



Creditreform Latvija SIA
credit management survey

**TRADE CREDIT AND PAYMENT
DELAYS IN COMMERCIAL
TRANSACTIONS AMONG
BUSINESS ENTITIES IN LATVIA
IN 2010.**

RESULTS OF SURVEY

May 2011

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INTRODUCTION

Creditreform Latvija SIA has made a survey on the conditions of sales and payment delay trends in commercial transactions among business entities in the domestic market. The aim of this survey is to evaluate the terms of payment transactions between entities in Latvia, to find out how companies organize the credit management, what are the problems with the payment delays and how they are resolved.

The survey was conducted in random business sectors in which post paid conditions for goods and services are essential. Thank to all who participated in the survey.

In accordance with the data of the research more successfully from the crisis are recovering the enterprises which simultaneously with the development of the product manufacturing and regaining of their market segments, particularly in the field of export, have been able to retain sufficiently stable financial condition. Confirmation of this is the assessment of credit risks made in compliance with the CrefoScore models' risk classes. From all the enterprises registered in the Commercial Register in relatively low risk classes of solvency (1 – 5) in the beginning of the current year there were 59.8% of the businesses. These businesses do not have considerable problems to balance a cash flow to fulfill the financial commitment with their business partners and state. It is necessary to stress that the stability of an enterprise's finances in current circumstances has become as one of the most significant preconditions of the competitiveness. Nevertheless there is still considerably large proportion of those enterprises (33,8%) which have serious difficulties of finances thus to a big extent threatening the regular payment making in due time for their business partners. Consequences – debts were delayed for a longer period in 2010 and on average made up 22.1 day and were bigger than in the previous two years. One of the most significant causes – the lack of the current assets, considerable part of whom are frozen in the delayed debtors' debts.

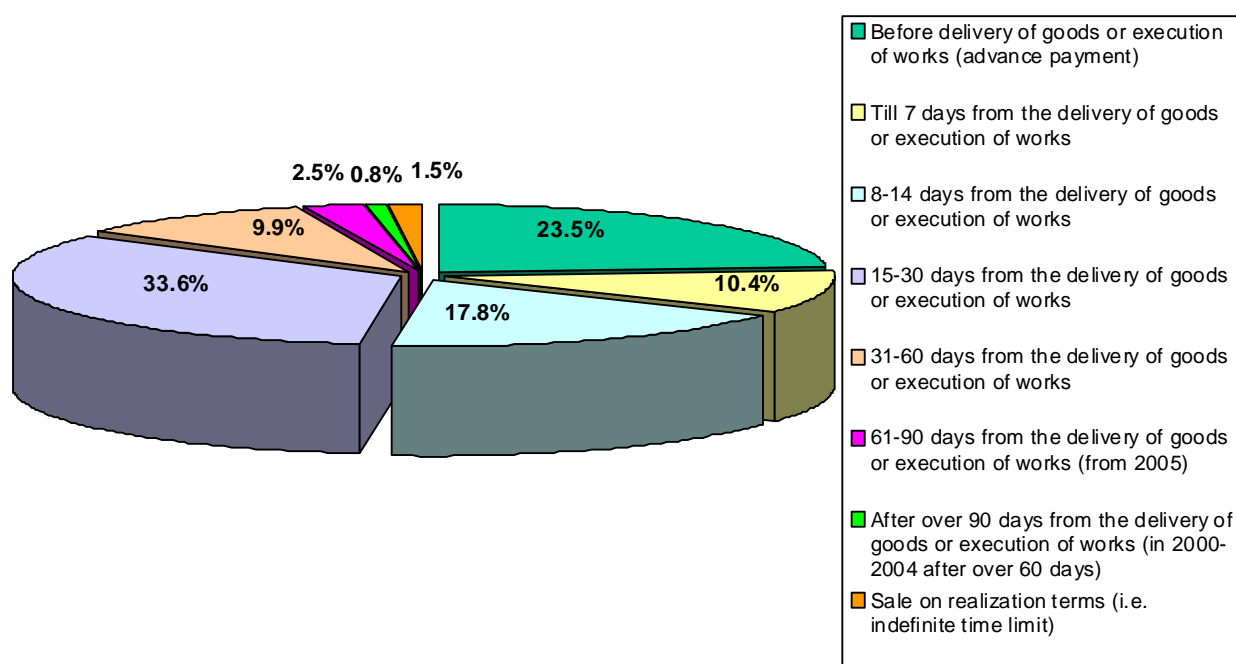
It can be asserted that managing of a heightened risk of delayed payments is of the cornerstones for a successful development of a business. Just because of this a big proportion – 23.5% in the total sales amount is made up by the prepayment. Entrepreneurs are afraid to risk to sell goods and services on the conditions of the deferred payment but in cases if the postpayment is made available the payment terms fixed in the agreements have become almost twice shorter than in the years before the crisis. It is understandable that currently in the circumstances of very limited crediting by the banks and in the conditions of the deficiency of the own current assets the reciprocal crediting of the enterprises is very significant. Any credit is related to the risk of payment in due time therefore a thorough and professional assessment of these risks in the management of finances of any enterprise has not lost its topicality. Research shows that the approach to the assessment of the customers' solvency is individually different for every enterprise though by every passing year more and more companies use the services of the specialized credit management firms.

BUSINESS ENVIRONMENT

Over the past years, experience motivated businesses to evaluate business partners and customers more thoroughly. Most of the businesses developed precise procedures for customers solvency, therefore providing a positive financial cooperation. The survey shows that during 2010, most enterprises has regained confidence in its customers, making it possible to pay with a longer post-delivery for the goods or services. Despite this, businesses in their sales transactions continue to remain cautious and set shorter transaction dues.

In 2010, the average contractual transaction payment term was 25.3 days from delivery of goods or execution of the works, which is longer than the terms in the previous years. In 2010 year, the figure is close to that of 2004 and 2005. The yearly average of the down payment terms of the transactions were approximated to 30 days after delivery of the goods or services.

Picture 1: Contractual payment terms in Latvia in 2010



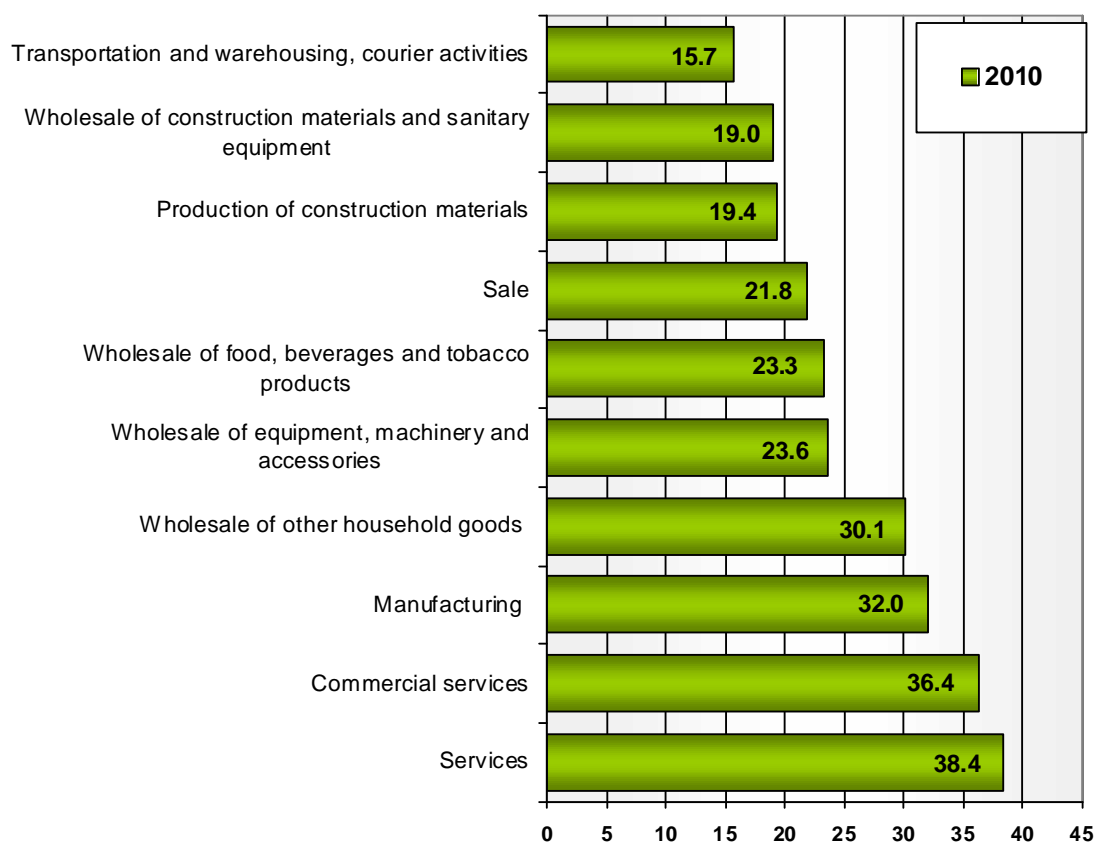
Last year, 23.5% of the surveyed respondents required prepayment in their contracts of delivering of goods or services. There is still a very small proportion of contracts, where the deferred payment term is more than 90 days - 0.8%. The largest share - 33.6% of contracts that provide the deferred payment term is in the interval of 15-30 days, a slight increase in comparison to previous years. The graph shows that the payment terms in the range of 8-14 days and 31-60 days from the delivery of goods or execution of works of the previous years level.

It is predictable that the conditions of sales and the tendencies of the payment delays in the local deals among the legal entities in 2011 principally are going to remain at the level of the year 2010 because the common growth of economy mainly is going to be ensured by the export of goods and services what partly will enable to compensate still quite weak domestic demand and the development of the service industries oriented to the internal market. Notwithstanding to this fact as the forecasts of the Ministry of Economy indicate as well in the internal market there are going to be noticeable certain signs of recovering what are going to activate the local business activities particularly the development of small and microenterprises. As well there is a slight hope for the active restart of crediting by the banks particularly for the financing of the business persons' current assets. Thus as a significant source of providing the finances for the circulating capital of the business transactions still is going to remain the reciprocal crediting of enterprises using the conditions of the deferred payment. Thus there as well inevitably exist risks for bigger or smaller payment delays of invoices the causes of which can be of the whole spectrum.

The contractual payment terms are different in certain business sectors. The shortest contractual payment terms in 2010 determined the transportation and warehousing, courier activities sector companies – 15.7 days, wholesale of construction materials and sanitary equipment companies - 19.0 days, followed by the business, trade - 21.8 days.

The longest payment terms in 2010 for agreements with customers were determined the commercial service providers - 36.4 days and industry companies - 32.0 days, followed by wholesale of other household goods companies - 30.1 days.

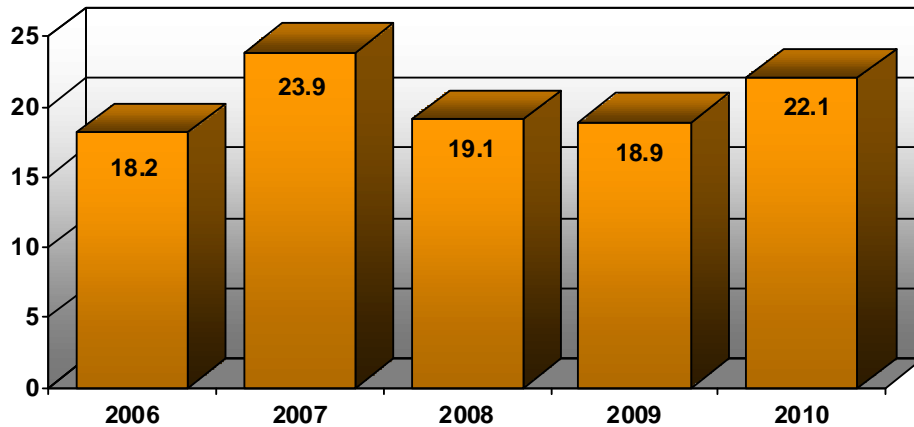
Picture 2: Average contractual payment terms in individual business sectors in 2010 (in days from delivery of goods or execution of works)



PAYMENT DELAYS

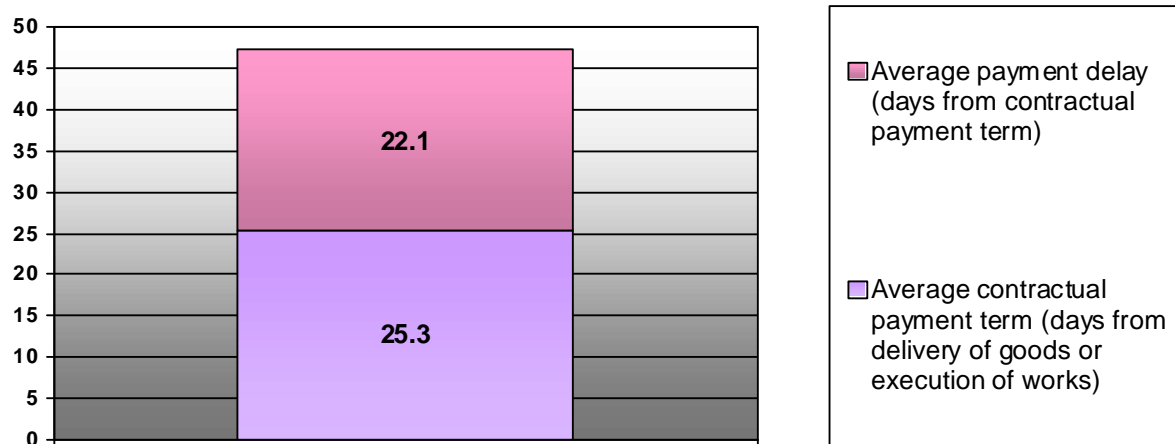
Deferred payment conditions maintain very important place in corporate financial management. Although the monitoring of the payment in 2010th year has become tighter, the average payment delays have increased. The survey shows that, compared with the previous year, the average payment after the deadline has been a tendency to grow and its account for 22.1 days, which is 3.2 days higher than in 2009.

Picture 3: Average payment delays in Latvia in 2006-2010
In days from contractual term of payment



The survey shows that in 2010. the general slowdown in the amount receivable (totalizing the average contractual payment term and the average payment delay) making an average of 47.4 days after delivery of the goods or works.

Picture 4: Average payment terms and delays in Latvia in 2010

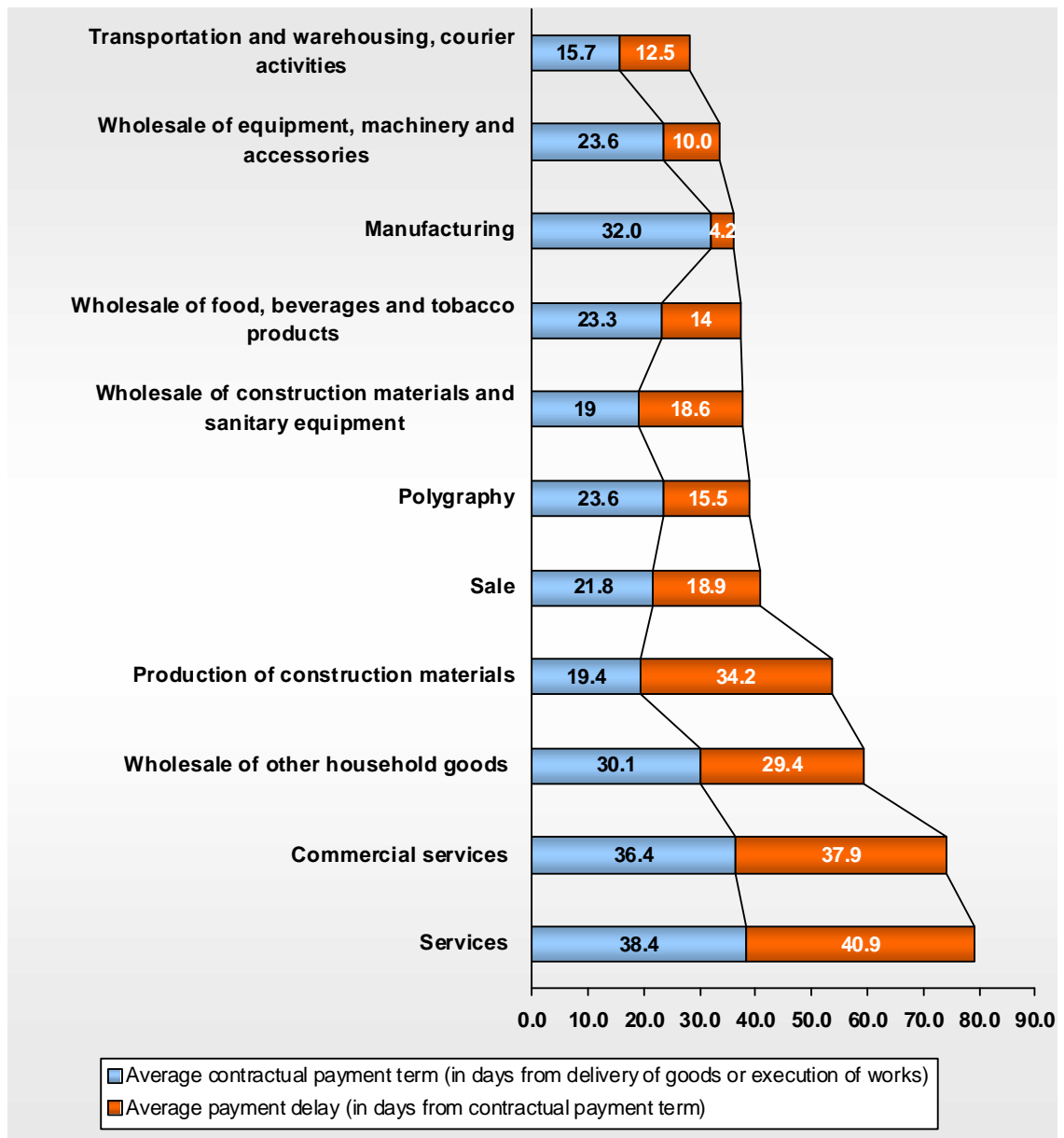


Taking into account that the average delay terms of payments had an explicit tendency to increase last year this fact presents evidence of completely unsolved problems in many places in debtors' debt management. Concerning this it is not significant whether the debt collecting is done by the companies themselves or by involved specialized companies; the important fact is that this work provides the expected results for the ensurance of the sufficient cash flow. There has to be taken into consideration that it is incomparably more difficult to recover a long-term debt than a debt collected in due time what simultaneously requires smaller costs as well.

Looking at total amounts receivable movement in certain business sectors, in 2010 the service and commercial service sectors observed longer payment for goods or services - 79.3 and 74.3 days, the wholesale of other household goods sector companies - 59.5 days, and in the production of construction materials sector companies - 53.6 days.

Fastest payments for the goods or services in 2010, received transportation and warehousing, courier activities sector companies - 28.2 days, wholesale of equipment, machinery and accessories sector companies - 33.6 days and the industry enterprises - 36.2 days.

Picture 5: *Average amounts receivable movement in the individual business sectors in 2010.g. (in days from delivery of goods or execution of works)*

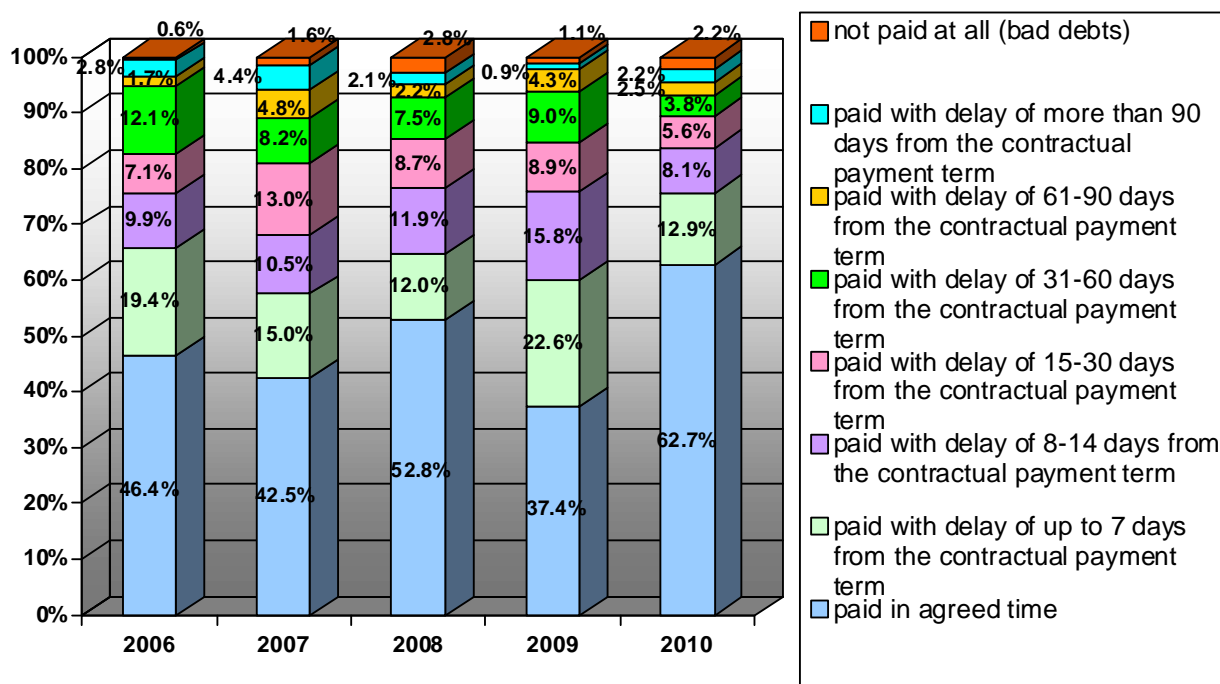


DELAYED PAYMENT STRUCTURE

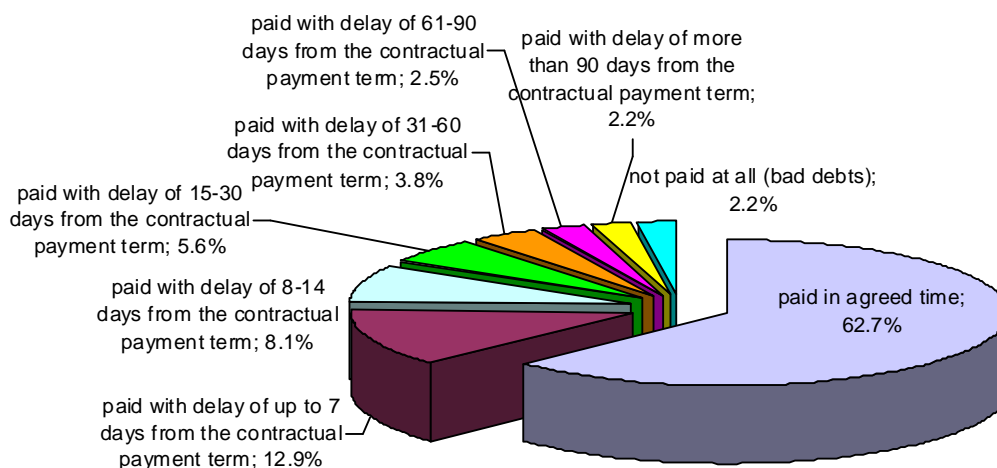
The survey shows that last year amount of invoices paid in agreed time in the commercial transactions of business entities decrease significantly from 37.4% to 62.7%.

At the same time, according to data from the survey, last year were increased amount of outstanding debts and bad debts (a late payment more than 90 days and not paid at all) and accounted 2.2%. Attention to linking the rapidly growing payments paid with delay of more than 90 days from the contractual payment term, which last year still accounted for a relatively small portion - 2.2% of the total bill amount. Survey results show that in last year, most payments were delayed in the interval from 7 to 60 days, where includes 30.4% of all late payments.

Picture 6: Payment delays in Latvia in 2006-2010



Picture 7: Payment delays in Latvia in 2010

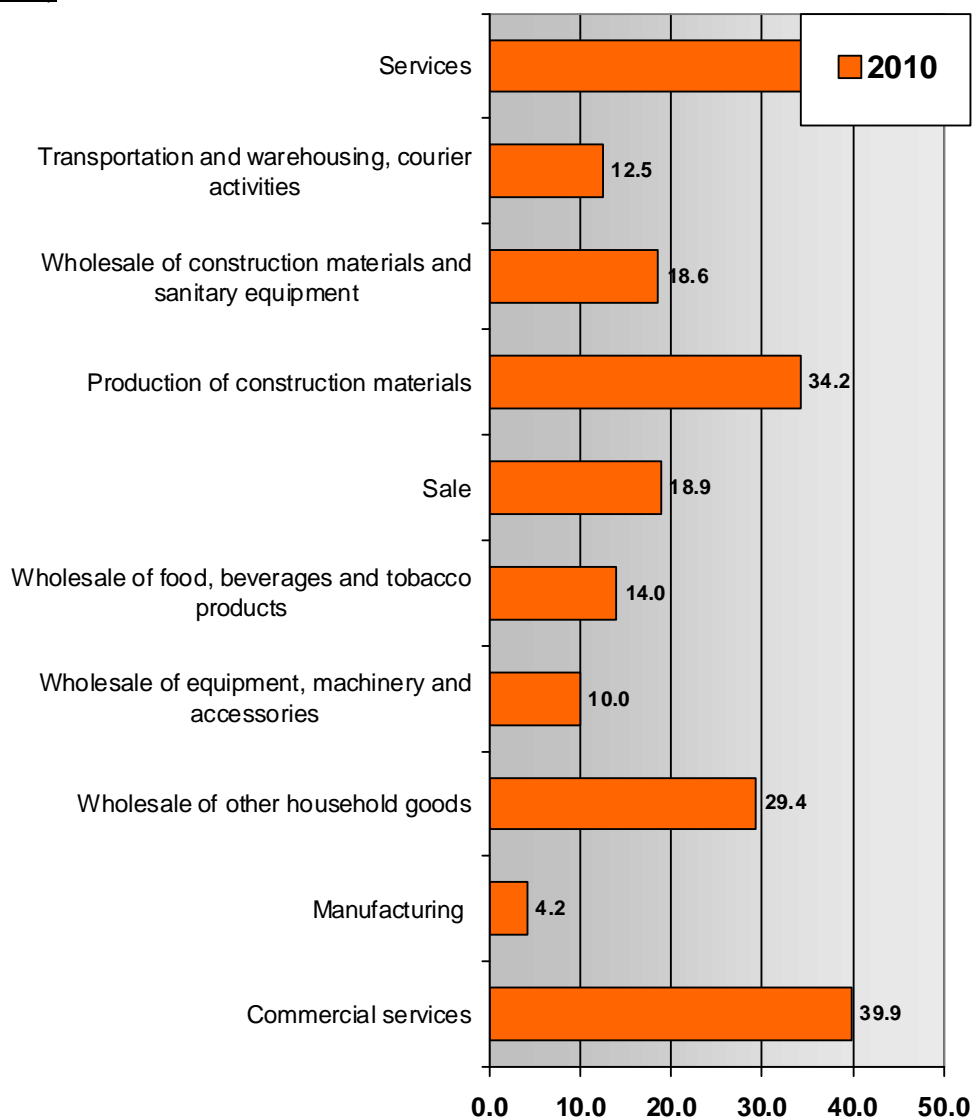


PAYMENT DELAYS BY BUSINESS SECTORS

The survey shows, that the longest payment was delayed in the service sector firms (40.9 days) and construction industry companies (34.2 days). Longer payment delays occur in the wholesale of other household goods sector enterprises - 29.4 days, business, trade - 18.9 days and the wholesale of construction materials and sanitary equipment sector enterprises - 18.6 days.

The fastest delayed payment in 2010 were paid in sectors such as industry's enterprises - 4.2 days, and wholesale of equipment, machinery and accessories sector companies - 10.0 days, and transportation and warehousing, courier activities sector companies - 12.5 days.

Picture 8: Average payment delays in certain business sectors in 2010 (in days from contractual payment term)

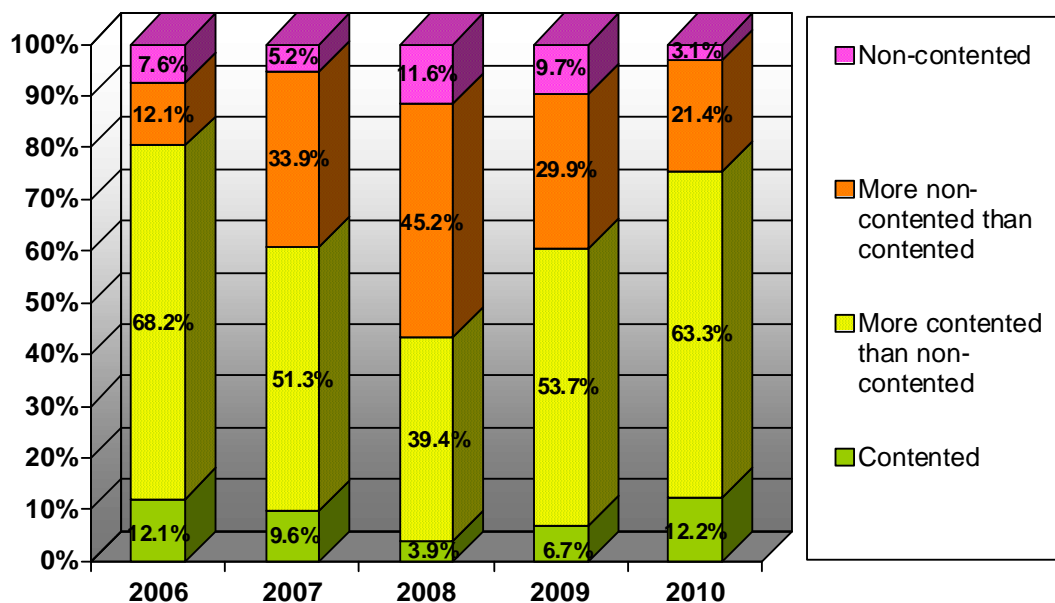


EVALUATION OF THE CUSTOMERS' PAYMENT DISCIPLINE

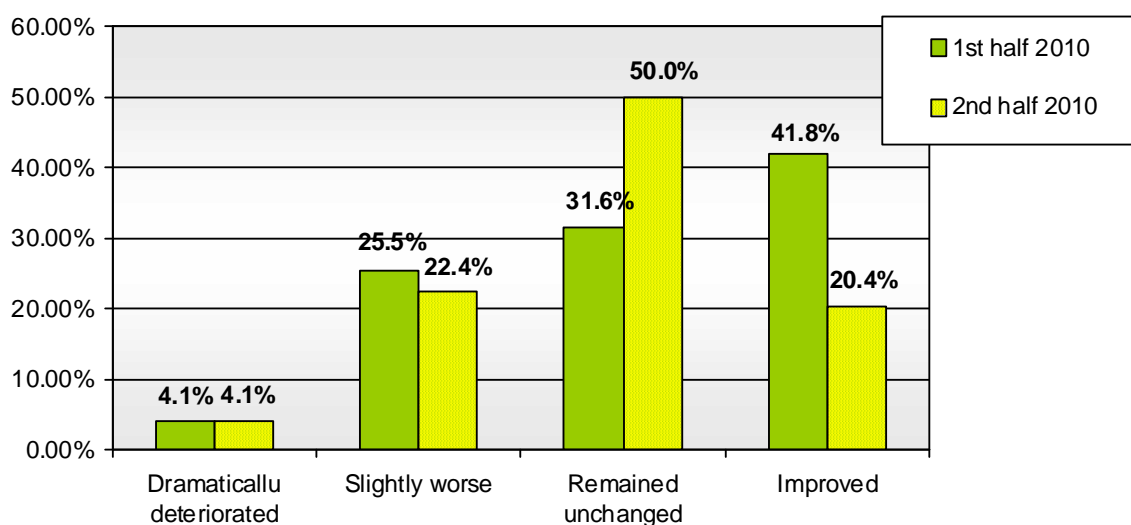
Businesses are contented with customer payment discipline in 2010. In the chart, 12.2% of businesses are contented with customer payments, but more contented than non-contented is 63.3%. Overall contented are 75.5% of all businesses, which are 15.1% higher than in 2009.

Problem of invoice payment in due time has not lost the importance. Completely non-contented with the customers' payment discipline 3.1% but more non-contented than contented – 21.4% of cases.

Picture 9: Satisfaction with customers' payment discipline in 2006-2010



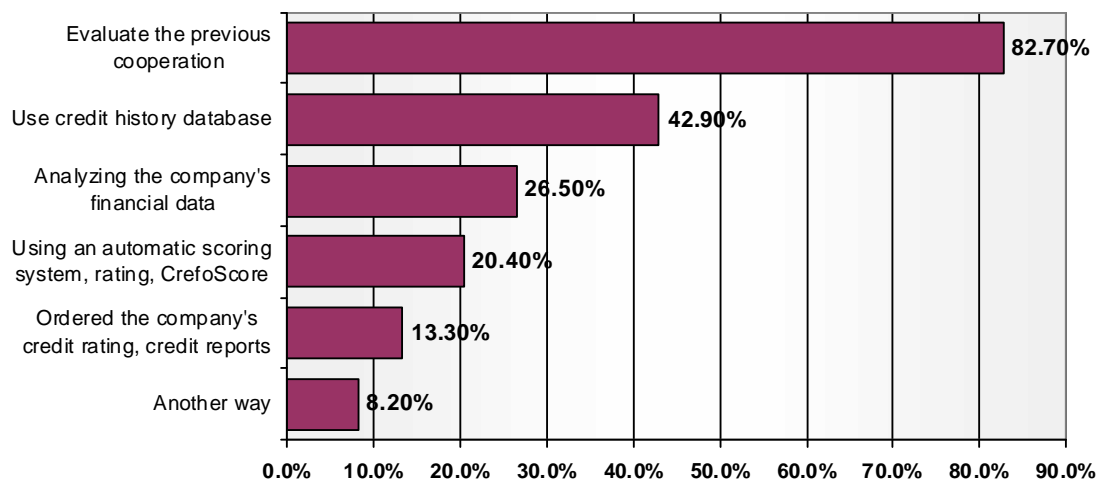
10.attēls. Customers' payment discipline changes 2010th year.



RISING IMPORTANCE OF OUTSOURCING IN DELAYED PAYMENT PROBLEM SOLVING

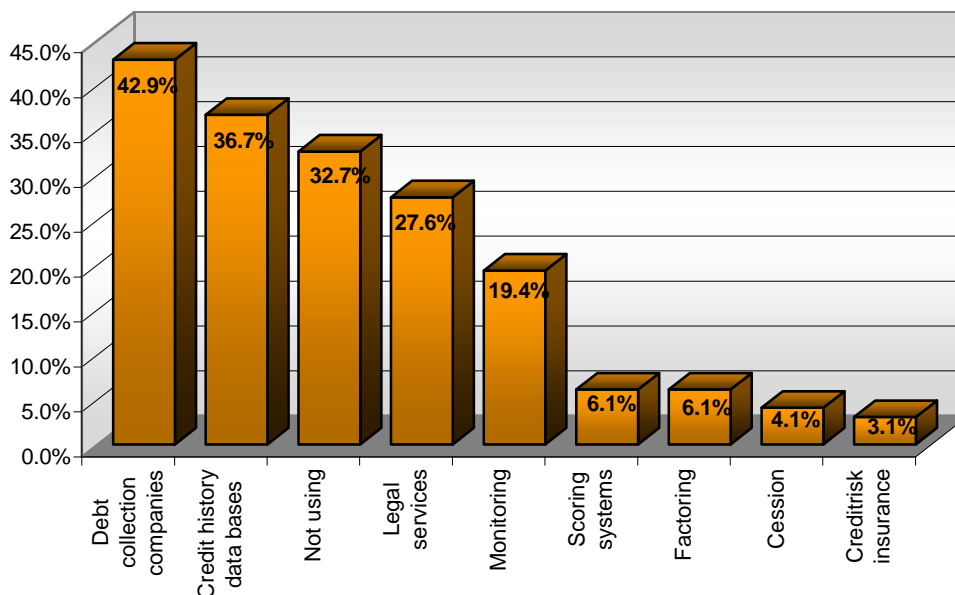
Risk to cooperate with an enterprise which deliberately or non-deliberately will not fulfil the undertaken commitment exists in any transaction. To ascertain in due time with which enterprise to cooperate and with which - better not 98% of the entrepreneurs check the customer's solvency before the conclusion of a deal. Approach to the assessment of the customers' solvency is individual for every enterprise though 82.7% of the enterprises ground on the previous cooperation and the successful result of it. In addition to a positive assessment of the cooperation a part of the enterprises analyse as well the reports of finances, credit records or ratings of the customer. In 2010 42.9% of the entrepreneurs for the assessment of the customers' solvency used the credit record data bases, 26.5% analysed the data of finances, 20.4% used the automatic evaluation system, ratings, Crefo Score whereas 13.3% ordered the enterprise's credit assessment, credit statements.

Picture 11: *How do companies ensure that customers will fulfill the commitments*



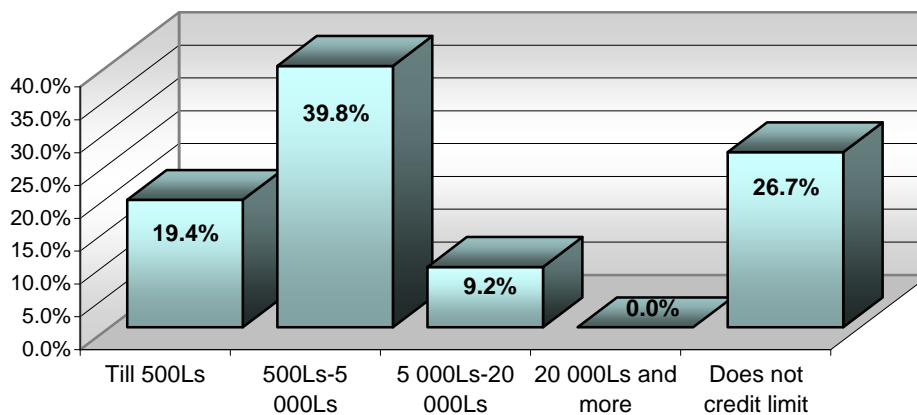
For a professional assessment of the customers' solvency the enterprises broadly use outsourcing. Research shows that almost half of the inquired entrepreneurs in the work has involved the debt collecting companies – 42.9%.

Picture 12: *The use of professional services in order to solve delayed payment problems in enterprises in 2009*



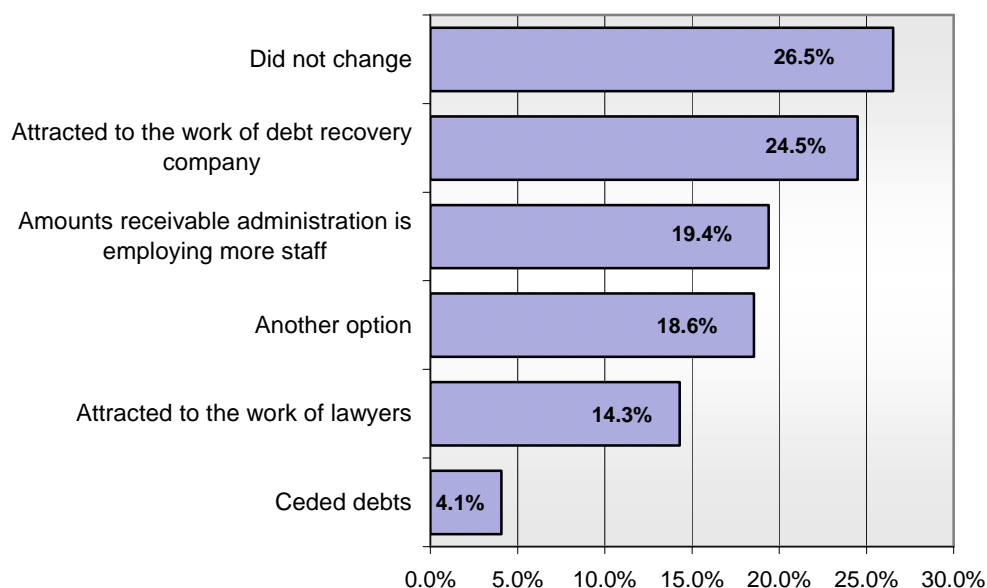
To secure against the deals where for a customer there are done the works or delivered the goods for the sum that exceeds the possibilities of finances 68.4% of the enterprises fix the credit limits for their customers. From them 29.6% of the enterprises fix the credit limits for all the customers and 38.8% fix the credit limits for certain groups of customers. Comparatively big part of the entrepreneurs does not fix the credit limits for the customers – 31.6%. According to the research for the most of the cooperation partners there is fixed the credit limit within the range from Ls 500.00 to Ls 5000.00.

Picture 13: Set credit amounts for 2010



Research provides evidence that during the year of 2010 a big part of the enterprises stabilized their debtor administration procedure. During the year of 2010 26.5% of the entrepreneurs did not change the debtors' debt administration procedure of their companies. 24.5% of the entrepreneurs in their turn in their work involved a debt collecting company. Big number of entrepreneurs copes with the debt administration themselves and 19.4% of the entrepreneurs during the year of 2010 for the debtors' debt administration employed more employees. As another variant the entrepreneurs mention the cooperation mostly with the prepayment and with more strict postpayment regulations in agreements, the improvement of the internal procedures and credit policy as well still more thorough assessment of the customers' solvency.

Picture 14: Are companies changed their debt management procedures during 2010

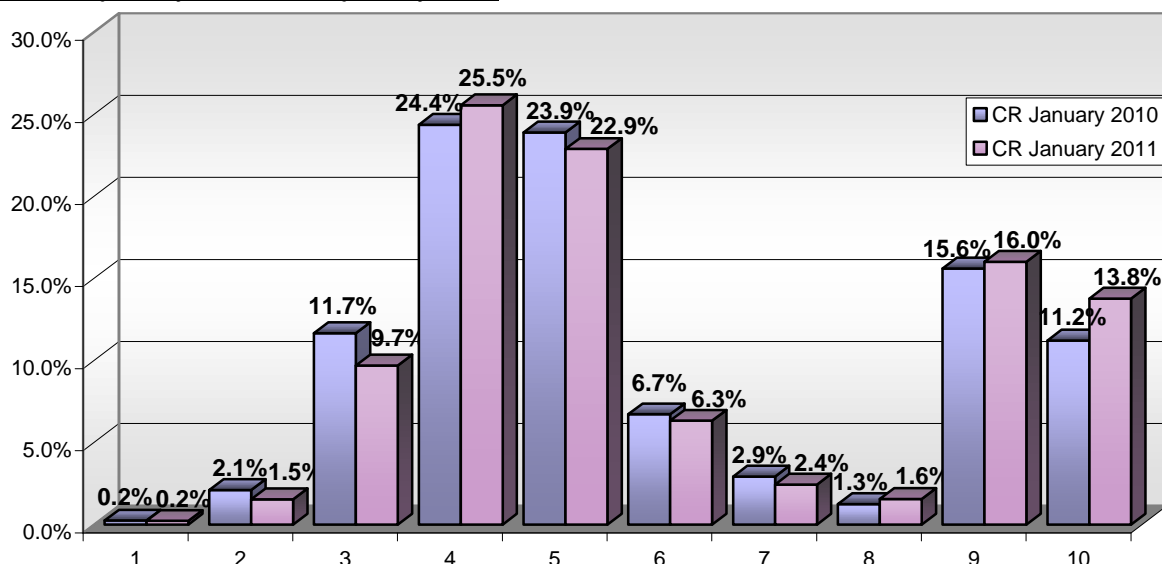


Effective guidance for the operational assessment of credit risk

It is important to note that the operators of their co-solvency risk assessment is increasingly used in a variety of new advanced tools and techniques that allow operational and cheaper to obtain timely, appropriate and integrated information analysis.

Creditreform in collaboration with German company Creditreform Risk Management has developed a special mathematical model CrefoScore, which is automatic on-line credit-risk evaluation system www.crediweb.lv site. Its main ingredient is the Score - especially index calculated by the score of 100 - 600, and it indicates the probability with which the company next 12 months to live up to their financial commitments. More easily and faster perception - created 10 CrefoScore risk classes from one to ten, where the first to eighth class presented the status of the company. While in the ninth risk class enterprise comes when during the year has registered a significant payment delayed fact, but the tenth - when a company is insolvent, or runs its reorganization or liquidation proceedings. To arrive at this index is to evaluate not only the most recent financial information on companies, but also its credit history, a large number of structural data (number of employees, company age, legal form, etc.), business sector risk indicators, as well as information on insolvency, reorganization, liquidation, judicial protection and bankruptcy proceedings. CrefoScore is updated every day for all the companies included in the Commercial Register of Latvia. CrefoScore not evaluate companies which were established less than a half of the year, banks, insurance companies and companies that deal with financial asset management.

Picture 15: Percentage breakdown of Latvian Commercial Register enterprises in CrefoScore risk classes in January 2010 and in January 2011



Earlier this year, most of the Commercial businesses were in the fourth CrefoScore risk class (ability to pay above the average). During 2010, the number of companies in 5th risk class has increased by 1.1% in early 2011 and up 25.5% of total Commercial businesses. Almost as much Commercial enterprises at the beginning of 2011 ranged in 5th risk class (average payment) - 22.9%, which, together with 4.riska class accounts for almost a half of the Commercial Register companies - 48.4%. Significant changes have also occurred in the ninth and tenth CrefoScore risk classes (cooperation with these companies is not recommended for credit risk). The number of companies in the ninth CrefoScore risk class increased only by 0.4%, therefore in 10th risk class negative changes occurred by 2.6%. These high-risk classes in early 2011 ranked 29.8% from all companies registered in CR, an increase of 3% over the same period last year.

Using in publications, a reference to the SIA Creditreform Latvija is mandatory.