



Does media reputation affect properties of accounts payable?

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ABSTRACT

We examine economic benefits of a firm's corporate reputation by investigating the association between its media reputation and properties of trade payables in a sample of listed UK firms. Our results document a significant positive association between a firm's overall media reputation and both the level of its trade accounts payable and the number of days of trade credit received, suggesting that a favourable media reputation affects suppliers' credit risk perception of the firm and facilitates the firm's use of trade credit as a source of finance.

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Introduction

Prior research indicates that a favourable corporate reputation is generally considered to be a valuable intangible asset, which may lead to a competitive advantage and stronger firm performance (Barney, 1991; Fombrun & Shanley, 1990; Hall, 1992). In this vein, Roberts and Dowling (2002) demonstrate that firms with a favourable corporate reputation are more likely to maintain a higher profitability level over time. Corporate reputation may affect profitability through several operating and finance mechanisms. In this paper we examine how a firm's use of trade payables is affected by its corporate reputation in a sample of listed UK firms. In the UK, more than 80% of business to business transactions are made on credit and accounts payable are an important source of short-term finance for most firms (Summers & Wilson, 2003). We argue that a firm's general media reputation may significantly affect its perceived trade credit risk, enabling a firm to enhance its working capital management and its use of trade payables as a source of finance.

Reputation thrives largely on generalized perceptions of relevant publics. Information intermediaries, such as financial analysts and public media, play a significant role in building those perceptions. In this paper, we use public media data to assess a firm's corporate reputation by integrating media coverage and the tenor of media content with regard to the firm. We analyse media content with regard to our sample firms over a five-year period. We relate

a firm's media reputation to two key properties of its trade accounts payable: the level of accounts payable and the number of days of trade credit obtained. Our results show that a firm's media reputation is positively and significantly associated with both the level and the period of trade payables. Furthermore, our results indicate that the positive association between media reputation and the level of accounts payable is stronger for smaller and less profitable firms, suggesting that the effect of a positive media reputation on a firm's reliance on supplier trade credit as a source of finance is stronger for firms that are less likely to have an established credit quality reputation. Regarding a firm's trade accounts payable period, our results indicate that the positive effect of media reputation is strengthened for less profitable firms, but not for younger and smaller firms. For older and larger firms, which are generally endowed with stronger purchasing power, a favourable media reputation may have the effect of bolstering their bargaining power towards their suppliers.

This paper contributes to the literature in several respects. First, our results add to the corporate reputation literature by corroborating the economic relevance of corporate reputation for a firm's financing policy. The positive association of a firm's overall media reputation and its key properties of trade payables indicate how a firm might benefit from its media reputation in optimizing its financing decisions. A second contribution relates to the business finance literature, by showing how a firm's overall reputation can be instrumental to its working capital management. Our results suggest that a positive media reputation may both complement and substitute credit quality evidence and allow firms to rely more on cost-effective supplier trade credit as a source of short-term finance.

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Thirdly, our research adds to the literature in which information asymmetry issues play a key role in determining how economic agents interact, such as the literature on agency relationships in finance and accounting. Our research suggests that, in the absence of relationship-specific information, higher-level reputational processes and related affective reputation signals may act as a substitute for lacking agency-specific (cognitive) evidence and effectively reduce perceived information asymmetry.

The remainder of this paper will be as follows. In the second section we present our theoretical arguments and develop our research questions. In the third section we elaborate the research design. We present and discuss results in the fourth section and conclude in the fifth section.

Literature review and theoretical development

Supplier trade credit

A firm's use of trade credit obtained from suppliers is likely to be affected by several motives and conditional factors. Prior research documents a number of determinants for a firm's use of trade credit, which can be related to two basic motives: a transaction motive and a finance motive (Nilsen, 2002).

The transaction motive emanates from synergies of combining operating and financing transactions. In the absence of trade credit, firms will have to pay for purchases upon delivery. If the timing of delivery and, thus, payment is uncertain, firms need to hold a precautionary cash reserve to pay for the goods at the time of delivery. By combining the purchasing of goods and the financing of these purchases, terms of payment become less uncertain. Firms will be able to group payments, making cash flows more predictable. Thus, the use of supplier trade credit provides firms the opportunity to reduce the volume of precautionary cash volumes by accumulating future payments and allows them to economize on cash management (Elliehausen & Wolken, 1993; Ferris, 1981; Nilsen, 2002; Schwartz, 1974).

The finance motive relates to credit market imperfections, whereby financial institutions may ration credit supply to firms. When credit rationing applies, firms are likely to use supplier trade credit as a welcome substitute for missing or expensive short-term funds from financial institutions. Consequently, supplier trade credit can be seen as the ultimate alternative for obtaining essential finance for the purchase of goods (Emery, 1984; Petersen & Rajan, 1997). The pecking order theory in corporate finance suggests that internally generated funds and institutional finance are preferred over trade finance, because of the relatively high cost of supplier trade credit (Atanasova, 2007; Myers & Majluf, 1984). Two-part credit terms are commonly used in financing business transactions. When a firm uses trade credit at the cost of a cash discount, the interest rate charged in these trade credit arrangements is often higher than the interest rate charged by financial institutions. However, because of its direct availability, the transaction cost of trade credit is generally much lower than the cost of obtaining credit from financial institutions. When borrowing from financial institutions, costs of time and effort apply and have to be taken into account each time institutional credit is arranged. In addition, firms may take a cash discount in supplier credit for granted, regardless the actual payment date, while penalties for late payment are often not enforced by suppliers. Consequently, bank debt may be actually more expensive to a firm than supplier trade credit (Elliehausen & Wolken, 1993; Giannetti, Burkart, & Ellingsen, 2011; Nilsen, 2002). Moreover, Biais and Gollier (1997) and Burkart and Ellingsen (2004) argue that supplier trade credit is more than a substitute for institutional finance. They argue that the incidence of supplier trade credit is a significant signal of trust of suppliers towards the firm and, thus, may be

instrumental to obtaining bank credit. In this regard, supplier trade credit and bank credit are seen as complements.

Whereas information asymmetry with regard to a firm's credit risk drives credit rationing by financial institutions, it also affects supplier trade credit (Smith, 1987). Information asymmetry with regard to the creditworthiness of a firm implies that suppliers face increased risk of the firm not paying for goods or services supplied. With higher information asymmetry, suppliers are likely to refrain from offering trade credit. In our research we will investigate whether a firm's overall reputation, as transpiring through the media, is associated with agency-specific information asymmetry. We expect that a positive media reputation will affect agency-specific information ambiguity and reduce a firm's credit risk as perceived by suppliers, leading to more reliance on supplier trade credit as a source of finance.

In concert with Bhole and Mahakud (2004) and Paul and Wilson (2007), we examine two properties of supplier trade credit use: the **level** of trade accounts payable (measured as trade accounts payable on total assets) and the **period** of trade credit obtained (measured as days of trade payables outstanding).

Reputation and media

Reputation is mainly about perception. A firm's reputation stands for how a firm as a whole or some of its attributes are perceived by relevant publics (Deephouse, 2000; Elsbach & Kramer, 1996; Fombrun, 1996; Fombrun & Shanley, 1990; Hall, 1992; Martins, 1998; Rindova, Williamson, Petkova, & Sever, 2005). Fombrun (1996) defines a corporate reputation as "a perceptual representation of a company's past actions and future prospects that describes the firm's overall appeal to all of its key constituents when compared with other rivals" (Fombrun, 1996, p. 72). Bromley (1993) indicates that stakeholder-specific expectations towards a firm may engender several dimensions of a corporate reputation (e.g., regarding its financial performance, workplace environment and social responsibility), which eventually add up in an overall 'net image' of a firm. According to Carroll (2004), one can distinguish three essential components of a firm's reputation: (1) name recognition, (2) a general impression of the firm, and (3) a series of (cognitive) associations. Whereas associations mainly cover cognitive content of dimensional impressions,¹ a more general impression is predominantly affective and implies an evaluation of favourability aggregating positive and negative valence components.² It leans to what is referred to in organizational studies as the "tenor" of perceptual assessments (Deephouse, 2000; Pollock & Rindova, 2003).

From an economic perspective, reputation is usually defined as observers' expectations or estimates of a particular attribute of a firm (Milgrom & Roberts, 1986; Rindova et al., 2005; Weigelt & Camerer, 1988). Since reputation is built through consistent behaviour, firms with a favourable reputation on key attributes are perceived to own capabilities that generate predictable patterns of behaviour and performance. As such, reputation serves as a rational and analytical frame for stakeholders, allowing to derive estimates of future behaviour of these firms (Bautista Delgado-García, de Quevedo-Puente, & Díez-Esteban, 2013; Fombrun, 1996; Pfarrer,

¹ The reputation literature is quite ambiguous on the cognitive dimensions used to describe reputation content. Gardberg and Fombrun (2002) line up a literature review-based attribute list which contains six reputation attributes: Overall corporate appeal, Products and services, Vision and leadership, Financial performance, Workplace environment and Social responsibility. Overall corporate appeal would correspond to the overall affective dimension, whereas credit risk (an aspect of financial performance) would constitute a cognitive dimension.

² According to Fombrun and Shanley (1990), firms with more positive and non-negative news enjoy higher rankings in Fortune Magazine's "Most Admired of the Year" special issue.

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