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How contractors can check their client or agency is financially sound

Contractors who are working for clients or agents that are in financial trouble are frequently one of the last creditors to find out; often the first they hear of it is after the company goes bust. So what can contracting professionals do to safeguard themselves?

"There are a number of options for contractors to choose if they want to credit check a client or agent before signing a contract," explains Sid Home from Creditsafe. "The credit reports vary in price and sophistication, so contractors should consider the size of the potential contract, and therefore the size of their potential losses, when ordering reports."

According to Home, credit reports range from the instant online variety, with automated analysis completed by a computer algorithm, to a detailed report compiled over several days by an expert credit analyst.

So how does it work?

The major credit agencies download accounts and company data from Companies House, which is then sometimes offshored for number crunching and processing in India and the Far East.

The processing takes the 'fundamentals' - basic company information from balance sheets, profit and loss accounts and cash flow statements - and turns them into financial ratios. Ratio analysis is a technique where the financial health of a company can be checked at a glance.

Every major credit agency has its own set of risk criteria that are applied to the basic ratios, and are then sold on to the smaller agencies. The contractor generally subscribes for a year for full access, and the reports clearly state each company's credit risk.

"Automation has its advantages in terms of cost, speed and breadth of coverage," continues Home, "but it can sometimes be out of date. If the data download was on 1 December, and the contractor credit checked a potential client on 1 January, six or seven County Court Judgements (CCJs) could have been registered on the business in that period."

As an aside, Home advises contractors to check carefully when they subscribe to an annual service that they do not inadvertently check the box for an automatic renewal. This can be when the cost of the service rockets.

The value of an up-to-date credit report

In addition to subscribing to an online credit checking service, contractors may wish to request a dedicated credit report on a potential client or agency. This says Home, results in a much more detailed and insightful analysis: "A report by an experienced credit manager often reveals facts about a potential client or agency that an automated check will not. For example, it will find the latest CCJ's, ungazetted petitions for the winding up of companies, High Court writs, look into directors' other companies, some of which may be in receivership, and follow up trade references. They will interview the financial controller/director and will check for web sites and so on, and give a much more detailed overview of the business."

Automated checks have also been known to do a disservice to the companies they rate by giving them lower credit ratings that they would deserve if assessed by a credit manager.

Home has found companies that are very effective at being tax efficient but have been trading for decades with substantial assets, downgraded because their profits fail to meet the automated system's expectations.

Credit checks work both ways

"Contractors gain two benefits from a detailed credit report," continues Home. "They ensure their potential client is credit worthy and they can also find out whether there is a larger business behind their client. Sometimes they can turn this fact to their advantage."

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>
> Sid Home, CreditSafe

As a detailed credit report will reveal the holding or parent company, contractors may find the client is part of a much larger and financially robust corporation.

The contract they are currently investigating could be the introduction into a much larger source of business and the contractor may ultimately wish to develop a long term relationship with the parent company.

The value of most contractors' contracts runs into the tens of thousands of pounds, which would be a hefty sum to lose if the agency or client could not pay the bill.

Creditsafe have developed a free practical guide to credit assessment that contractors can use to assess the credit risk that clients and agencies might pose during a contract.

So, as credit reference subscription services and full credit checks by an experienced analyst can cost a contractor well under a hundred pounds, this is a small price to pay for peace of mind and the knowledge that you will get the money you have worked so hard for.

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