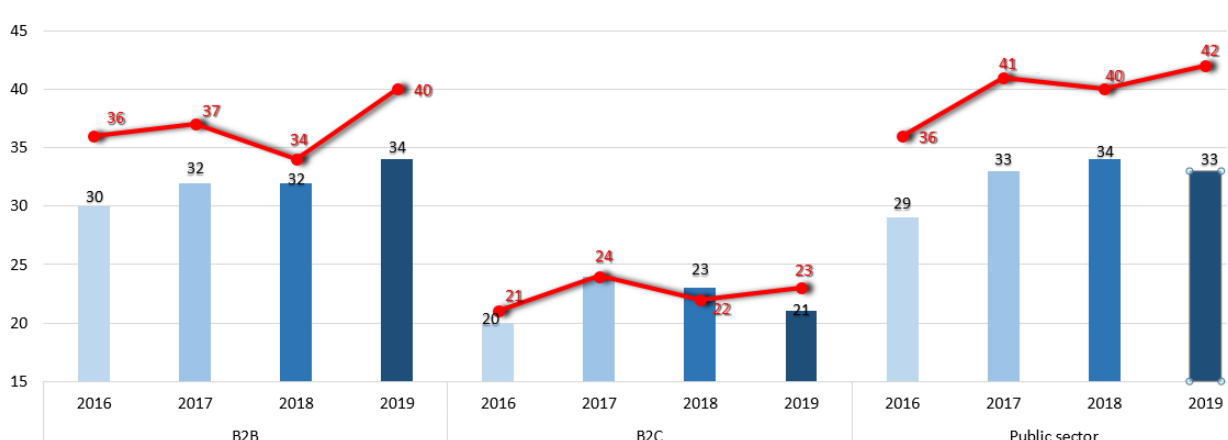
## Deferred payment

Verification of contractors is crucial, in particular when deferred payment (trade credit) is used. This method is commonly used by B2B and B2C systems. On the one hand, it allows to increase sales, strengthen the loyalty of parties through a policy of price discounts and gives contractors more time to collect funds to repay liabilities. On the other hand, may result late payments or even payments gridlocks.



## Payment gridlocks

Maintaining the appropriate level of financial liquidity is a key problem faced by today's enterprises. A liquidity crisis is a financial situation characterized by a lack of cash or easily-convertible-to-cash assets on hand across many businesses what is identify as a case of insolvency. Such situations could generate late payments or even payment gridlocks which not only lead to bankruptcy of the company itself, but also the impact on financial problems of other entities.

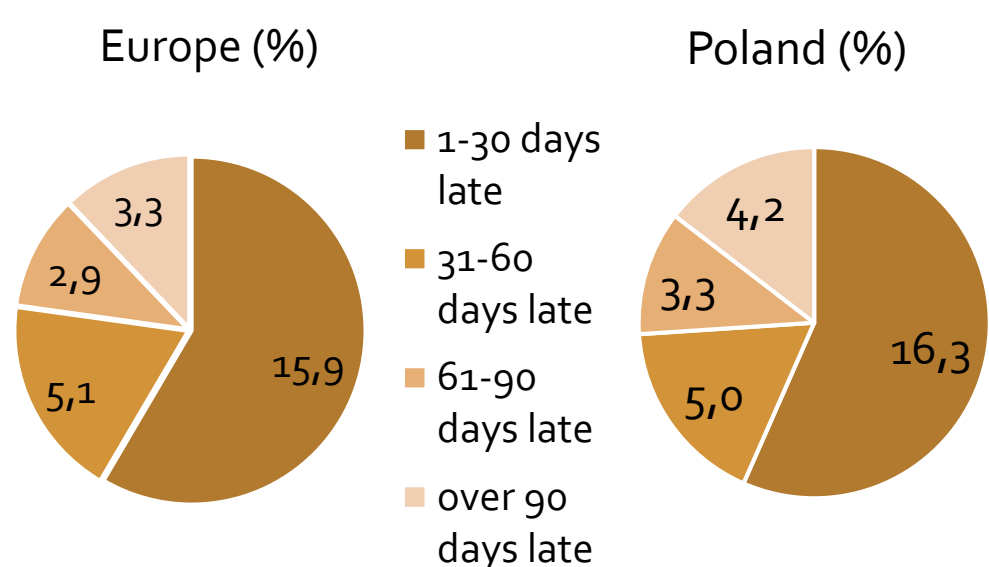


Payment terms in different types of businesses during past 4 years. Blue bars stand for payment terms allowed (in days). Red lines stand for time actually taken by customers (in days).

Source: Based on: „European Payment Report 2019”, Intrum, p. 6-7, 2020

The European average payment time continues to increase, particularly in B2B (an increase from 34 days in 2018 to 40 days in 2019). Despite of extending payment period, the trend of late payments continues also in public sector where the average time to pay liabilities in the last four years was 23% longer than allowed.

Based on the data from the report six out of ten companies have been asked to accept longer payment terms than they feel comfortable with and 58 % have accepted longer payment terms. According to data collected in the Payment Practices Barometer - September 2019, over 80% of East European companies reported this problem.



Percentage of past due B2B receivables by age of account.

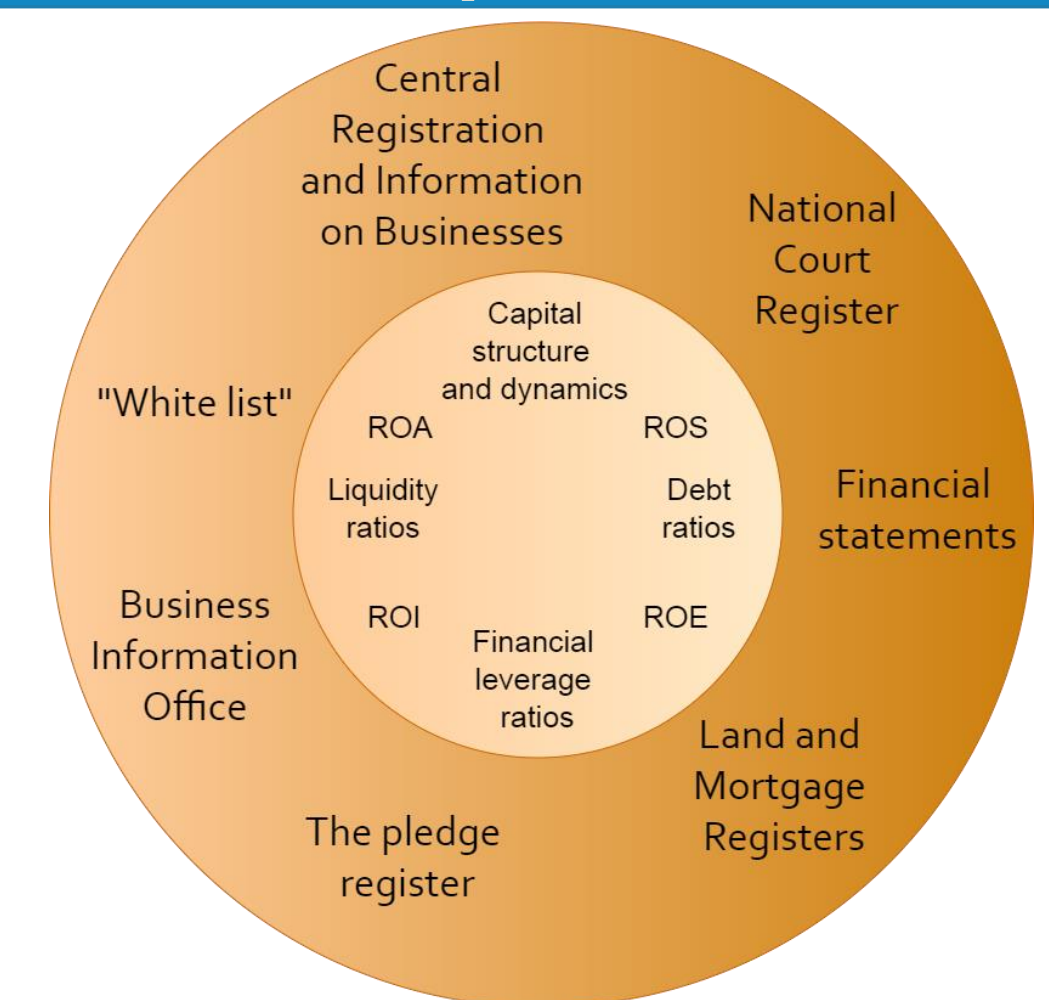
Source: Based on: „Eastern Europe: trade credit risk expected to rise, as economic growth loses steam”, Atradius Payment Practices Barometer, 2019

## Sources of information about business partners

A very effective way to check a contractor is business intelligence. Companies check the potential business partner in official registers which are free and publicly available.

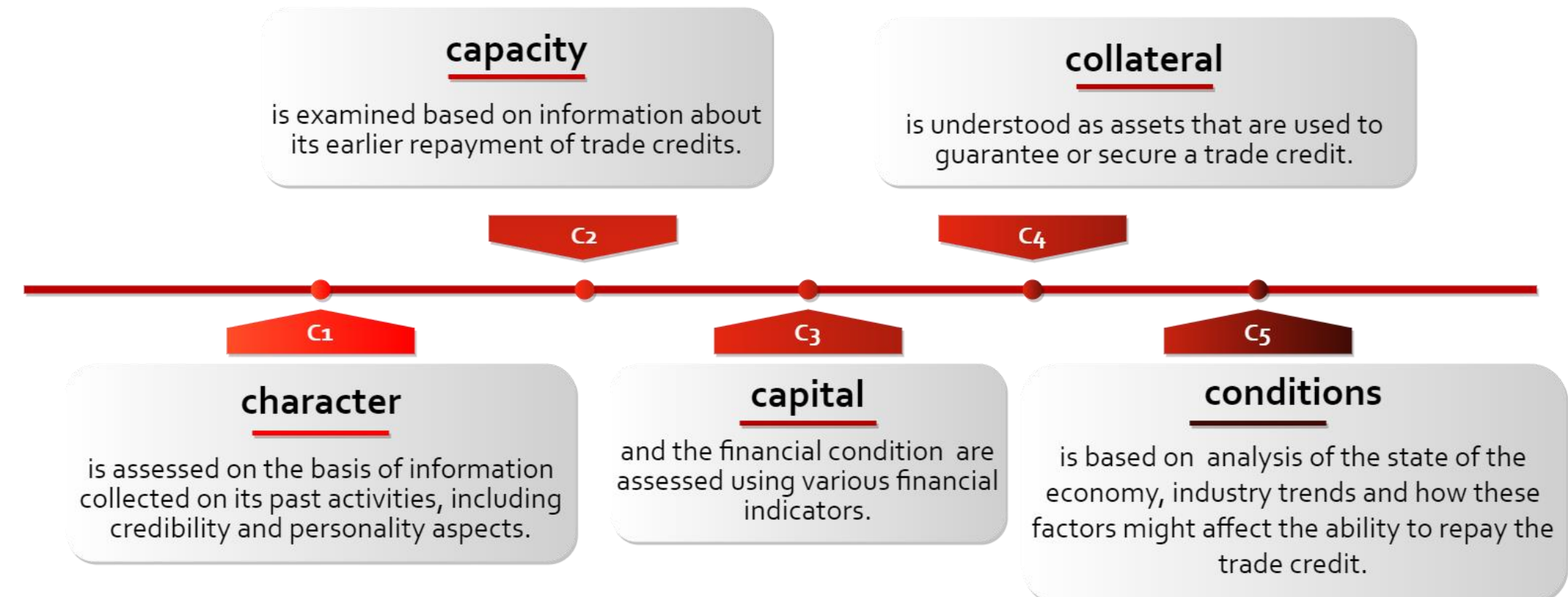
The National Court Register (*Krajowy Rejestr Sądowy*) provides information on the legal status of a registered entity and the material elements of its financial condition. The Central Registration and Information on Businesses (*Centralna Ewidencja i Informacja o Działalności Gospodarczej*) contains information about entrepreneurs conducting business activity in Poland. At the white list companies check the status of the contractor relevant for liability for VAT obligations. Thanks to financial statements contractor can be assessed in financial terms.

There are also paid methods, primarily searching for information in debtors' registers kept, e.g. by Business Information Office (*Biuro Informacji Gospodarczej*).



Internal and external sources of information about the enterprise

Data obtained from these sources are the basis for in-depth contractor analyzes, but are also used to contractor' verification with the 5C method. It is an expert method based on the knowledge of credit inspectors (analysts), based on decision criteria. It belongs to the group of quantitative and qualitative methods, because analyzing hard financial indicators is supplemented with expert judgment. The graph below shows 5C method elements.



Source: Based on: Michalski G., „Płynność finansowa w małych i średnich przedsiębiorstwach”, p. 166, PWN, 2013

## Tools of assessing credibility

- Robotic Process Automation (RPA)** is class of software based on metaphorical software robots (bots) or artificial intelligence (AI)/digital workers. In case of contractor verification RPA robots could be used to:
  - searching databases to obtain information about contractors,
  - downloading and saving data from an enterprise class system e.g. SAP,
  - generating reports based on collected data.
- Machine learning** uses computer algorithms that improve automatically through experience. It is seen as a subset of artificial intelligence and could be used to:
  - updating databases,
  - preparing analysis,
  - running reports.
- Business intelligence (BI)** comprises technologies and software. BI is used by enterprises for:
  - processing collected data,
  - create visual panels with key information about contractors.

## Summary

Huge risk while running a business is undoubtedly the loss of receivables due to insolvency or dishonesty of the contractor. Deferred payments used in companies have many benefits, however, they can cause payment gridlocks when the contractor is not able to regulate payments. To avoid cooperation with an insolvent contractor, specialist perform the credibility check. Entrepreneurs have many resources at their disposal to verify credibility of the contractor. Thanks to described methods of searching for information about contractors, analysts can check legal status, debts, financial condition or the condition of the company. In addition to analysts, modern technologies are also helpful in checking the contractor. Thanks to the automation and robotization of processes, companies can find information about contractors much more efficiently. These improvements give the opportunity to verify partners more often, and thus better protection against loss of money. In conclusion checking of business partners should be carried out regularly. There are many methods and tools helpful in this activity, which means that with little effort we can protect the company against loss of receivables.