

**RISKS OF INTERACTION WITH CONTRACTORS IN THE CONSTRUCTION
INDUSTRY**

CZU: 330.322.5:624

DOI: <https://doi.org/10.53486/isca2024.38>

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Abstract: The article is devoted to the specifics of forecasting the risks of interaction with contractors in the construction industry. Due diligence in choosing contractors is necessary when working with business partners in any industry, but in the construction sector it is of particular importance. This is due to the specifics of the interaction of contractors in construction and the high degree of dependence of the timing of work and the economic entity's own reputation on the quality and timeliness of services provided by the subcontractor or service organization. The article proposes a typology of counterparties, which allows us to determine the main risk factors of interaction with each type of business partner. The identification of these risk factors will determine the further trajectory of interaction with the counterparty and ways to minimize possible business risks.

Keywords: due diligence, counterparty, risk factors, construction.

JEL Classification: M49

Introduction

Business dealing at all stages is accompanied by the presence of risks that can have a negative impact on its financial stability. The group of business risks caused by interaction with counterparties is quite large-scale. Although relations between enterprises are fixed by contractual obligations, nevertheless, in practice there are cases of their violation or non-fulfillment for various reasons (dishonesty of the counterparty and his use of fraudulent schemes, activities under the guise of a day-to-day company, management errors, deterioration of financial condition, bankruptcy and others). In all these cases, the result of such partnership is loss of income, which are identified as losses and have a negative impact on the financial condition [1, pp. 3-10]. It should be noted that the industry specifics of the work of a particular enterprise can also lead to certain problems in contractual relationships with business partners. An example is the construction industry, where, in addition to the construction company or enterprise itself, a large number of different market entities participate, including research centers, construction and installation organizations, suppliers of construction and installation equipment and building materials, banks, legal organizations and etc. Complex mutual relations are developing between them, requiring the creation of a clear organization and coordination of the work of all participants in the construction process, characterizing them as partners [3, pp. 489-493]. In this regard, before starting business cooperation with a counterparty, due diligence should be exercised and each counterparty should be checked for its reliability.

Basic Content of the Paper

Diagnostics of possible risks of interaction with a counterparty plays a key role in analyzing the reliability of a counterparty. As part of the ongoing research, it is proposed to diagnose risks when interacting with counterparties, taking into account their typology.

In the construction industry, the following typology of contractors can be proposed:

1. Key participants of the construction market:

1.1. Developers are organizations that have purchased a site and are building an object on it. These include developers (hereinafter referred to as type 1).

1.2. Customers (in accordance with the Urban Planning Code — technical customers) are organizations that are hired by the developer and they, in turn, organize and conduct the entire complex of works from obtaining technical conditions for commissioning the facility (hereinafter type 2).

1.3. Construction organizations that perform construction and installation work directly (construction of monolithic structures, brick, roofing, finishing works, installation of engineering networks, etc.) (hereinafter type 3).

1.4. Organizations that carry out design work. This type of contractors primarily includes general designers who perform a full range of design work. At the same time, they are usually responsible only for architectural work or a set of works (architectural and design work). The remaining types of work are transferred by them to contractors if there are no employees in the staff who are able to perform all types of required work. In this case, contractors can perform specialized work, for example, sanitary (heating, ventilation, water supply, sewerage, fire extinguishing), electricity connection services, communication network design, the entire range of engineering works (hereinafter - type 4).

1.5. Organizations that carry out survey work in terms of geodesy, geology, ecology, meteorology, and surveys. At the same time, this type of contractors includes both large organizations that can perform the entire range of survey work, as well as medium-sized and small enterprises that provide only one or more of the above works (hereinafter referred to as type 5).

1.6. Suppliers and manufacturers of products, equipment and materials (hereinafter type 6).

2. Organizations that ensure the functioning of construction enterprises:

2.1. Electric grid and gas supply organizations (hereinafter – type 7).

2.2. Organizations offering public utilities (hereinafter referred to as type 8).

2.3. Real estate agencies (hereinafter referred to as type 9).

3. Organizations participating in the project financing system:

3.1 Commercial banks (hereinafter referred to as type 10).

3.2 Individual interest-holders (hereinafter referred to as type 11).

3.3 Organizations providing services and supplying materials during the implementation of the project (contractors, suppliers of materials, tax and legal consultants (hereinafter referred to as type 12).

The main types of risks that arise when interacting with the above-mentioned counterparties are summarized in table 1.

Table 1. Types of risks depending on the type of counterparties

Item no.	The type of counterparty	Possible risks
1	Developers	1. Changing the terms of the agreement unilaterally 2. Difficulties in the production of construction works, which may lead to the failure of the deadlines for the completion of the object 3. Emerging environmental liability for environmental damage caused by construction work
2	Customers	Delay in payment for completed works and services rendered
3	Construction organizations that perform construction and installation work directly	1. Delay in the execution of works and the provision of services 2. Poor-quality performance of work and provision of services 3. Violation of safety standards during construction and installation works

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Item no.	The type of counterparty	Possible risks
4	Organizations that carry out design work	<ol style="list-style-type: none"> 1. Violation of contractual obligations on the part of contractors to whom a part of the project has been transferred for implementation 2. Poor-quality performance of work and provision of services 3. Lack of material and technical base to fulfill the obligations assumed 4. Lack of qualified staff
5	Organizations that carry out survey work in terms of geodesy, geology, ecology, meteorology, and surveys	<ol style="list-style-type: none"> 1. Poor-quality performance of survey work, resulting in engineering errors and emergencies 2. Additional financial costs due to poor-quality performance of survey work
6	Suppliers and manufacturers of products, equipment and materials	<ol style="list-style-type: none"> 1. Delayed delivery of goods 2. Supply of goods, equipment and materials of inadequate quality
7	Electric grid and gas supply organizations	<ol style="list-style-type: none"> 1. Non-fulfillment of measures under the technical connection agreement within the prescribed period 2. Suspension of gas and electricity supply for reasons beyond the control of the organization
8	Organizations offering public utilities	<ol style="list-style-type: none"> 1. Changes in tariffs for housing and communal services 2. Suspension of water supply for reasons beyond the control of the organization
9	Real estate agencies	<ol style="list-style-type: none"> 1. Increase in agency fees, which entails additional financial delays 2. Non-fulfillment of contractual obligations
10	Commercial banks	<ol style="list-style-type: none"> 1. Non-compliance with the deadlines for the implementation of the project roadmap 2. The risk of not achieving the technical and economic indicators of the project
11	Individual interest-holders	The risk of assignment of rights under an equity participation agreement
12	Organizations providing services and supplying materials during the implementation of the project	<ol style="list-style-type: none"> 1. Violation of contractual obligations on the part of material suppliers and project consultants 2. Poor-quality performance of work and provision of services

Source: compiled according to [4, 5].

Thus, the type of risks is determined by the specifics of the counterparty's functioning in the construction market. Taking into account the specifics of the work of a particular business partner will allow to identify problematic aspects of business cooperation and develop preventive measures to solve them.

Forecasting risks when interacting with contractors in the construction market should begin with the collection of an information base. Table 2 summarizes the basic information characterizing the specifics of the work of a particular business partner and allows you to identify the risks of cooperation with them.

Table 2. Information base for identifying risks of interaction with counterparties, depending on their typology

Item no.	Type of counterparty	Information data
1	Developers	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Developer's reliability rating 3. Developer's documents on the official website 4. Extract from the Unified State Register of Legal Entities 5. Construction dates 6. Information about the new building on a special website 7. Information about bankruptcy and litigation of the developer 8. Information about the commissioned objects of the developer 9. Availability of preferential and subsidized programs

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Item no.	Type of counterparty	Information data
2	Customers	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Information about participation in the self-regulating organization 4. Information on the availability of the necessary material and technical base 5. Information on the availability of specialists, information about which is included in specialized national registries 6. Information about completed projects
3	Construction organizations that perform construction and installation work directly	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Information about membership in the self-regulating organization to perform certain works 3. Extract from the Unified State Register of Legal Entities 4. Information about the experience of performing such work 5. Availability of leasing agreements 6. Information about participation in public procurement 7. Information about the participants in the subcontractor chain
4	Organizations that carry out design work	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Information about membership in the self-regulating organization to perform certain works 3. Information about the organization's experience in the construction market 4. Extract from the Unified State Register of Legal Entities 5. Information about the experience of performing the same work 6. Data on the state of the material and technical base 7. Information about the availability of qualified staff
5	Organizations that carry out survey work in terms of geodesy, geology, ecology, meteorology, and surveys	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Information about the experience of performing the same work 4. Data on the state of the material and technical base 5. Information about the availability of qualified staff
6	Suppliers and manufacturers of products, equipment and materials	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Information about the executive proceedings of the organization 4. Information about certificates or product declarations
7	Electric grid and gas supply organizations	Information about the status of the network organization
8	Organizations offering public utilities	Information about the organization of cooperation with public utilities organizations after the completion of the construction project
9	Real estate agencies	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Information about the experience in the market 4. Information about the executive proceedings of the organization 5. Information indicating the positive business reputation of the organization
10	Commercial banks	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Availability of the appropriate license 4. Information about the experience of opening escrow accounts.
11	Individual interest-holders	Information about the status of the shareholder in the equity participation agreement
12	Organizations providing services and supplying materials during the implementation of the project	<ol style="list-style-type: none"> 1. Financial indicators (accounting statements of the organization) 2. Extract from the Unified State Register of Legal Entities 3. Information about the executive proceedings of the organization 4. Information about certificates or product declarations 5. Availability of qualified staff to provide the required service

Source: compiled according to [2, 4, 5].

Thus, the specifics of the work of key participants in the construction market is that in order to perform certain works, they must be members of a self-regulating organization and have the necessary material and technical base and qualified staff. When checking organizations that support the activities of construction companies, attention should be paid to their legal capacity and the availability of permits for the provision of declared services. Organizations involved in project financing have their own requirements, and the information base is focused on collecting data on compliance with these requirements.

The identified risks, which are caused by cooperation with a counterparty in the construction sector, can be divided into two groups: stop factors and risk factors. When identifying stop factors, cooperation with the organization is not recommended, and when detecting risk factors, cooperation is possible, but subject to certain preventive measures.

Table 3 summarizes the stop factors and risk factors in interaction with key participants in the construction market.

Table 3. Stop factors and risk factors in interaction with key participants of the construction market

Item no.	Type of counterparty	Stop factors (general)	Risk factors
1	Developers	<ol style="list-style-type: none"> 1. The organization is in liquidation status 2. It is planned to exclude from the Unified State Register of Legal Entities 3. The legal entity is declared bankrupt 4. The presence of a mark on the unreliability of information about the head 5. The head and founder belong to the mass 6. The registration address is a mass one 7. Non-compliance of the OKVED (Russian Classification of Economic Activities) with the activities carried out 8. The current account is blocked by the decision of the Federal Tax Service of the Russian Federation 	<ol style="list-style-type: none"> 1. Experience in the construction market for less than 3 years 2. Significant amount of accounts payable 3. Lack of membership in the self-regulating organization 4. Lack of necessary logistical resources and qualified staff
2	Customers		<ol style="list-style-type: none"> 1. Less than 3 years of experience in the construction market 2. Significant amount of accounts payable 3. Lack of membership in the self-regulating organization 4. Lack of necessary logistical resources and qualified staff
3	Construction organizations that perform construction and installation work directly		<ol style="list-style-type: none"> 1. Less than 3 years of experience in the construction market 2. Significant amount of accounts payable 3. Lack of membership in the self-regulating organization 4. Lack of necessary logistical resources and qualified staff 5. The existence of legal proceedings due to non-fulfillment of contractual obligations
4	Organizations that carry out design work		<ol style="list-style-type: none"> 1. Less than 3 years of experience in the construction market 2. Lack of membership in the self-regulating organization 3. The presence of negative reviews about the quality of the work performed
5	Organizations that carry out survey work in terms of geodesy, geology, ecology, meteorology, and surveys		<ol style="list-style-type: none"> 1. Less than 3 years of experience in the construction market 2. Lack of membership in the self-regulating organization 3. The presence of negative reviews about the quality of the work performed 4. Lack of necessary material and technical base or qualified staff
6	Suppliers and manufacturers of products, equipment and materials		<ol style="list-style-type: none"> 1. Information about the unsatisfactory financial condition of the organization 2. Availability of enforcement proceedings 3. Lack of declaration and certificates for products.

Source: compiled by the authors.

As can be seen from table 3, stop factors cover aspects characterizing the legal capacity and legal status of the organization, and risk factors are related to the assessment of the counterparty's resource base of the construction market.

Table 4 summarizes the stop and risk factors indicating the unreliability of contractors-organizations that ensure the functioning of construction enterprises.

Table 4. Stop factors and risk factors in interaction with contractors-organizations that ensure the functioning of construction enterprises

Item no.	Type of counterparty	Stop factors (general)	Risk factors
1	Electric grid and gas supply organizations	<ol style="list-style-type: none"> 1. The organization is in liquidation status 2. It is planned to exclude from the Unified State Register of Legal Entities 	Availability of information about poor-quality performance of services

2	Organizations offering public utilities	3. The legal entity is declared bankrupt 4. The presence of a mark on the unreliability of information about the head	Availability of information about poor-quality performance of services
3	Real estate agencies	5. The head and founder belong to the mass 6. The registration address is a mass one 7. Non-compliance of the OKVED (Russian Classification of Economic Activities) with the activities carried out 8. The current account is blocked by the decision of the Federal Tax Service of the Russian Federation	1. Experience in the construction market for less than a year 2. Availability of information about poor-quality provision of real estate services 3. Lack of qualified staff

Source: compiled by the authors.

Based on table 4, it can be concluded that in addition to stop factors, risk factors that arise when cases of poor-quality service provision and lack of relevant experience in the organization are identified should be taken into account.

Table 5 shows a list of stop factors and risk factors for identifying the unreliability of organizations involved in project financing system.

Table 5. Stop factors and risk factors in interaction with organizations involved in project financing system

Item no.	Type of counterparty	Stop factors (general)	Risk factors
1	Commercial banks	1. The organization is in liquidation status 2. It is planned to exclude from the Unified State Register of Legal Entities	Lack of experience in project financing
2	Individual interest-holders	3. The legal entity is declared bankrupt 4. The presence of a mark on the unreliability of information about the head	Information about the unsatisfactory credit history of an individual interest-holders
3	Organizations providing services and supplying materials during the implementation of the project	5. The head and founder belong to the mass 6. The registration address is a mass one 7. Non-compliance of the OKVED (Russian Classification of Economic Activities) with the activities carried out 8. The current account is blocked by the decision of the Federal Tax Service of the Russian Federation	1. Information about the unsatisfactory financial condition of the organization 2. Availability of enforcement proceedings 3. Lack of declaration and certificates for products 4. Lack of qualified staff

Source: compiled by the authors.

The considered list of risk factors is not exhaustive and can be supplemented in the process of checking the counterparty. The peculiarity of the proposed set of risk factors is that they allow to take into account the specifics of the counterparty's work, depending on its attribution to a specific type.

Conclusion

Summarizing the identified risk factors allows us to proceed to determining the trajectory of further cooperation with the counterparty. If one or more stop factors are identified, cooperation with the counterparty is associated with certain threats that can have a negative impact on the financial security of the organization. If one or more risk factors are identified, it is necessary to conduct a more extensive verification in order to analyze the possible consequences of cooperation with such a participant in the construction market. If the expected benefits of cooperation exceed the possible negative consequences of existing risks, it is recommended to apply various risk management methods:

- 1) the use of prepayment, letter of credit payment;
- 2) liability insurance;
- 3) involvement of a specialized organization for the implementation of construction control;
- 4) the inclusion in the contract of a special clause on the penalty for failure to meet the intermediate and final deadlines for the contractor's work;

5) reserving funds to cover unforeseen expenses.

Thus, the proposed approach to risk assessment depends on the specifics of the activity of a particular counterparty in the construction market allows to assess risks in more detail and provide basic approaches to minimize their negative impact on the organization's activities.

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