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THE RELATIONSHIP BETWEEN DIFFERENT TYPES OF CREDITOR AND SMOOTH EARNINGS AND SMOOTH CASH FLOW: EVIDENT FROM UK PRIVATE FIRMS

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Abstract

This paper investigates the interplay between different types of creditors and the smoothness of earnings and cash flow reported by 6,283 UK private firms from 2011 until 2016. Specifically, this paper investigates whether creditors prefer smooth earnings or smooth cash flow. On one hand, creditors are demanding more income smoothing for contracting efficiency and firms with smoother earnings are related to lower cost of debt (Gassen & Füllbier, 2015). On the other hand, unlike cash lenders (banks) who are concerned about both the principal and the interest, lessors are primarily concerned about the ability of the borrower to make periodic lease payments while trade creditors rarely use financial statements when offering credit to customers (Collis et al., 2013; Gallardo, 1997). The main finding shows that creditors prefer smooth cash flow than smooth earnings and the result is consistent with different types of creditors (banks, lessors and trade creditors).

***Keywords*:** Creditors, Private Firms, Smooth Cash Flow, Smooth Earnings.