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Price Discrimination as a Factor that Affect Trade Credit among Manufacturing Firms of Uganda

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Abstract:- This article is an analysis of price discrimination as a factor that affect Trade credit among manufacturing firms of Uganda. The study also thought to address repayment behavior as a knowledge gap which other studies on trade credit practices from price discrimination and transaction cost theories have not addressed. This study sought to establish whether price discrimination affect trade credit practices and examine whether repayment behavior mediates this relationship among manufacturing firms of Uganda. The study took a correlational cross sectional survey approach and employed both qualitative and quantitative approaches. A sample size was 78 respondents out of a population of 31 firms with three respondents each and with data analysed using SPSS version 20. Validity and reability of the instruments were both ensured. Results from the study indicate that price discrimination representing independent variable was a positive predictor of trade credit while repayment behavior (mediator) was not a significant predictor. The limitations faced included the fact that a few respondents did not have full knowledge of what was involved and some thought they were revealing too much information about the firm. My contribution to the world is a confirmation that firms should seriously consider repayment behavior before granting trade credit to customers and that price discrimination is positively associated to trade credit.

Keywords:- *Manufacturing Firms, Trade Credit, Price Discrimination, Firm Market Power, Customer Demand, Repayment Behavior, Uganda.*

I. INTRODUCTION

Trade credit is the practice of buying goods and services without immediate payment. This is used by all business entities in both developed and developing Countries (Leire&Cowton, 2009). Many studies have examined trade credit practices from the financing (Schwartz, 1974; Salima, 2007; Altunok, 2011, Cunat, 2012, Santiago, Fenandez and Udell, 2012), price discrimination (Meltzer, 1960; Schwartz and Whitcomb, 1979; Altunok, 2011, Cunat, 2012), and transaction cost perspectives (Williamson, 1996); Ferries, 1981; Summers & Wilson, 1997; Kevin, 2013;Cunat, 2012), but non has introduced the mediating variable of repayment behavior.

➢ *Background*

Studies reveal that Trade credit is a source of financing and its key determinants include volume of transactions, price of trade credit and enhanced buyer/seller relationship, (Gofman, 2013). Scholars such as Petersen and Rajan (1997), DemirgucKunt, and Maksimovic, 2001) have observed that both small, medium and large firms use trade credit as a source of funding to finance purchases and offer financing to receivables. Horen, (2007) stated that in the business world, the volume of trade credit has been higher than short-term loans received from banks. According to Fabbri & Klapper, 2008, of the World Bank Enterprise Survey database, of 40,000 firms in 50 developing countries, about 87% extended trade credit to their customers.

Whereas trade credit supply is explained by financing, price discrimination and transaction cost theories, they do not adequately articulate trade credit as evidenced by decline in trade credit supply and demand especially in developing countries, Uganda inclusive (Araujo & Oliveira, 2009; Investor Survey Report, 2012/13).The gaps /weaknesses identified by those theories include: ignoring the impact of repayment behavior, which categories of firms may access trade credit, a wrong assumption that trade credit accessibility applies only when financial markets are imperfect and buyers have unsatisfied demand for bank institutional finance. Furthermore, the theories fail to explain what happens with markets where price discrimination cannot be applied and when supplier's competition is high. Transaction cost ignores factors that affect the level of transactions inside a firm, ignores opportunism and contextual grounding of human actions, existence of stock outs and fails to arrive at contractual arrangement.

This study looked at price discrimination as a factor that affect Trade credit and it also represents the independent variable. Trade credit represents the dependent variable and Repayment behavior as a mediating variable, (Bhatt and Shui, 2002).Therefore, combining price discrimination with repayment behavior could better explain trade credit supply.

In Uganda, existing data indicate that during 2013 only 30% of manufacturing firms supplied trade credit (Investor Survey Report, 2012/13) compared to 58.9% in 2003 as per the table below.

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	Kenya	Uganda	Tanzania
Trade Credit	83.2	58.9	62.3
Bank Loan	39.1	20.2	19.1
Bank Overdraft	66.4	23.5	30.4

Table 1:- Share of Manufacturing Firms Receiving External Finance (%)
Source: World Bank (2002/03), Investment climate Surveys.

Access to credit in Uganda is a challenge to domestic investors with 70 % of firms financing their investments through retained earnings (Investor survey report 2012/13) and only 30% offering trade credit.

- *Research Problem*

Trade credit supply in Uganda is limited by numerous challenges (Fisman & Raturi, Giannetti et al, 2008; Ng et al., 1999; Kazooba, 2006) and these include lack of adequate trade credit to develop the economy and to improve firm performance, failure to honor short term obligations when they fall due, poor debt collection practices and increased stock out costs plus liquidity problems. Reduction in trade credit use is a serious problem resulting from the increased risk of non-payment by firms as more companies get into financial difficulties, (Humphrey, 2009). Scholars such as Ferris, (1981); Salima (2007); Isaksson (2002); Fabbri & Menichini (2006); Cunningham (2007) have applied financing, price discrimination, and transaction costs to represent factors that affect trade credit. However, discussion of these factors have inherent weaknesses that limit their efforts in explaining practices channeled towards achieving better trade credit use. Besides, discussions of these factors ignore the concept of repayment behavior, which plays an important role in enabling trade credit accessibility by users. This is so, because repayment behavior is critical since the strongest appeal of most firms is high repayment rates. Supply of trade credit world-wide has been on the increase but in Uganda it's on a reducing trend and only 30% of manufacturing firms use it (investor survey report 2012/13), Okurut, Schoombee and Servaas (2004, Humphrey, 2009). Other reasons include: difficulty in getting character references, behaviors of credit users and high costs of administering it (Okurut, Schoombee and Servaas, 2004). Furthermore, existing studies (Salima, 2007, Raghuram, (2002), Mitchel (1996), Williamson (1996), Ferries, 1981, indicate that the different theories for supply of trade credit have ignored repayment behavior (Bhatt & Shui, 2002).

The conventional trade credit studies cannot adequately explain trade credit supply and demand and therefore introducing repayment behavior will provide an enriched understanding and make an original contribution to the current debate. The study will also establish the relationship between trade credit and the factors that affect it and examine whether repayment behavior mediates this relationship among manufacturing firms of Uganda.

II. THEORETICAL AND CONCEPTUAL FRAMEWORK

Price discrimination as a factor affecting trade credit among manufacturing firms in Uganda is the topic of this paper. The key terms include Manufacturing firms, trade credit, price discrimination, firm market power, customer demand, repayment behaviour and Uganda.

The theories that explain the study include financing, price discrimination and transaction costs. Price discrimination also doubles as the independent variable.

Whereas trade credit supply is explained by financing, price discrimination and transaction cost theories, they do not adequately articulate trade credit as evidenced by decline in trade credit supply and demand especially in developing countries, Uganda inclusive (Araujo & Oliveira, 2009; Investor Survey Report, 2012/13).The gaps /weaknesses identified by those theories include: ignoring the impact of repayment behavior, which categories of firms may access trade credit, a wrong assumption that trade credit accessibility applies only when financial markets are imperfect and buyers have unsatisfied demand for bank institutional finance.

The conceptual framework below shows price discrimination as a factor that affect Trade credit among manufacturing firms of Uganda. The independent variable is represented by price discrimination and its determinants include firm market power and customer demand. The dependent variable is trade credit and its determinants include Volume of transactions, Price of trade credit and Enhanced seller/buyer relationship. The mediating variable is repayment behaviour and the study looked at manufacturing firms of Uganda because they greatly contribute to the economic development of the country (Wahid, 2013).

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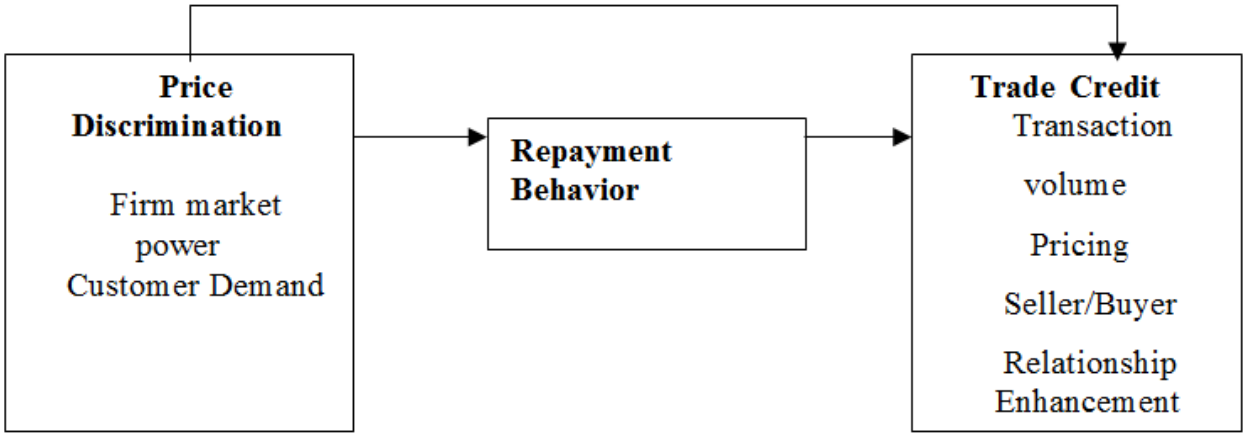

Fig 1:- Conceptual Framework

Source: Derived from Financing theory (Swartz, 1974), Price discrimination theory Mian & Smith, 1992) and Transaction cost (Ferris, 1981).

The main questions that will be answered have to answer in this research include: is there a positive relationship between price discrimination and trade credit, is there a positive relationship between firm market power and trade credit, is there a positive relationship between customer demand and trade credit and is there a mediating effect of repayment behavior between price discrimination and trade credit?

The purpose of this study was to examine whether price discrimination affect Trade credit among manufacturing firms in Uganda and develop an alternative working model that will provide an enriched understanding and explanation of Trade credit based on price discrimination and repayment behavior.

This paper is structured as follows. The first part of this paper contains the literature review that discusses price discrimination in relation to trade credit in manufacturing firms. The second part describes sampling, methodology and techniques. The third part is on findings and its discussions while the fourth part discusses conclusion and policy implications. In this research, the case study is conducted in 31 firms with 78 respondents.

III. LITERATURE

A. Price discrimination and Trade Credit

Price discrimination as a factor that affects trade credit is the practice of charging a different price for the same good or service. There is a very big relationship between price discrimination and trade credit because the more use of price discrimination means enhanced trade credit use. Price discrimination can only occur if the following conditions are met: the firm must be able to identify different market segments, such as domestic users and industrial users. Suppliers may also use discounts to price discriminate. Pike et al. (2002), argue that suppliers may offer larger cash discounts to large buyers with lower risk for the purpose of price discrimination rather than reducing risk. Moreover, the same argument applies to cases where there is a strong relationship between the supplier and the buyer or where the seller is large with significant market power. So if the supplier is large with market power and attracts creditworthy customers, the main purpose of the discounts will be price discrimination. The Price discrimination however fails to explain what happens in markets where price discrimination may not be exercised and it also ignores repayment behavior.

Firms that lack access to finance often also lack a strong reputation. In addition, lack of access to finance implies that providing trade credit is relatively expensive, so one would expect these firms to be less willing to sell goods on credit. Indeed several studies have found that the provision of trade credit and access to finance are positively correlated (see, for example, Petersen and Rajan 1997). As such, a significant and negative relationship between the percentage of goods sold on credit and an interaction between *customer power* and a firm's access to finance, is also evidence in favor of our hypothesis.

Our contribution in regard to price discrimination and trade credit is to find out using this study, what happens if price discrimination may not be exercised in different markets Secondly, to find out if price discrimination may consider repayment behavior as a mediator.

B. Firm market power and Trade credit

According to Ng et al. (1999), a supplier can extend trade credit period or offer unearned discount rate to buyers with long-term relationships The research results of Petersen & Rajan (1997) are also consistent price discrimination that firms with much market power offer more trade credit. Such firms operating with high profit margin have incentive to achieve high sales without reducing price to buyers. As a result, they offer the same credit terms to all buyers. However, Brennan et al. (1988) further explain that those buyers with access to other cheaper financing sources realize payment before discount date to obtain discount savings. The buyers without access to other sources are also likely to pay on due date to avoid expensive interest costs. Wilson & Summers (2002) state credit terms provided determine the effective price of products. Brennan et al. (1988) also discuss that extending payment period and giving discount for immediate payment

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are methods of reducing price for customers. However, Fisman & Love (2003) explain that trade credit can only be used as price discrimination in the following situations: first, the flexibility of demanding from credit customers is lower than cash customers. Low flexibility indicates constant demand therefore stable supplier and customer relationship; second, information asymmetry exists in the credit market. In the case of information inefficiency of customers about product, suppliers extend trade credit to increase sales; third, trade credit is used to compete with other competitors in the same industry. Petersen & Rajan (1997) demonstrate that firms with higher profit margin would like to grant more trade credit as they rely significantly on trade credit to achieve higher continuous sales.

Customers exert their market power in order to extract more customer surplus by reducing the risks they face with respect to product quality. In addition, they can explain the seemingly contradictory results of Banjeree, et al. (2004), who find a negative relationship between customer market power and provision of trade credit, and Wilson and Summers (2002), who find a positive relationship (Wilson and Summers (2002).

C. Customer demand and Trade Credit

Poor demand conditions are a negative signal to the suppliers with respect to the amount of trade credit. During periods of low demand, firms have to pay a larger share of their purchases in cash. An increase in promotional expenditures has about the same magnitude of effect as for firm size or demand conditions. Higher skills signal higher ability and may therefore proxy for lower risk. These results suggest that lower risk has a significantly positive association with the trade credit amount. Relatively older firms obtain more trade credit, which may be due to a build-up of trust and reputation over time, gained, for instance, by repeated interaction and the fact that they have had time to enlarge and improve their social networks with suppliers. Surprisingly, the share of tangible assets in total assets is negatively related to the amount of trade credit. The hypothesis was for tangible assets to be positively related to trade credit because such assets may be used as collateral and can be seized in the case of a breach of contract. Since an explanation for this odd result may be multicollinearity, the regression was re-run without the variable tangible assets. The status of the firm seems to be the most important determinant of trade credit amount by far (Anders, 2002).

Borrowers who are constrained by equity requirements are classified as "rationed." They have limited discretionary income and liquid assets, making sacrifices in current consumption or precautionary savings costly. Borrowers not wishing to forgo current consumption can sometimes obtain additional credit by using unsecured personal credit, but this credit is riskier and therefore more costly than other forms or credit. These borrowers' demand for credit is not sensitive to interest rates. For many borrowers, additional unsecured personal credit is available only from specialized high-risk lenders at a substantially higher cost. Traditionally, finance companies provided this type of credit.

D. Repayment behaviour and Trade Credit

Repayment behavior is the likelihood of repayment by the firm (debtor) to whom trade credit is granted (Bhatt &Shui, 2002).The issue of repayment behavior is critical because the strongest appeal of most firms is high repayment rates (Bhatt &Shui, 2002). The low default rates of some firms have led observers to believe that giving credit to some firms might not be as risky as has been traditionally assumed (Bhatt & Shui, 2002). Results of a statistical test by Bhatt, 2002, indicate that some clients' character is such that some are able but not willing to pay and others have the capacity to pay. Chances for repayment are increased if the borrower has experienced lower transaction costs in accessing trade credit (Bhatt et al…). Additionally norms plus values of firms also guide, influence, direct, shape or predict actual behavior (Suki, 2006, Rhodes & Courneya, 2003). To enhance repayment, it is important to rightly identify potential profitable firms to offer trade credit to (Bhatt & Tang, 1998). Repayment behavior is supported by the agency theory (Jensen and Meckling, 1976), which is characterized by adverse selection and moral hazard phenomena.

Our contribution in regards to repayment behavior and trade credit is to seriously advise firms (vendors) to consider repayment behavior before granting trade credit to customers and monitor performance of debt collection staff.

IV. SAMPLING, METHODS AND TECHNIQUES

A. Sampling

The sample size was 31 manufacturing firms based on Yamane (1973). Previous studies such as Nkundabanyanga, (2012); Kamukama (2010); Kharel (2007), have used Yamane (1973) in their sample selection and their results were reliable. For the purpose of this study, the formula derived from Yamane (1973) was used as indicated below:

n = N/1+N (e)2, where; n = sample size; N = total population; e = tolerable error (0.05 or 95%).

Senior Managers with trade credit knowledge of the firm were purposively selected from each firm. This selection included Chief executives, Debt management staff, Accountant, Director, Head of finance, Head of marketing plus other knowledgeable staff making a number of at least 3 people per company. The aim of purposive sampling was to select information rich respondents from whom one would learn about the issues that are central to the purposes of the study (Patton, 2002). According to Saunders et al, (2000), researchers prefer probabilistic sampling methods over non probabilistic ones. However in applied social research, there may be circumstances where it is not feasible, practical or theoretically sensible to do random sampling (Trochim, 2006). Due to lack of any reliable sampling frame, this research used both probability and non probability sampling.

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Stratified random sampling method was used so as to obtain a representative sample. With this technique, the population was stratified into a number of non overlapping sub population/stratas and senior managers were selected from each stratum randomly and purposely. The strata or sub populations involved manufacturing sectors like textiles, soft drinks, furniture, construction and other manufacturing firms. Both stratified and purposive random sampling techniques were used in order to collect the information from these respondents. The technique chosen suited the frame of the study and ensured relevance of the data that was collected.

B. Methodology and techniques

The methodology covered the research philosophies, paradigms, research design, study population and sample size, data sources, sampling design and procedures, data collection instruments, reliability and validity of research instruments, operationalization and measurements of research variables, data analysis, limitations and ethics of the study.

This study adopted positivistic philosophical view based on the fact that reality is external and objective (Cavana et al., 2001). This research philosophy was deemed appropriate here because the research aimed at testing hypotheses through an empirical scientific process with measurements to identify and establish the relationships between latent variables and obtain statistically significant findings that were generalized about the population that was studied.

The philosophical assumptions underlying this study came mainly from positivism. The positivisits/objectivists position enabled the study to test objectives and hypotheses developed from existing theories to determine facts or truth, while the interpretivists/subjectivist allowed the study to examine contextual factors that influence, determine and affect the interpretations based on the respondent's experiences (Davies, 2003). Quantitative (deductive) and qualitative (inductive) were the two commonly used research approaches. These are based on positivism and phenomenology.

V. FINDINGS AND DISCUSSIONS

The study was conducted under three major categories namely; (1) price discrimination, (2) repayment behaviour and (3) trade credit.

Data was collected using a close ended questionnaire that was administered directly to the respondents. The unit of analysis was manufacturing firms and the main respondents were debt management staff, head of finance, head of marketing plus other knowledgeable staff. The selected respondents were employees of the manufacturing firms in the Districts of Kampala, Wakiso and Mukono. A sample of 31 manufacturing firms was used in the study, 100 questionnaires administered and 78 questionnaires received back from respondents. This represented 78% response rate since the pilot survey targeted 100 respondents. This section covers the detailed explanation of the tests performed on our data and how obtained results relate to both the theoretical underpinnings and existing empirical work in the existing literature.

A. Hypotheses

- **H1:** There is a positive relationship between price discrimination and trade credit.
- **H2:** There is a positive relationship between firm market power and trade credit.
- **H3:** There is a positive relationship between customer demand and trade credit.
- **H4:** There is a mediating effect of repayment behavior between price discrimination and trade credit.

B. Firm Characteristics

This table shows the number of employees that were recruited per year during the period of four years.

N = 31	**Min**	**Max**	**Mean**	**SD**
Number of employees recruited in Year-1	3	112	16	27
Number of employees recruited in Year -2	6	86	31	34
Number of employees recruited in Year -3	2	90	27	35
Number of employees recruited in Year- 4	6	110	42	59
Current Number of workers	**3**	**275**	**37**	**64**

Table 2:- Firm Characteristics

The results indicate that more employees were recruited in the fourth year, meaning that age of the firm may mean stability hence more employees required.

C. Type of manufacturing firm

The table below shows the five different categories in which the manufacturing firms were grouped. They included textile and garments, construction, food processing, furniture and wood processing and others.

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		Count	Valid %	Cumulative %
Valid	Textile & Garments	4	12.9	12.9
	Construction	7	22.6	35.5
	Food Processing	5	16.1	51.6
	Furniture & Wood Working	6	19.4	71.0
	Others	9	29.0	100.0
	Total	**31**	**100.0**	

Table 3

The results indicate that the study was for 31 firms and the highest number was from others and construction which is 52% of the total firms.

D. Location of manufacturing firm

This section shows the location of the manufacturing firm in the districts of Kampala, Wakiso and Mukono.

		Count	Valid %	Cumulative %
Valid	Kampala	10	32.3	32.3
	Wakiso	17	54.8	87.1
	Mukono	4	12.9	100.0
	Total	**31**	**100.0**	

Table 4

The results in the table show that 17 firms representing 55% were from Wakiso district, 10 representing 32% were from Kampala and 4 representing 13% were from Mukono district.

E. Size of firm

This section shows the size of the firm in terms of the number of employees. The categories and the number of staff are indicated in the table below:

		Count	Valid %	Cumulative%
Valid	1 - 10 employees	20	64.5	64.5
	11 - 100 employees	8	25.8	90.3
	101 - 250 employees	2	6.5	96.8
	Over 250 employees	1	3.2	100.0
	Total	**31**	**100.0**	

Table 5

The results show that out of the 31 firms in the pilot study, 28 firms representing 90% have employees ranging from 1 to 100, while 3 firms representing 10% have employees ranging from 101 and above.

F. Correlations Model

	Mean	SD	1	2	3	4	5
Financing (1)	3.400	.700	1.000				
Price Discrimination (2)	3.317	.427	.358*	1.000			
Transaction costs (3)	2.500	.658	-.489**	-.385*	1.000		
Repayment Behavior (4)	2.129	.645	.541**	.537**	-.667**	1.000	
Trade Credit (5)	3.395	.614	.675**	.574**	-.562**	.554**	1.000

Table 6

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

G. Regression Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.994	.931		1.067	.296		
Financing	.402	.130	.458	3.089	.005	.672	1.488
Price Discrimination	.484	.208	.337	2.326	.028	.705	1.418
Transaction costs	-.209	.156	-.224	-1.342	.191	.531	1.882
Repayment Behavior	-.024	.177	-.025	-.134	.894	.428	2.337
Dependent Variable: Trade Credit							
R	.784						
R Square	.615						
Adjusted R Square	.556						
Std. Error of the Estimate	.409						
R Square Change	.615						
F Statistic	10.384						

Table 7

H. Mediation Testing

Item	**C I**	
	Lower	**Upper**
PD-RB-TC	-.035	0.566

Table 8: Mediation Testing

The predictors account for 55.6% of the variance in the Trade Credit. Among the predictors, the more influential was Financing (Beta = .458, sig. <.05) followed by Price Discrimination (Beta = .337, sig. <.05). The adjusted R^2 is the combined effect of all predictors to trade credit and other factors un investigated. It's noted that repayment behavior was not a significant predictor in the Regression model (sig. >.01).

Our results from the study indicate that price discrimination representing an independent variable was a positive predictor of trade credit as indicated in our lierature while repayment behavior (mediator) was not a significant predictor. The correlation analysis carried out revealed that there was a positive relationships between the independent variable with trade credit.
There is also evidence that Repayment bahavior mediates the relationship between price discrimination and trade credit.

We had hypothesized that there is a relationship between price discrimination, repayment behaviour and trade credit. This hypothesis was derived from existing empirical research (Kihanga, 2008, Fafchamps, 1996), which found that repayment behaviour can mediate that relationship. It is observed that both small and large firms use trade credit as a financing mechanism.

The results indicate that there is a positive association between the two variables. This is supported by the argument that trade credit is viewed as a substitute for institutional finance (Salima, 2007), Raghuram, 2002). Price discrimination views trade credit as dependent on firm's market power and customer demand.

According to the findings of the study, repayment behaviour's mediating role is not so significant and there is a positive relationship between price discrimination and Trade credit.

VI. CONCLUSIONS AND POLICY IMPLICATIONS

This study was motivated by the decreasing level of trade credit use among manufacturing firms of Uganda. Based on the results from our study, we can conclude that price discrimination and repayment behavior have an influential bearing on trade credit and it is confirmed both at individual and combined interaction with trade credit.

On the basis of our results from the study, we recommend that manufacturing firms and policy makers adopt price discrimination and repayment behavior pillars into their existing operational frameworks. These could result into improvement in trade credit use, improvement of firm performance and economic development.The study examined trade credit among manufacturing firms by relating it to price discrimination and repayment behavior. We focused on predictive powers of price discrimination on trade credit.

Our results means manufacturing firms and policy makers involved in trade credit management should appreciate considering them as ingredients in enhancing their operational strategies geared towards improving trade credit use, enhancing firm performance and economic development of the country.

Our results should be given importance based on the fact that the mediating role of repayment behavior in enhancing the scope of trade credit was not confirmed and and previous studies have not used it. Our study results adds to existing literature on trade credit research both regionally and in developed nations.Theoretically, our results reveal that combining price discrimination and repayment behavior can lead to efficient trade credit.

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