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Trade Credit and Cost Stickiness Focusing on the Agency Problem and Customer Concentration[1]

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Research Paper

Introduction

The importance of costs stems from their role in the profitability of companies, which is the main goal of organizations, and also their influence on the decision-making of internal and external users of the financial information. The traditional pattern of cost behavior considers a symmetrical relationship between changes in firm activity and costs. However, studies in recent years show asymmetric cost behavior about the changes in sales levels, meaning that the rate of increase in costs relative to the increase in the level of activity and sales is more than the rate of cost reduction when the level of activity and sales decrease, which is called cost stickiness. Understanding cost behavior in the case of changes in sales and examining the factors which affect asymmetric cost behavior lead to a greater awareness of managers' motivations and decisions. The main purpose of this study is to investigate the relationship between trade credit and corporate cost stickiness as well as the moderating effect of agency problems and customer concentration on the relationship.

Materials and methods

The sample of this paper includes 161 companies listed on the Tehran Stock Exchange in a period of 7 years from 2014 to 2020. In this study, we have used the developed model of Banker et al. (2014) to determine the presence of cost stickiness. The basis of this model is the same model of Anderson (2003), with the difference that Bunker et al. (2014) also consider resource adjustment decisions in terms of increasing sales as management authority. In the traditional model of cost stickiness, the managerial authority has been considered only in terms of sales reduction. It assumes the increasing costs in terms of increasing sales happen mechanically; that is, it ignores management authority in decisions to increase resources. Following Anderson et al. (2003), the main variables of the cost stickiness model are sales revenue and sales, general, and administrative expenses (SG&A) deflated by the inflation rate calculated

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by the central bank in addition, in the second and third hypotheses, the moderating effect of agency problems and customer concentration on the relationship between trade credit and corporate cost stickiness are investigated. Therefore, we divide our sample into two categories with high and low agency problems and high and low customer concentration (based on the median of the total sample), and the models for each subgroup are estimated. Following Gao et al. (2018) and Chavocharia et al. (2012), we use the acquisition ratio as a proxy for agency problems. In addition, according to Costa and Habib (2020) research, the customer concentration proxy has been calculated based on the company's major customers.

Results and Discussion

Our results show that trade credit as an external governance mechanism has a negative relation with cost stickiness. In addition, the findings show that the agency problem strengthens the relationship between trade credit and corporate cost stickiness, however, customer concentration weakens that relationship. It means that firms with high agency problems engage more in overspending on operational costs, such as SG&A. Therefore, managers' empire-building tendencies lead to cost stickiness, and this positive relation is weaker under strong corporate governance, implying that corporate governance can mitigate the agency problem, and results in lower cost stickiness. In addition, we show that in companies with less customer concentration, cost stickiness is lower due to the reduced likelihood of customer bargaining which means the suppliers' monitoring role will be more prominent.

Conclusion

From a cost management angle, we confirm trade credit's monitoring role. So, our findings contribute to both the trade credit and the cost management literature. In addition to showing that companies using high levels of trade credit display less cost stickiness, we further document that this behavior is desirable because it restraints opportunistic managers. Besides, we contribute to agency problem and customer concentration literature by documenting that the trade credit and cost behavior relationship varies conditional on the characteristics of the managers in the firms, as well as on the suppliers' incentives for monitoring the cost management approaches of their buyers. The presence of trade credit is likely to assure shareholders and other stakeholders, regarding the operational efficiency of companies, particularly when the external governance system is weak.

Keyword: Trade Credit, Cost Stickiness, Agency Problem, Customer Concentration.

JEL Classification: M41, F18.