

The Trade Credit in the Spanish Agro-food Industry

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1. Introduction

Trade credit arises in commercial operations when goods or services are not paid immediately on delivery but the payment is deferred for a certain period. This behaviour alters the working capital needed to finance the production process and in turn has effects on the individual decision making of firms. Its generalized use can affect the relationships between firms and may diminish the profitability of creditor companies. What is more, trade credit operates out of the bank system and thus works without transparency on conditions and habitual practices and without control of the monetary authority. This entails a risk since it can modify monetary aggregates and the mechanism of transmission of monetary policy.

A first approach of its importance in the Spanish economy can be obtained from the Central Balance Sheet Data of Banco de España (BDE, 2006). It shows that this source of finance reaches, on average, 14.5 percent of total assets, 34.6 percent of total debts and 42.8 percent short-term debts. Trade credit is a more extended practice in the countries of South Europe. However, probably everywhere it is a structural phenomenon that persists through time. It causes somewhat puzzlement since it does not seem logic that suppliers were the most important short-term financing channel, taking into account that these firms operate within developed economies with

Abstract

Selling on credit is rather frequent in Mediterranean countries. Its generalized use can lead to excessive enlargements of the payment periods and can consequently deteriorate the profitability of firms. Despite the relevance of this problem, empirical research works are just a few. This work intends to fill this gap and to shed light on the factors related to the extension of trade credit. In the theoretical and empirical literature, different motives have been proposed to explain this issue: a mechanism to reduce transaction costs, a financial alternative to the bank system and an additional tool to improve commercial activities. To contrast these ideas a panel of 388 firms of the Spanish agrofood industry has been taken, and static and dynamic regression models have been estimated by using robust methods to heteroskedasticity, autocorrelation and endogeneity of the explanatory variables. The results confirm that trade credit receivable is associated with more active firms and with cheaper bank financing. Other factors with positive relationships are short-term bank debts and accounts payable. These findings are consistent with commercial motives, rather than a pure financial view, in the sense that financial distressed producers extend trade credit as a way of promoting their products and in turn increasing their sales.

Keywords: delayed payments, firm behaviour, credit.

Résumé

Le crédit commercial est assez fréquent dans les pays méditerranéens. Son utilisation généralisée peut mener à un allongement excessif des délais de paiement et par conséquent, détériorer la rentabilité des entreprises. Malgré l'importance de cette pratique, le nombre d'études consacrées à ce sujet reste encore limité. L'objectif du présent travail est d'essayer de combler cette lacune et d'identifier les facteurs liés au recours au crédit commercial. Dans la littérature théorique et empirique, différentes hypothèses ont été avancées pour expliquer un tel phénomène: un mécanisme pour réduire les coûts de transaction, un financement alternatif au système bancaire et un outil supplémentaire d'amélioration des activités commerciales.

Pour contrecarrer ces idées, un panel de 388 entreprises de l'industrie agroalimentaire espagnole a été mis en place et des modèles de régression statiques et dynamiques ont été estimés en appliquant des méthodes robustes à l'hétéroscédasticité, à l'autocorrélation et à l'endogénéité des variables explicatives. Les résultats confirment que les délais clients sont associés à des entreprises plus actives et avec un financement bancaire plus avantageux. D'autres facteurs de relations positives sont les dettes bancaires à court terme et les encours. Ces résultats s'expliquent par des raisons commerciales plutôt que par une vision purement financière, dans la mesure où les producteurs en difficultés financières prolongent le crédit commercial afin de promouvoir leurs produits et augmenter leurs ventes.

Mot Clés: délais de paiements, comportement d'entreprise, crédit.

powerful financial systems. In the last years Administration has been aware of the problem that trade credit may cause and it is trying to stop the excessive enlargement of payment periods and to avoid the deterioration of small and medium firms' profitability. It was made concrete in the Directive 2000/35/EC of the European Parliament and of the Council that establishes measures to fight late payments in commercial transactions. Indeed, the situation is worrying in some industries, i.e. the Spanish agro-food industry has collection periods from customers of almost three months on average in 2005, reaching four months in drinks producing firms, as can be seen in Table 3.

Different arguments have been posed to explain the use of trade credit: operational motives, since it is mainly seen as a mechanism to reduce transaction cost; financial motives, an alternative channel to the bank system, that is, companies with easy access to external sources use trade credit to finance promising firms with worse ability to obtain funds; and commercial motives, where trade credit is interpreted as an additional tool to promote sales, widen

markets and gain competitiveness. Most of the empirical works support financial motivations. However, the Spanish agrofood industry mainly has small and medium firms, lots of them with costly and scarce source of financing. In this context, the practice of selling on credit and enlarging collection periods is not completely understood by financial arguments. On the contrary, commercial motives would seem a more appropriate explanation for financially constrained firms selling on credit and allowing delayed payment, as it is observed in the Spanish

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food industry. The aim of this work is to study the recent evolution of trade credit granted in a sample of agrofood companies and to identify the financial and productive characteristics of the firms that extend more credit. More specifically, this work attempts to deepen into the motives behind the trade credit that agrofood suppliers offer.

To achieve this, information from mercantile official registers was taken. A panel data was constructed for 388 firms and 8 consecutive years, 1998-2005. Different regression models have been estimated through generalized method of moments, GMM, which is more appropriate in situations with heteroskedasticity, autocorrelation and endogeneity of the regressors. The results indicate that the level of activity of the firm, debt cost, size and short-term liabilities are the factors most related with the extension of trade credit. The remaining of this work is structured as follows: a brief summary of theories and empirics on trade credit, the empirical model and the sample used are presented in section 2, then the estimations are shown in section 3 and discussed in section 4. Finally, section 5 is devoted to conclusions.

2. Methodology and data

2.1. Theoretical and empirical background

The use of trade credit can be explained through numerous arguments and theories. Perhaps the more intuitive group of ideas would be operational motives. That is, the practice of trade credit lessens transaction costs, given that delayed payments permit to accumulate invoices, and thereby they diminish the number of payments and make easier and cheaper the cash management (Schwartz, 1974). Furthermore, longer-term cooperation agreements between sellers and buyers can optimize the flows of goods and cash (Ferris, 1981). Even other costs derived from an irregular demand (such as customer queues or large inventories) can be reduced by improving (constraining) the trade credit conditions in situations of deficit (excess) in demand (Emery, 1984). Both buyer's and seller's wealth may increase by using trade credit because both save costs.

In spite of the fact that these operational motives probably induce an important amount of trade credit, we consider (following Schwartz, 1974) that they do not say too much about the variations between firms and industries, neither can they explain the trend to enlarge collection periods, as can be observed in Table 3 for the sample. As a consequence, other proposals should be explored to identify some patterns in the extension of trade credit.

2.1.1. Financial motives

The basic idea is that there is a transmission of credit from healthy firms with availability of funds and easy access to capital markets to financially constrained firms with difficulties to borrow money from the bank system. Despite the main activity of suppliers is not financial, they may exhibit better capacities than financial institutions derived from advantages in information acquisition, in controlling buyers and in recovering the goods supplied, as explained by Petersen and Rajan (1997). First, sellers have more information than financial institutions to know the creditworthiness of the buyers as they operate within a common industry. This implies that sellers can recognize more easily potential problems of risk default and reduce losses from customers (Smith, 1987). Second, sellers have the possibility of stopping new supplies of goods, and this can be used to enforce buyers to meet their payment obligations (Petersen and Rajan, 1997; Cuñat, 2007). Third,

suppliers could take the goods and resell them in case the buyer fails the payment of the purchase (Emery, 1984; Mian and Smith, 1992). Since financial institutions do not have to do with production activities, sellers can do these operations in better conditions.

Another financial argument shows how taxes motivate trade credit. According to Brick and Fung (1984), the direction of the trade credit flow depends on the different marginal tax rates between buyers and sellers. For example, a customer will prefer to buy on credit, for cash if its tax rate is lower (higher) than that of the seller. As a consequence, sellers with high tax rates are more likely to extend credit. Furthermore, the motives for giving and receiving trade credit are mutually excluding.

Financial motives have been tested in empirical works by using different measures that approximate the availability to obtain funds. The cost of external financing of the firm is the most direct alternative of quantifying its access to financial markets. That is, lower debt costs imply better conditions and might lead to provide more credit to clients. This negative relationship is supported by several empirical studies, such as Hernandez de Cos and Hernando (1999) on Spanish companies, Rodríguez-Rodríguez (2006) on Canary Island firms, and Marotta (2005) on Italian firms, among others.

Size and age can be seen as expressions of quality and reputation of the company, which could also mean a better access to capital markets. Therefore, they can be thought as appropriate proxies for credit worthiness of a firm. A positive relationship between size and accounts receivable is found by Petersen and Rajan (1997) on U.S. firms, by Hernandez de Cos and Hernando (1999) and Delannay and Weill (2004) on firms from several Eastern European Countries. On the other hand, a positive effect of the age of the firm on trade credit given is observed in the works by Petersen and Rajan (1997) and Rodríguez-Rodríguez (2006). Other explanatory variables used to test financial motives are the ratio of equity to total assets (Delannay and Weill, 2004) or the return on assets ratio (Marotta, 2005), as measures of internal funds availability with influence on trade operations. Rodríguez-Rodríguez (2006) uses the operating result on turnover ratio to test financial motives arguing that the more profitable a firm the more likely it is to access institutional finance.

However, financial motives do not give a satisfactory explanation of why small sellers offer, or why large buyers take trade credit (Smith, 1987). This is also the principal objection for financial motives to be a credible explanation for productive agrofood firms. If this industry were made up of large companies that sell their goods to small commercial distribution firms, this scheme of transmission of credit from healthy to constrained firms would be, a priori, assumable. As it is well-known, the situation seems to be the contrary, that is, many small and medium suppliers providing goods to large distribution companies, and being trade credit a habitual practice that steadily grows. The main idea behind next sections is that there are other motives rather than financial inducing the prolific use of trade credit.

2.1.2. Commercial motives

They defend the role of trade credit as a way of stimulating the purchases of sellers. Nadiri (1969) was the first who considered trade credit as a selling expense. Like advertising, it affects the position of the firm and provides return over time. As another selling expenditure it can be optimally determined in the context of the neoclassi-

cal theory of the firm. Sellers can make an improved offer, product plus credit, and in the long-run, they will try to establish a dependent and lasting relationship with buyers in search of maximizing expected profits (Wilner, 2000).

Price discrimination toward financially constrained buyers is another view linked to commercial motives (Brennan et al., 1988; Petersen and Rajan, 1997). Potential buyers with difficulties to obtain credit of the banking system constitute new opportunities. Giving easier terms of payment to this segment through trade credit, seller's market can be extended.

Other authors, Smith (1987), Long et al. (1993), argue that when a supplier offers delayed payments he adds the possibility of verifying the quality of its products. Trade credit has a promotional or commercial motivation in the sense that the buyer pays once the quality of goods is known. By selling on credit, small, new or not well-established companies can enhance competitiveness in relation to similar suppliers. Another suggestion of this idea is that postponed payments are expected when a reputable buyer does not know too much on the performance of the seller, so the delayed period is used to check it.

And associated with this, the frequent observation that large companies pay late or take unearned discounts could be interpreted as a quasi-rent on the buyer's reputational capital, (Smith, 1987) but also as a demonstration of market power. Wilner (2000) also enquires why firms without financial problems take trade credit. He analyzes the effect of bilateral relationships and posits that they can be damaging if one firm depends on the other. More explicitly Van Horen (2004) suggests that a supplier dealing with large clients is more likely to permit delayed payments in order to avoid its change to another supplier. Rather than a voluntary offer, she contemplates the possibility that it was the customer who forces the supplier to sell on credit under the threat of not buying and looking for other suppliers. She formulates the "reputation" hypothesis as "firms that lack a solid reputation will provide trade credit to customers with large bargaining power compared to firms with a good reputation".

All these arguments appear as more credible within the Spanish agrofood industry but what should we empirically observe if they were true? First, the profit maximization model of Nadiri (1969) postulates trade credit is positively related to the level of sales and inversely to its opportunity cost. Second, firms with high gross profit margin would be more inclined to follow price discrimination policies as they have more incentives to sell and to finance an additional unit (Petersen and Rajan, 1997). Third, quality and reputation issues hypothesize, (Long et al., 1993) that (1) extending credit small and young firms exhibit quality and acquire prestige so they are expected to sell more goods on credit than large suppliers that usually have a well-established reputation; and, (2) high-quality suppliers could discourage low-quality firms by rising the cost of trade credit, so short-term debts and accounts payable should be positively related to accounts receivable.

2.2. Empirical model

In order to test and explore the patterns behind the extension of trade credit in the sample, a panel data econometric model is specified:

$$y_{it} = \sum_j \beta_j x_{jit} + \mu_i + v_{it} \quad \forall i, t \quad (1)$$

with i ($i = 1 \dots I$) denoting individuals, t ($t = 1 \dots T$) time and j ($j = 1 \dots J$) exploratory variables, and being y_{it} and x_{jit} values of the variables, β_j coefficients to be estimated, μ_i the unobserved time-invariant individual effects and v_{it} the error term with the usual assumptions. Individual-invariant time effects Totaln be modelled by adding a λ_i term.

Table 1 - *Expected sign of the Regressors.*

	Motive Financial	Commercial
Total asset turnover	+	+
Debt cost	-	-
Return on assets	+	
Profit margin		+
Size	+	-
Accounts payable	-	+
Short-term bank debt	-	+

Total asset turnover=sales/total asset
Debt cost=financial expenditures/(long and short run debts less commercial creditors).
Return on assets=operating profit/total assets
Profit margin=operating profit/sales
Size=total assets/total assets (industry average)
Accounts payable =accounts payable/total assets
Short-term bank debt=(short run debts less commercial creditors)/total assets.

The dependent variable used in this analysis is the proportion of accounts receivable to total assets. From the empirical revision of section 2.1 some explanatory variables were selected, according to our sample. Their expected signs are shown in Table 1. Both perspectives, financial and commercial, predict a positive sign for the ratio of sales to total asset as an expression of the level of activity of the firm, and a negative one for the cost of external financing. The price discrimination view, within commercial motives, indicates positive signs for return on assets or profit margin ratios. Different signs are expected for the size of the firm and for the accounts payable and short-term bank debt ratios under the different trade credit theories, which might boost the empirical knowledge on the determinants of the extension of trade credit in the sample.

Equation (1) can be estimated by different procedures, depending on the assumptions. Fixed and random effects models have been widely used, but a less restrictive estimation is possible by means of instrumental variables and the generalized method of moments, GMM. It is a more robust alternative that allows to cope with potential heteroskedasticity and autocorrelation of the error term and also endogeneity of the regressors. Given the difficulty in obtaining other variables correlated with the original ones but not with the error term, it raises the possibility of using these same variables but lagged as instruments. Time effects are modelled through dummy variables and firm effects, given their large number, are eliminated by estimating the equation (1) in first differences. An alternative to first differences is the orthogonal deviations transformation, which removes individual effects but does not introduce serial correlation (Arellano and Bover, 1995). In this case, each observation is obtained as a deviation to a weighted mean of future values, that is:

$$y_{it}^* = \sum_j \beta_j x_{jit}^* + v_{it}^* \quad \forall i, t \quad (2)$$

$$x_{jit}^* = \sqrt{\frac{T-t}{T-t-1}} \left(x_{jit} - \frac{x_{j,t-1} + \dots + x_{j1T}}{T-t} \right)$$

Arellano and Bond (1991) propose the utilization of GMM and the orthogonality conditions between the residuals of the transformed equations and the lagged values of the original explicative variables. The estimation by GMM is carried out in two stages, using the second one a weighted matrix constructed with the residuals obtained in the first stage. The procedure followed in this work consists in regressing jointly the system of equations in orthogonal deviations (2) and levels (1). It was proposed by Arellano and Bover (1995) and Blundell and Bond (1998) in order to reduce the weakness of instruments. It is necessary to test lack of second order autocorrelation because the GMM estimator is based on $E(\Delta v_{it} \Delta v_{i,t-2}) = 0$. In addition, a Sargan test of overidentifying is used to validate the orthogonality restrictions.

A dynamic model is also specified in order to capture the effects of the variables over time. It is a way of considering that the changes of the variables do not affect instantaneously but they have a period of adjustment.

$$y_{it} = \alpha y_{i,t-1} + \sum_j \beta_j x_{jit} + \mu_i + v_{it} \quad \forall i, t \quad (3)$$

If the time dimension of the data set is short, the estimation by fixed or random effects is inconsistent due to the fact that the lagged dependent variable is correlated with the error term. An efficient and non-biased option is the previously-mentioned GMM estimator (Arellano and Bover, 1995; Blundell and Bond, 1998).

2.3. Data

The sources of this work are the provincial mercantile registers, to whose information we have accessed through the SABI data base (<http://www.informa.es/>). The selection includes companies of food and beverage industry (code 15 following CNAE-93 classification from INE, National Statistics Institute of Spain), with information on customers' accounts over the period 1998-2005. This variable has been the bounding factor as a lot of firms present abbreviated balance sheets and customers' account appears aggregated with other receivables. After removing outliers, a panel sample of 388 firms was obtained with data of 8 consecutive years.

Table 2 classifies several accounting ratios of the firms of the sample according to the percentiles of the customer accounts receivable to total assets ratio, in order to accomplish a first approach to the factors associated with the extension of trade credit. The average proportion of trade credit extended to customers is 29% on total assets (row number 1), meanwhile the trade credit payable to suppliers is 21% (row 2). A creditor position is the most usual, being the net trade credit (extended less payable 8%) over total assets on average (row 3). All three digit industries have also a creditor position (not shown in Table 2), being median values of net trade credit in fish processing (9,0%), dairy (10,7%), meat processing (11,7%) and grain milling (18,6 %) the highest. This highlights the role of financial intermediation assumed by agrofood firms and the interest in deepening the factors associated with this behaviour.

If other variables are considered, there seems to be a positive rela-

Table 2. *Some Variables of the Sample Classified According to the Accounts Receivable*
Total Assets Ratio

	percentile average										
	average	1	2	3	4	5	6	7	8	9	10
1. Accounts receivable (%)	29	3	11	17	21	25	30	34	39	45	61
2. Accounts payable (%)	21	18	15	16	18	20	21	22	24	26	28
3. Net trade credit (%)	8	-14	-3	1	3	5	9	11	14	19	33
4. Total asset turnover (%)	149	114	97	113	123	135	152	153	166	197	245
5. Return on assets (%)	3.7	3.3	3.8	3.4	3.0	3.3	4.2	4.0	4.0	3.6	4.0
6. Profit margin (%)	3.4	3.8	6.0	4.2	3.2	2.9	3.5	3.2	3.1	2.4	2.1
7. Size (%)	100	117	159	126	114	108	95	96	65	63	56
8. Short-term bank debt (%)	23	24	22	21	21	22	23	23	25	28	25
9. Debt cost (%)	7.4	14.8	5.3	6.7	6.1	8.3	7.2	7.2	7.0	6.0	5.3
10. Current (%)	199	215	214	256	212	188	177	190	202	158	176
11. Reserves (%)	26	23	25	31	29	26	28	28	27	23	23

1. Accounts receivable/total assets
2. Accounts payable/total assets
3. (Accounts receivable - accounts payable)/total assets
4. Sales/total assets
5. Operating profit/ total assets
6. Operating profit/Sales
7. Total assets/total assets (industry average)
8. (Short run debts less commercial creditors)/total assets
9. Financial expenditures/(Long and short run debts less commercial creditors)
10. Current assets/current liabilities
11. Reserves/total assets

tionship between trade credit extended and the level of activity: the total assets turnover ratio, sales/(total assets), increases in each percentile (excluded the first), passing from 97% in percentile n. 2 to 245% in n. 10 (row 4). Thus, a first approach to the sample gives some support to the hypothesis that the extension of trade credit is used as a means of promoting sales. That is, besides a productive activity, the companies of the sample provide financial services to gain competitiveness and increase market share. A less clear positive relationship is observed between trade credit extended and operating profit to total asset ratio (row 5): the 1-5 percentiles take values lower than 4%, below the values of the remaining. However, the firms that extend more trade credit have a lower profit margin (row 6).

On the other hand, firm size (row 7) is negatively related to accounts receivable, so the smaller a supplier is the more credit it gives, in proportion to its total assets. This could mean that larger companies have some capacity to choose customers with better payment conditions, in detriment of the remaining firms that have to work with stretching payment periods. Trade credit seems to play an important role for small producers, and this would be in consonance with commercial motives, rather than with the financial ones.

Trade credit received from suppliers rises with trade credit given to customers. As can be seen in row 2, the first four percentiles show an account payable ratio lower than 20% but higher than this percentage in the followings, getting almost 30% in the last percentile. Likewise, the ratio of short-term bank debts (row 8) shows a slight positive relationship at first look. These insights seem also opposite to the financial view. Firms inclined to extend trade credit would not have many reasons to receive it or to borrow from banks. Therefore, a negative relationship would be expected according to this perspective.

The cost of bank debts (row 9) takes a very expensive value, 14,8%, for the firms of first percentile, in contrast with a cheaper financing of the ones that extend more trade credit, last percentile (5,3%); thus, a ne-

Table 3 - Days Sales Ooustanding.

	year								
	1988	1999	2000	2001	2002	2003	2004	2005	85
15. Food and drink industry	78	81	83	82	86	83	84	85	85
151 Meat processing	72	80	83	81	83	87	90	88	
152 Fish processing	82	77	79	76	78	76	76	77	
153 Fruit & vegetables	76	76	79	77	84	84	78	81	
154 Oils & fats	64	64	68	78	62	62	64	69	
155 Dairy	71	73	80	76	76	75	78	72	
156 Grain milling	79	77	81	83	80	82	77	85	
157 Animal feed	59	62	65	63	68	61	63	66	
158 Miscellaneous products	75	77	77	74	86	73	73	72	
159 Drinks	104	106	110	112	114	110	112	116	

gative link seems more plausible. The current ratio (row 10) and the reserves to assets ratio (row 11) show also a loose negative relationship with trade credit extended: starting from the third percentile they take descending values.

The days sales outstanding or average collection period for the food and drink firms of the sample (Table 3) is almost three months, rising from 78 days in 1988 to 85 in 2005. This is an increase of 7 days during the studied period, a day each year on average. To fight against delayed payment periods in commercial operations, the Spanish late payments law, the transposition of Directive 2000/35/EC, starts on December 2004. Although the time to observe its effects is short, no signal of trend change is perceived in year 2005.

At a lower level of disaggregation two industries stand out. On the one hand, animal feed presents the shortest collection period, around two months, 59 days in 1998 and 66 in 2005. On the other extreme, the drink industry reaches by far three months, 104 days in 1998 and 116 in 2005. Except for fish and miscellaneous products, the average collection period of all other subindustries registers a growth, being the largest for drinks firms with 12 days of increase. The variability of collection periods is bigger within meat and drinks industries, so that periods up to 10 or 11 months can be found in some companies.

3. Results

3.1. Univariate tests

Table 4 presents tests for mean equality in an attempt to respond to the question: are there differences between firms that extend more and less trade credit? To do this, first the firms of the sample are classified in two groups, above and below the median of the accounts receivable to total assets ratio; second parametric (ANOVA F) and nonparametric (Kruskal-Wallis) tests are performed to check if differences exist in the central tendency measures of both groups. The answer is yes: all the ratios, except reserves to assets, have statistically different values for the mean or median if firms are separated into more or less inclined to extend trade credit. For example, food and drink firms that extend more trade credit (Table 5) are smaller (49.3% of the median size against 68.8%) and they owe more to suppliers (22.4% of total assets against 14.0%) and to banks in the short run (23.6% of total assets against 19.1%).

Table 5 also provides further evidence on this question within three digit agrofood industries, taking into account the variables most associated with commercial motives such as size accounts payable and short-term bank debt ratios. Only oils & fats and dairy do not present statistically differences in these ratios. For the remaining industries, firms above the median of the accounts receivable ratio present:

Table 4. Univariate Tests For Mean Equality of Some Variables Classified According to the Accounts Receivable Ratio

	Total Assets Ratio	
	F (ANOVA)	χ^2 (KRUSKAL-WALLIS)
1. Accounts receivable (%)	5218.80**	2327.30**
2. Accounts payable (%)	231.02**	305.98**
3. Net trade credit (%)	1204.90**	1027.70**
4. Total asset turnover (%)	472.26**	530.03**
5. Return on assets (%)	8.80**	20.23**
6. Profit margin (%)	21.75**	15.06**
7. Size (%)	94.72**	105.17**
8. Short-term bank debt(%)	25.64**	35.05**
9. Debt cost (%)	3.47	44.17**
10. Current (%)	15.76**	0.19
11. Reserves (%)	0.81	0.70

Asterisks, (*), (**), indicate the null of mean or median equality is rejected at critical level of 5 % and 1%, respectively.

Tab. 5 - Medians of Size, Accounts Payable and Short-Term Bank Debt Ratios Below and Above the Median of the Accounts Receivable Ratio

	Total Assets Ratio								
	SIZE (%)			ACCOUNTS PAYABLE (%)			SHORT-TERM BANK DEBT (%)		
	below TOTAL ASSETS median	above TOTAL ASSETS median	KRUSKAL-WALLIS χ^2	below TOTAL ASSETS median	above TOTAL ASSETS median	KRUSKAL-WALLIS χ^2	below TOTAL ASSETS median	above TOTAL ASSETS median	WALLIS χ^2
15. Food and drink industry	68.8	49.3	105.17**	14.0	22.4	305.98**	19.1	23.6	35.05**
151 Meat processing	47.1	45.5	0.52	14.6	23.2	71.94**	15.5	20.0	13.81**
152 Fish processing	100.0	65.9	7.06**	17.1	22.8	17.8**	22.4	25.5	0.13
153 Fruit & vegetables	83.4	49.4	14.36**	15.5	25.7	53.60**	25.3	26.6	0.098
154 Oils & fats	80.7	72.8	0.80	18.5	19.1	0.07	46.3	45.7	0.127
155 Dairy	80.1	66.1	1.79	16.3	16.4	0.58	29.9	26.4	0.00015
156 Grain milling	33.6	38.5	0.07	15.4	21.2	1.32	25.5	32.3	9.41**
157 Animal feed	67.9	43.2	13.28**	15.1	26.1	22.32**	12.2	16.1	0.016*
158 Miscellaneous products	67.2	53.4	12.37**	13.8	21.0	78.99**	15.9	23.2	33.12**
159 Drinks	86.2	61.7	22.50**	10.1	18.0	81.29**	19.2	24.4	10.81**

Asterisks, (*), (**), indicate the null of median equality is rejected at critical level of 5 % and 1%, respectively.

- in meat processing: higher accounts payable and short-term bank debt ratios;
- in fish processing and fruit & vegetables: smaller size and higher accounts payable ratios;
- in grain milling: higher short-term bank debt ratios;
- in animal feed, miscellaneous products and drinks: smaller size, higher accounts payable and short-term bank debt ratios.

Next, a more in depth joint analysis is carried out by studying the type of relationship of these variables with accounts receivable.

3.2. Multivariate regressions

The GMM estimations, static and dynamic, are presented in Table 6. Both consider the joint system of equations in levels and orthogonal deviations. They use as instruments the same variables lagged 1 and 2 years for the equations in deviations, and orthogonal deviations lagged one period for the equations in levels. Annual and industry dummies are included in all estimation to control temporal shocks and industry specific effects but their results are not shown in the Tables.

The basic hypotheses of the estimator are fulfilled. That is, the Sar-

Tab. 6 - Gmm Estimations (Second Stage) Joint System of Equations in Levels and Orthogonal Deviations Dependent Variable: Accounts Receivable Total Assets

	STATIC		DYNAMIC	
	coefficient	t value	coefficient	t value
Accounts receivable, -1.			0.564	10.30**
Total asset turnover	0.050	3.97**	0.034	2.94**
Profit margin	-0.028	0.790		
Debt cost	-0.036	-4.05**	-0.022	-3.33**
Size	-0.011	-2.37*	-0.005	-2.02*
Accounts payable	0.238	3.50**	0.177	3.67**
Short-term bank debt	0.216	4.35**	0.118	2.48**
Statistics	value	prob	value	prob
Wald, joint.:	68.22 (χ^2_6)	0.000**	299.42 (χ^2_6)	0.000**
Wald, dummy.:	54.54 (χ^2_{16})	0.000**	11.75 (χ^2_{15})	0.698
Wald, time.:	41.88 (χ^2_8)	0.000**	3.83 (χ^2_7)	0.799
Sargan test:	118.90 (χ^2_{108})	0.222	119.70 (χ^2_{101})	0.099
AR(1) test: N(0,1)	-5.08	0.000**	-6.80	0.000**
AR(2) test: N(0,1)	-1.81	0.070	0.58	0.559

Time and three-digit industrial dummies are included Asterisks indicate significance at 5%.

(*) and 1%.

(**) level DPD package for Ox was used, Doornik et al. (2002).

garg tests do not reject the suitability of the instruments. The AR(2) tests indicate there are no serious problems with second order autocorrelation. Wald tests reject the null of joint insignificance of the regressors employed. Wald tests for time and three-digit dummies indicate they are significant for the static model but not for the dynamic one. Explanatory variables that were not significant, such as market interest rate or other financial ratios, were excluded from the final estimations. Further regressions have been undertaken (Table 7) to check the robustness of the results. In this case the dependent variable is net trade credit, accounts receivable less accounts payable to total assets ratio.

The dynamic adjustment model reduces second serial correlation of the residual as is shown by AR(2) tests. Both lagged dependent variables are positive and significant, which indicate there is not an immediate response to changes in the short run. Instead, the variations of the dependent variables to movements in the explanatory variables are slow and take time. The adjustment process for net trade credit is faster than for accounts receivable, given a lower coefficient estimated for the former. The period of adjustment is 1.29 years for accounts receivable but only 0.41 years, less than 5 months for net trade credit. This result points out that there exists a persistence of large periods of payment that should be modelled through lagged variables, otherwise wrong conclusions may be obtained.

The results confirm a clear relationship between the volume of sales, total asset turnover and the accounts receivable ratio, given positive and significant coefficients in both models. Debt cost is negative and significant. The profit ratio is not significant in both estimations (it is omitted in the dynamic model). The return on assets ratio is neither significant and its results are not shown. The size variable is negative and significant at 5% level in both estimations. The account payable and the short-term bank debt ratios are positive and significant in both estimations.

4. Discussion

The results indicate more active firms, with higher values of total asset turnover ratio, extending more trade credit. This is in consonance

Tab. 7 - mm Estimations (Second Stage) Joint System of Equations in Levels and Orthogonal Deviations Dependent Variable: Net Trade Credit/Total Assets.

	STATIC		DYNAMIC	
	coefficient	t value	coefficient	t value
Accounts receivable, -1.			0.289	2.16*
Total asset turnover	0.031	3.21**	0.018	1.54
Debt cost	-0.117	-15.00**	-0.088	5.44**
Size	-0.016	-2.21*	-0.014	-2.38*
Short-term bank debt	0.304	5.27**	0.273	5.15**
Statistics	value	prob	value	prob
Wald, joint.:	305.80 (χ^2_4)	0.000**	507.20 (χ^2_5)	0.000**
Sargan test:	80.43 (χ^2_{72})	0.232	74.05 (χ^2_{67})	0.259
AR(1) test: N(0,1)	-5.56	0.000**	-3.34	0.001**
AR(2) test: N(0,1)	-1.59	0.111	0.25	0.802

with predictions of financial and commercial theories but it does not permit to discriminate between them. Likewise, the debt cost is negative as is established by both theories. The debt cost is in fact the price of capital that suppliers use for selling on credit, so whatever the motives are its demand is downward sloped. Cheaper bank financing induce to sell more on credit or to enlarge collection periods, adding a financial activity to its own production.

The idea that more profitable firms provide more credit to their customers is not supported for the data, and the price discrimination motive vanishes, given that profit and return on assets ratios are not significant.

The size variable reveals that larger suppliers do not play as financial intermediaries providing credit to distressed customers as predicted by financial theories. On the contrary, smaller producers appear as more inclined to provide credit and to delay collection moments. Univariate tests point out this would be also correct for industries such as fish processing, fruit & vegetables, animal feed, miscellaneous products and drinks. This leads to think that the role of sales promotion might be more appropriate, since larger firms have a lesser need of selling on credit to encourage product demand than smaller ones.

The account payable ratio, positive and significant in both estimations in Table 6, indicates that there are suppliers without better financing alternatives than postponing payments. And in spite of its expensive cost and its drawbacks, they continue granting credit because they have strong commercial motivations or because they do not have other way of selling their products. Other possible interpretation could be that customers enlarge payments periods because they do not have too many incentives to pay on time to suppliers with financial difficulties. That is, the scarce bargaining power of small producers leads to an involuntary action of extending trade credit. In any case, a positive sign between receivable and payable ratios is against a financial perspective of trade credit. Within three digit industries, Table 5 shows that account payable (median) ratios range between 10.1 (drinks) and 18.5 (oils & fats) for firms below the median of accounts receivable ratio against a range between 18.0 (drinks) and 26.1 (animal feed) for firms above the median.

The positive sign of the short-term bank debt ratio also strengthens this finding, as it implies that there are a lot of firms making use of short-term bank loans to finance their sales. Table 5 supports this insight within a more disaggregate level, at least for meat processing, grain milling, animal feed, miscellaneous products and drinks: firms below the median of accounts receivable ratio present lower short-term bank debt ratios (15.5%, 25.5%, 12.2%, 15.9% and 19.2%, respectively) in com-

parison with firms above the median (20.0%, 32.3%, 16.1%, 23.2% and 24.4%).

Net trade credit regressions confirm that the creditor position of firms is clearly related to short-term bank debts and to smaller sizes, which again points to commercial theories, in the line of Nadiri (1969), Long et al. (1993), Deloof and Jegers (1996), Van Horen (2004). On the other hand, financial theories are discarded on the grounds that there is no evidence of larger or creditworthy suppliers transmitting credit to customers with difficulties.

5. Conclusions

A set of firms within the Spanish agrofood industry has been studied to investigate the motives behind the extension of trade credit. Specifically, a panel of 388 firms over the period 1998-2005 has been analyzed. In this sample, a creditor position in relation to trade credit is the most common, i.e. firms sell to customers more than they buy to their suppliers on credit. The difference between trade credit extended and received is 8% on average. The collection period was 78 days in 1998 and rose to 85 days in 2005. This is an increase of 7 days during the studied period, a day each year on average. This upward tendency does not seem to have been broken by the entrance of the late payment legislation in December 2004. It is worth to note that excessively large collection periods, almost 4 months, are detected in drinks firms. Except for fish and miscellaneous products, the average collection period of all other three digit industries registers a growth, being the largest for drinks firms with 12 days of increase.

At a first glance to the sample, it can be seen that the accounts receivable ratio is positively related to total asset turnover and accounts payable, and negatively to size and debt cost. Tests for mean equality point out differences between groups of companies with distinct customs of selling on credit. Generally speaking, agrofood firms extending to clients more trade credit are statistically smaller and more indebted in the short-run with banks and with suppliers. These insights persist, to a greater or lesser extent, if the tests are applied within three digit industries such as meat processing, fish processing, fruit & vegetables, grain milling, animal feed, miscellaneous products and drinks. Oils & fats and dairy seem to have a different behaviour in this respect.

More in-depth regression analysis with static and dynamic estimations confirms these relationships and allows to test some theories on the extension of trade credit. Commercial motives are supported by the data against financial ones. The positive sign of total asset turnover ratio and the negative one of debt cost do not help to discriminate between competing theories. However, financial theories do not seem plausible in the Spanish agrofood industry. Instead, the role of trade credit as a mechanism to promote sales and gain competitiveness is reinforced. The negative link with size and the positive one with accounts payable and short-term bank debt ratios prove the existence of firms extending trade credit that do not have the best conditions to do it. Customer receivables are financed by both types of short-term debts, providers and banks, and this means that producers have to use expensive financing in order to finish their production cycles. The causes behind this behaviour are probably the composition of the sample, small productive firms, the strong competition of the market within they operate and the market power of large customers.

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