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Monetary policy, accounting conservatism and trade credit[☆]

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ABSTRACT

Using a sample of A-share listed firms in China during the 2003–2012 period, this paper investigates the effect of accounting conservatism on trade credit, taking changes in monetary policy into account. We find that corporations with higher accounting conservatism obtain more trade credit and that accounting conservatism has a greater influence on trade credit under tight monetary policy. Furthermore, the backgrounds of the supplier and customer influence the positive relationship between accounting conservatism and trade credit. This influence is more evident when a company is privately owned and has greater market power, and less evident when the supplier or customer is the controlling shareholder.

1. Introduction

As a basic feature of accounting reporting, the main role of accounting conservatism is to promote the signing of debt contracts by preventing an enterprise from over-reporting its assets and thus damaging the interests of creditors (Watts, 2003; Jiang and Zhang, 2007). The creditors of an enterprise are mainly banks and trading partners (i.e. suppliers and customers), so two types of debt contracts exist: bank credit contracts and trade credit contracts.

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Previous studies focus on the effect of accounting conservatism on bank credit (Zhang, 2008; Rao and Jiang, 2011; Zhu, 2011; Cheng and Liu, 2013), with less attention being paid to trade credit (Hui et al., 2012). However, trade credit is widely used in both developed and developing countries. In the UK, for example, trade credit accounts for 70% of short-term debt and 55% of credit loans (Kohler et al., 2000). Rajan and Zingales (1995) show that on average, trade credit accounted for 17.8% of the total assets of American companies in 1991, and for over 25% of those of their German, Italian and French counterparts. Although China's financial system is not sound, trade credit plays a decisive role in its national economy.

Focusing on accounting conservatism and changes in monetary policy, we investigate how these two elements affect trade credit and discuss the different effects of accounting conservatism on trade credit for trading parties with different backgrounds.

Specifically, we aim to answer the following questions. First, do accounting conservatism policies affect trade credit financing? The literature on trade credit is currently based mainly on the theories of alternative financing and market power. From the perspective of demand, the theory of alternative financing holds that credit rationing prevents some companies from obtaining sufficient bank lending. They therefore turn to trade credit financing, despite having to bear the higher costs of trade credit (Petersen and Rajan, 1997; Biais and Gollier, 1997). From the supply perspective, market power theory considers that due to market power, suppliers (customers) will take the initiative to provide a large amount of low-cost trade credit to a company to promote sales (supplies) (Summers and Wilson, 1999; Fisman and Raturi, 2004; Van Horen, 2005). Regardless of what theory applies, a company seeking trade credit needs to sign a debt contract with a supplier or a customer. Hui et al. (2012) argue that as accounting conservatism can recognize losses in a timely fashion, it can protect the interests of customers and suppliers when signing contracts and reduce potential losses from such transactions. We therefore examine whether companies with higher accounting conservatism obtain more trade credit.

Second, how does accounting conservatism influence trade credit when monetary policy changes? In a period of tight monetary policy, the problem of credit discrimination, or credit rationing, becomes worse and it becomes harder for companies to obtain bank loans. Meanwhile, suppliers or customers become more cautious about providing trade credit because of increasing uncertainty in the economic environment. We therefore investigate whether accounting conservatism has a greater effect on obtaining trade credit when the demand for trade credit increases and the supply reduces. Third, does accounting conservatism have different effects on trade credit for trading parties with different backgrounds? Previous studies find that enterprises with different levels of market power and different types of ownership obtain trade credit differently (Lu and Yang, 2011; Zhang et al., 2012), and that the contractual relationship in transactions between related parties can affect the choice of trade credit mode (Liu et al., 2009). We therefore investigate whether the different backgrounds of companies and their suppliers or customers affect the relationship between accounting conservatism and trade credit.

To test these research questions, we use data for Chinese listed companies during 2003–2012. First, we find that companies with higher accounting conservatism obtain more trade credit. Second, accounting conservatism has a greater effect on trade credit under tight monetary policy. Third, the positive relationship between accounting conservatism and trade credit is related to the backgrounds of the supplier and the customer. The influence on this positive relationship is most marked when a company is privately owned and has greater market power, and less evident when a supplier or customer is the controlling shareholder.

The contributions of this paper are as follows. First, previous research on trade credit focuses on the motives for trade credit, but we explore the operational mechanism of accounting conservatism, a factor in obtaining trade credit, from the perspective of debt contracting. Second, with respect to monetary policy, we investigate the effect of accounting conservatism on trade credit under different monetary policies, which enriches the literature on macro-economic policy and micro-enterprise behavior. Finally, taking the different backgrounds of the parties into account, we discuss the joint effect of corporate characteristics, associated relationships and accounting conservatism in the contracting process, which expands the research on trade credit.

The rest of this paper is structured as follows. The second section briefly outlines the previous research with respect to trade credit and accounting conservatism, and outlines our research hypotheses; the third section explains the process of sample selection and the establishment of the model; the fourth section presents the