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Assessment of the credibility of key business clients

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Abstract

The economic recession brings problems often affecting the existence of enterprises and organizations. The growing problem of increase in the number of claims after maturity affects many enterprises. One of the tools for the management of customer receivables is regular assessment of the credibility of current and potential customers. The subject of the article is the proposal of the methods for assessing the credibility of key customers in the manufacturing enterprise.

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1. Introduction

Every enterprise, regardless of the business plan, exposes to different types of risks when doing business, and one of them is the credit risk of customers. “The fundamental for success in this field is an early identification of risk fields and acceptance of appropriate decisions to increase possibility of the success of enterprise.” (Vodak, Soviar, Lendel, 2013). This issue is discussed not only in the environment of the financial institutions, but also in the context of non-financial organizations. If the customers do not fulfil their payment terms agreed in the company contract, these problems pass on the enterprise itself. Undervaluing of the solvency of the customer for verification to obtain their current and future claims many times leads enterprise to unpleasant financial situation. There are currently methods and ways of evaluating the creditworthiness of its business partners, especially in the banking

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sector, but less in area of enterprises providing other than financial services. „Continuously increasing competition and technical progress has caused that individual trade businesses begin to direct their efforts towards consumers“(Krizanova, Majerova, Kliestik, Majercak, 2013). Also “most leaders of the fastest growing companies consider innovation to be the source of their strongest competitive advantage; more organizations consider it a strategic priority. Due to technological advances, organizations have porous boundaries and collaborate externally to innovate” (Gupta, Agarkhedkar, Sahney, 2015). It is important, however, for these enterprises to monitor the creditworthiness of their customers, because customer with the good financial stability is the safest way to generate profit at the moment. On the other hand, customer with low mark of the creditworthiness represents a risk of future losses. In the credit management, there are performed the analysis of solvency, and payment discipline of customers that are the basis for decisions about cooperation. ”The key how to control risk lies in adaption effective policies, procedures, and controls.“ (Virlanuta, Moga, Ioan, 2008).

2. Theoretical background and methods

An increase in the number of different financial (cash) help belongs to today's trends. Some clients are able to repay this type of commitments, others, however, not. Objective reflection of credit risk of counterpart (customer, client) is, for example, rating or credit scoring.

Rating depends on the probability of whether the counterparty does not pay in time its commitment and the rate of return, which indicates the percentage of the principal that the creditor gets back in the event of failure of the counterparty. In general, rating is seen as an independent assessment, which aims to identify, on the basis of a comprehensive analysis of a variety of known entity risks rated, how this entity is able and willing to get on time and in full to all its payable liabilities. (Vins, Liska, 2005) The rating system is based either on rating agencies (standardized approach) or on internal ratings. The latter can be performed via an internal rating based approach or an internal rating advanced approach (Altman and Sabato, 2005). Rating is done by a private rating agency, which grants business partner (debtor) with corresponding rating mark expressing entity's ability to meet individual commitments. Its purpose is both to convey information to users (lender of foreign capital) and on the other hand, to make business partners visible in order to bring them cheaper product. Initial rating agencies made the evaluation of a specific bond instruments. Then, they started to adapt to market requirements and the needs of investors, and thus began to focus on other subjects of evaluations. Today, rating is done in states, cities, enterprises, banks, etc. (Sedlacek, 2009) According to the purpose, rating is external or internal. Major rating agencies include, for example, D&B (Dun & Bradstreed), Standards & Poor´s, Moody's, Fitch Ratings, Capital Intelligence, Japan Bond Rating Institute, CRA Rating Agency (Czech Republic).

In comparison with standard rating there are various products of **scoring** on the market, that use the mark of rating, but in fact it does not meet the definition of rating and belongs more to the category of scoring (also referred to as ranking, internal rating). Scoring represents creditworthy models made up of ratio indicators and are based on the financial data of the entity evaluated. The subject of the scoring assessments is mainly business companies. (Sedlacek, 2009) Scoring models are based on quantitative analysis of financial data of the entity evaluated under the creditworthiness of the entity is estimated. Data collection is made in stable form so as to be usable as a database in the evaluation system. Particular importance is paid to the previous results of operations of the entity and do not include the non-quantifiable information. The output of the scoring assessment is similar to the output rating with the difference that there is no possibility of subjective opinion. (Sedlacek, 2009) Additional information we can get and apply by using quantitative soft computing prediction models. They usage „ into financial area as reliable and accurate prediction models can be very helpful in management decision-making process.„ (Falat, Marcek, Durisova, 2016)

2.1 Difference between rating and scoring

Rating and scoring are the tools to measure the financial health of the enterprise. The aim of both is to estimate the future development in the sense of ability to repay their obligations in full. The following table describes their fundamental differences: