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Does ownership structure affect trade credit policy in small- and medium-sized firms? Evidence from China

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ABSTRACT

This paper examines whether and how ownership structure affects the trade credit policies in small- and medium-sized firms (SMEs) using a sample obtained from a survey of Chinese enterprises. Specifically, we examine how ownership concentration affects SMEs' use of trade credit through influencing the availability of bank credit. We also examine whether the ownership of the ultimate controller influences the effect of ownership structure on trade credit. The results show that there is a significant negative relation between bank credit and trade credit when most of the firms' shares are controlled by a dominant shareholder, indicating that concentrated ownership may lower firms' ability to access bank credit, and SMEs use trade credit as a substitute for unavailable bank credit. The results also show that the effect of ownership concentration on the aforementioned relation is significant in private and state-controlled SMEs but not in foreign-controlled SMEs. Overall, our results suggest that ownership structure plays an important role in determining SMEs' trade credit policies.

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¿Afecta la estructura de propiedad a la política de crédito comercial de empresas pequeñas y medianas? Evidencia de China

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RESUMEN

Este artículo analiza cómo afecta la estructura de propiedad las políticas de crédito comercial en las pequeñas y medianas empresas (PYME) por medio de una muestra que se ha obtenido de una encuesta a empresas chinas. Específicamente se examina cómo la concentración de la propiedad afecta al uso del crédito comercial de las PYME al influir en la disponibilidad del crédito bancario. Asimismo, se estudia si la propiedad del controlador último influye en el efecto de la estructura de la propiedad en el crédito comercial. Los resultados revelan que existe una relación negativa significativa entre el crédito bancario y el crédito comercial cuando la mayoría de las acciones de la empresa son controladas por un accionista mayoritario, lo que indica que la propiedad concentrada podría reducir la capacidad de las empresas para acceder a créditos bancarios, y que las PYME utilizan el crédito comercial como sustituto del crédito bancario no disponible. Asimismo, se observa que el efecto de la concentración de la propiedad en esta relación es relevante en las PYME privadas y estatales, pero no en las PYME de control externo. En conjunto, los resultados sugieren que la estructura de propiedad desempeña un papel importante para determinar las políticas de crédito comercial de las PYME.

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1. Introduction

Trade credit is an important external financing source for firms of all sizes (Demirgüç-Kunt & Vojislav, 2001), which is also

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considered a substitute for unavailable bank credit especially during periods of monetary tightening or financial crisis (Choi & Kim, 2005; Love, Preve, & Sarria-Allende, 2007; Nilsen, 2002). For a long period of time, however, a puzzling question has remained unanswered: why do suppliers provide credit to customers when banks do not? The common explanation is that suppliers have a monitoring advantage over banks. In business, suppliers can obtain information about their customers automatically or at a low cost for long-term buyer/seller relationships, but banks can only obtain it at a higher cost (Burkart & Ellingsen, 2004). The higher monitoring cost results in banks having less incentive to lend to small or newly established firms.

However, if this explanation is correct, as Burkart and Ellingsen (2004) argued, why do suppliers regularly lend input but not cash directly to their customers? The main reason is that it is easy to divert cash but not input (Burkart & Ellingsen, 2004; Giannetti, Burkart, & Ellingsen, 2011). Since information is asymmetric between lenders and borrowers, bankers do not know whether the cash would be used as pre-commitment when they lend cash directly to borrowers. In other words, bankers face potential moral hazard in lending, which results in that they have less incentive to lend to firms with severe agency problems. However, the potential losses caused by moral hazard are not as large for suppliers as for banks for the difficulty in diverting input. Therefore, even if there is no significant difference in information about borrowers and thereby in monitoring cost between suppliers and banks, suppliers still have more incentive than banks to extend credit to their customers because their potential losses are lower.

In this paper, we shed light on the influence of agency conflict between banks and borrowers on firms' trade credit policies. Particularly, we explore how the agency conflict induced by ownership structure affects firms' trade credit policies through influencing the availability of bank credit. Firms in which the dominant shareholders have higher proportions of control rights have greater possibilities of undertaking moral hazard activities (Lin, Ma, Malatesta, & Xuan, 2011), which increases the credit risk faced by banks and in turn lowers the borrowers' ability to borrow from banks. However, the cost of potential moral hazard is different for banks and suppliers. Suppliers lend input but not cash directly, which reduces the possibility of borrowers misusing cash. Moreover, once borrowers go bankrupt, suppliers also can extract more salvage value than banks due to their liquidation advantage (Burkart & Ellingsen, 2004; Fabbri & Menichini, 2010; Giannetti et al., 2011). Therefore, lending to firms whose largest owner controls most of the shares is riskier for banks than for suppliers.

From the side of borrowers, given the non-financial motivation, anticipating the difficulty of obtaining financing from banks, firms in which the dominant shareholders have higher proportions of control rights have to rely more on trade credit in their financing strategies than those in which the dominant shareholders have lower proportions of control rights. In this case, higher trade credit is a suboptimal financing strategy for firms in which the largest owner controls most of shares due to unavailable bank credit. However, once they have opportunity to obtain bank credit, these firms will rearrange their trade credit policies and reduce the use of trade credit. But for firms with lower owners' control right proportion, obtaining bank credit should not affect the use of trade credit because their trade credit policies are independent of their financial positions.

Using data from a survey of enterprise in China, we first compare the account payable percentage (as a proxy of trade credit) between firms with higher and lower ownership concentration. We find that there is a significant difference of the account payable percentage in firms with higher ownership concentration, but no special difference in firms with lower ownership concentration. The regression results also show that bank credit has no effect on the account payable percentage when the ownership is relatively dispersed, but has a strong effect when the ownership concentration is relatively high and the effect becomes stronger as the ownership concentration increases. This result is robust after controlling for potential endogeneity, implicating that firms with higher ownership concentration have fewer possibilities to obtain bank credit, and thus rely more on trade credit in their financing strategies.

We also explore what role the ownership of the ultimate controller plays in determining SMEs' trade credit policies. Previous studies have found that the ownership of the ultimate controller has an important influence on firms' governance and thereby on financial decisions. In this paper, we examine how ownership of the ultimate controller affects the aforementioned relation. We find that, in firms with higher ownership concentration, the account payable percentage of privately controlled firms decreases significantly when bank credit is available, but keeps unchanged in state- and foreign- controlled firms when bank credit is available. This result can be partly attributable to the difference in governance. It implicates that the better governance can increase the firms' probability of accessing bank credit and result in the independence of its trade credit policy.

Our study contributes to the related literature in two dimensions. Firstly, we explain the use of trade credit from the aspect of agency conflict. To the best of our knowledge, very few existing studies have attempted to explain trade credit from this perspective, with the exception of Bastos and Pindado (2007).[1] Our study provides the empirical evidence that the agency conflict induced by ownership structure affects firms' ability of borrowing from banks, which is an important reason for firms' use of trade credit as a substitute for unavailable bank credit. Secondly, unlike previous studies in which most of the sample firms are listed companies, our study focus on the trade credit policy in SMEs. The ownership structure and financial policy in SMEs are different from those in listed companies. In SMEs, a few large owners always control most of the shares with very little monitoring by others, which may result in a more severe agency problem and thus a lower probability to access bank credit. On the other sides, the financing sources of SMEs, however, are relatively simple, which can help us to control other financing sources and explain the relationship between trade credit and bank credit well.

The rest of the paper is organised as follows. Section 2 reviews the related literature, Section 3 presents the methodology and describes the data, Section 4 analyses the results and Section 5 is the conclusion.

2. Related literature review

In this section, we review the related studies on trade credit. Generally, the existing explanations of trade credit fall into two categories: explanations from the financial aspect and from the non-financial aspect. The financial explanation considers trade credit as a substitution financing strategy when traditional financing is unavailable (e.g. Burkart & Ellingsen, 2004; Garcia-Appendini & Montoriol-Garriga, 2013; Petersen & Rajan, 1994; Petersen & Rajan, 1997). The main reason why suppliers provide credit to customers when banks do not is that suppliers have a monitoring advantage over banks (Burkart & Ellingsen, 2004; Feenstra, Li, & Yu, 2014; Jain, 2001). This advantage arises due to the specialisation of suppliers, that is, suppliers are mostly engaged in the same transaction as the borrowers (Jain, 2001). Therefore, suppliers can more easily obtain information about their customers than banks

[1] Bastos and Pindado (2007) made similar research, in which they developed an agency model based on adverse selection and moral hazard to explain the trade credit policy, but did not explain the relation between bank credit and trade credit.

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