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Accounts Receivable and Accounts Payable in Large Finnish Firms' Balance Sheets: What determines their levels?

It is commonly acknowledged that accounts receivable may form a substantial fraction of a firm's assets, and accounts payable may be an important source of outside funding. The importance of trade credit varies by country, and it is likely to be highest in industrial countries, although there is substantial variation across them. There is also substantial variation across industries. For Finnish manufacturing firms accounts receivable are on average 9.7 % and accounts payable 6.1 % of total assets. For wholesale firms the numbers are as high as 24.1Ê% and 23 %, respectively. Several theoretical studies attempt to explain why suppliers provide financial intermediary services to their clients, and why these are willing to use trade credit instead of, e.g., bank debt even if trade credit is well known to be a more expensive source of funds. However, firm level empirical evidence is scarce and it is all on U.S. data. This study is the first one to test the available theories using data on Finnish listed firms.

The most commonly cited theories on trade credit usage are listed below. Transaction costs have been stated to be one reason to maintain credit sales. It has been argued that firms use trade credit because it allows more flexibility in payments and makes it possible to cumulate the payments of several successive shipments to be paid at once thus leading to savings of transaction costs. It has also been suggested that trade credit is useful when there are seasonalities in the consumption pattern of the selling firm's products. Financial models on trade credit use suggest that firms with better access to the institutionalized capital market and with a lower cost of financing will offer trade credit to firms with high borrowing costs. It may also be argued that trade credit can serve to mitigate credit rationing while trade credit provides a signal on the buyer's good quality to the financial intermediary. Trade credit may also serve as a means of price discrimination when law prohibits companies from directly using different prices for different customers. This is possible when credit terms contain an early payment discount. Trade credit can be considered an implicit guarantee for the seller's products. The idea is that the buyer is given time to become convinced on the quality of the product before he pays for it. Some studies discuss the effect of changing macroeconomic conditions on the use and terms of trade credit. When loan supply is constrained, larger firms with easier access to institutionalized capital markets can extend trade credit to smaller firms. Under those circumstances it can be expected that smaller firms are willing to extend the term of the offered trade credit because rising interest rates make trade credit a more competitive form of short-term financing. The data sample consists of financial accounting data on firms that were listed on the Helsinki Stock Exchange either in the main list or in the OTC list during the research period 1989-1997. The entire sample size is 1018 observations from 121 firms. The firms in our sample have in general more accounts payable than accounts receivable. The medians for the whole sample are 13.3 % and 6 %, respectively.

The empirical results show that accounts receivable are strongly affected by the firms' incentive to use trade credit as a means of price discrimination. Market cost of capital also has an effect on their level. The latter result may be largely explained by an increasing demand of trade credit when market interest rates rise. Furthermore, we find that general macroeconomic conditions have an impact on corporate trade credit policies. It seems that our sample firms were less willing to extend trade credit during economic depressions.

The results show that the most important variables behind accounts payable policies are the supply of trade credit, firm size, level of interest rates, asset maturity, and internal (insufficient) financing. We find that the supply of trade credit enhances the level of its use. The results also suggest that the larger the firm is the more it is likely to use accounts payable as a financing tool. The relative share of current assets in the balance sheet is also a significant determinant of the level of accounts payable used. Finally, the results suggest that the most liquid and the least liquid firms use more accounts payable than the average firm does.