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Earnings performance of major customers and bank loan contracting with suppliers

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Abstract

Using a sample of 3725 loan facility–years for supplier firms that have financial data on their major customers during the period 1995–2011, this study investigates whether the earnings performance of major customers has effect on the price and nonprice terms of loans to the supplier firms. We find that various contracting terms are more favorable for loans to supplier firms whose major customers have higher return on assets (ROA). More importantly, we find that the effect of major customers' earning performance on loan contracting terms is weaker for the borrowers with prior loan relationships with banks, while it is stronger for the borrowers that are highly dependent on their major customers. Our results suggest that banks take into account major customers' earnings performance when contracting with their supplier firms, and the informativeness of customer earnings varies with the nature and strength of the customer–supplier relationships.

JEL classification

G21; M41

Keywords

Earnings performance; Supply chain; Credit risk; Loan contracting

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