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Financial Flexibility, Customer Concentration and Corporate Value

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Abstract

Taking A-share listed manufacturing companies from 2009 to 2019 in China as a sample, this paper studies the micro-mechanism of financial flexibility affecting company value from the perspective of supply chain relationships. The study found that financial flexibility helps to enhance corporate value, and the over-concentrated supply chain relationship will hinder the function of financial flexibility to enhance value. This research enriches the research on financial flexibility and corporate value, and also has important practical guiding significance for corporate financial management decision-making.

Keywords

Financial Flexibility; Customer Concentration; Corporate Value.

1. Introduction

With the acceleration of the process of global economic integration, the external environment of Chinese enterprises has become increasingly uncertain. If an enterprise wants to survive and develop in such an environment, it must abandon the old backward management model and improve management flexibility, especially financial flexibility. The Financial and Accounting Commission of the United States gave a clear concept of financial flexibility in 1984: Financial flexibility refers to the company's ability to take effective actions to change the amount and time of cash flow, thereby responding to unexpected demand and investment opportunities. A large number of studies have found that financial flexibility not only has the value of passive risk prevention from a traditional perspective, but also has the value of helping companies actively wait for market fluctuations to better grasp investment opportunities. The "prevention value" and "utilization value" are both valuable to the company. Financial behaviors such as investment and financing efficiency and dividend policy have important influences (Zeng Aimin et al., 2013). However, does the impact of financial flexibility on financial decisions ultimately enhance or destroy the value of the enterprise? This theoretical question has not been clearly interpreted so far. On the one hand, high financial flexibility means not only low capital returns and high opportunity costs, but also potential free cash flow agency costs; on the other hand, high financial flexibility will also improve the company's ability to resist economic fluctuations (cash flow shocks) and grasp investment Opportunity. Therefore, existing research believes that the impact of financial flexibility on corporate value has a "double-edged sword" effect.

As an important business relationship network of an enterprise, the supply chain relationship has an important influence on the development of the enterprise. In recent years, the increase in macro-uncertainty has led to an increase in information asymmetry, coupled with imperfect laws and property rights protection mechanisms, which have caused transaction costs between companies to rise. At this time, a stable supply chain relationship has become an important foundation for companies to maintain growth. At the same time, China's financial sector has seen the weakening of the role of financial development on the real economy, and the ability to allocate financial service resources has declined. As a link between upstream and downstream

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relationships, suppliers will use their information advantages, regulatory advantages and clearing advantages to provide customers with commercial credit, and even convert bank credit financing into commercial credit supply (Mitchell et al., 1997), that is, through credit funds The commercial credit channel is re-allocated to downstream manufacturers (Liu Xiaolu, 2012), and this process will weaken the financial flexibility of upstream suppliers to a certain extent, thereby affecting their value effect. However, does the supply chain relationship mediated by commercial credit necessarily reduce the value effect of supplier financial flexibility? This article finds that a stable supply chain relationship will bring value compensation to suppliers. Therefore, the value effect of financial flexibility will not be reduced, but its value effect is transferred to the form of commercial credit. However, the over-concentration of customer relationships intensifies the supplier's relationship-specific investment and operating risks, and causes the seller's surplus to be invaded by the strong buyer to a greater extent. This means that the over-concentrated customer relationship cannot provide sufficient value compensation and risk compensation. At this time, the supplier's financial flexibility is leaked through the commercial credit medium. Therefore, the excessively concentrated supply chain relationship weakens the value effect of supplier financial flexibility. This discovery not only expands the research on the interactive relationship between financial flexibility and corporate value from the perspective of supply chain relationships, but also reflects on the true impact of supply chain relationships on corporate value from the perspective of supply chain relationships on the “appropriation” effect of financial flexibility.

This paper takes Chinese A-share listed manufacturing in 2009-2019 as a sample, and empirical research finds that financial flexibility has an impact on corporate value: financial flexibility is positively correlated with corporate value. Further analysis shows that: the relationship between financial flexibility and corporate value is more significant when customer concentration is low.

The contribution of this paper is that this paper examines the interactive relationship between financial flexibility and corporate value and its evolution characteristics from the perspective of customers, and incorporates customer relationships into the empirical boundary of the research on the relationship between financial flexibility and corporate value, which reflects the logic and empirical innovation of this paper. Second, it has enriched the relevant literature on the influence of customers on the financial decision-making of listed companies in China. Third, this article provides a new logic from the perspective of financial flexibility for how to weaken vicious encroachment, enhance supplier value, and activate supply-side vitality and quality.

The following structure of this paper is arranged as follows: The second part is the theoretical analysis and research hypothesis, the third part is the research design, the fourth part is the empirical results, and the final part is the research conclusion.

2. Theoretical Analysis and Research Hypothesis

2.1. Financial Flexibility and Corporate Value

Financial flexibility has a double-edged sword effect. On the one hand, financial flexibility will increase corporate value. When the external capital market is imperfect and internal operating income is unstable, companies will face larger financing due to limited financing channels and excessive financing costs. Constraint level. The volatile business environment has brought potential investment opportunities for companies. When the cash flow of the company is inconsistent with investment opportunities, companies with sufficient financial resources can use financial flexibility to effectively alleviate the financing constraints faced by the company, and mobilize financial flexibility at low cost. To coordinate the inconsistency between cash flow and investment opportunities, so as to win more investment opportunities for the company and

ISSN: 2688-9323

increase the market value of the company (Wang Man et al., 2015). For example, Tong Hongxia (2021) found that financial flexibility can effectively alleviate the impact of unfavorable market factors on corporate finance and significantly enhance corporate value. Xiao Zhongyi et al. (2020) found that companies that actively adjust financial flexibility reserves can play an "adaptive effect" under the influence of environmental uncertainties in different dimensions, and help companies achieve the goal of continuous innovation.

On the other hand, financial flexibility will also increase the agency problem of the company, which is not conducive to the company's grasp of investment opportunities, thereby reducing the value of the company. For enterprises, financial flexibility is mainly manifested in two aspects: excess cash holdings and low debt ratio. Excessive cash holdings can make it easier for management to conduct rent-seeking; a low debt ratio can inhibit investors' supervision of enterprises, reduce their attention to enterprises, and reduce debt governance to empty talk. In short, excess cash holdings and low debt ratios will increase the agency's agency costs. Companies retaining too much cash will increase the opportunity cost of investment. Secondly, excessively redundant free cash flow will create more rent-seeking space, increase agency costs of enterprises, and even give rise to blind optimism and overconfidence of managers, which in turn induces inefficient investment and destroys corporate value (Liu et al., 2011) . Third, the low leverage ratio under high financial flexibility prevents enterprises from enjoying preferential interest tax deduction policies, which indirectly increases the cost of capital for enterprises. Finally, when the enterprise is moderately indebted, the creditor has a contingent governance effect on the enterprise, which can supervise and restrain the manager and reduce agency problems. However, low financial leverage is difficult to play the role of creditors' discretionary governance, which is not conducive to the enhancement of corporate value (Tang Song et al., 2009). For example, Sun Yemeng and Zhang Guitong (2020) found that excessive financial flexibility will aggravate the agency problem of enterprises, and overconfident managers will further promote enterprises' over-investment behavior through higher levels of cash flexibility. At the same time, overconfident managers tend to hold higher debts, and by reducing the flexibility of the enterprise’s debt, then increasing the enterprise’s over-investment behavior.

With frequent frictions in the Chinese market, the strategic function of financial flexibility can be fully utilized, and financial flexibility can give full play to its value-added role in an uncertain environment. At the same time, the debt governance mechanism of Chinese credit market is weak, that is, high financial flexibility will not reduce the value of enterprises due to the loss of external governance effects. In summary, this article believes that financial flexibility has a positive value effect. Based on this, this article proposes hypothesis H1.

H1: Under the economic background of the new normal, the financial flexibility of enterprise reserves has a value-added effect, that is, the improvement of financial flexibility can significantly increase the value of the enterprise.

2.2. Financial Flexibility, Customer Concentration and Corporate Value

Customer concentration determines to a large extent the "special investment" that both parties invest in maintaining relationship transactions. Therefore, large customers often have an important influence on the production and business decisions of enterprises. On the one hand, a robust supply chain relationship is an important driver of corporate value. Existing literature proves that good supply chain relationships help suppliers share valuable information resources from key customers, improve working capital management efficiency, reduce corporate daily operating costs, increase customer-specific investment in relationships, and promote corporate technological innovation, etc. Etc. (Zhang Min et al., 2012). Chen Zhenglin and Wang Yu (2014) found that supply chain integration can promote the improvement of the company's financial performance by reducing the company's period expenses, improving the

ISSN: 2688-9323

efficiency of asset use, and partially transferring profits to upstream and downstream partners. Chen Jun et al. (2015) found that in Chinese specific market environment, the existence of large customers is considered to be conducive to promoting supply chain integration, improving business conditions, reducing business risks, and sending positive signals to the market, thereby reducing the rights and interests of enterprises The cost of capital. Zhou Mei et al. (2021) took real estate listed companies as a research sample and found that the higher the customer concentration, the more opportunities for core companies to obtain major customers or to conduct business value cooperation with major customers. This is conducive to the company's asset utilization and market value. As well as the improvement in operating performance, commercial banks are more willing to lend to such enterprises. However, Li Huan et al. (2018) believe that companies with higher customer concentration, in order to maintain the relationship with major customers, suppliers pay more hospitality expenses, and because major customers default on accounts receivable, financial expenses increase. This will further deteriorate the company's performance. Wang Longfeng et al. (2021) found that the customer concentration effect has disrupted the virtuous circle between capacity investment and capacity disposal, resulting in a backlog of idle capacity and further reducing capacity utilization. These indicate that customers, as important stakeholders of an enterprise, have a certain influence on the value of the enterprise.

The above studies have focused on the impact of supply chain relationships on corporate value. This article focuses on the impact of supply chain relationships on the realization of value effects of financial flexibility. This helps to analyze the indirect impact of supply chain relationships on corporate value using financial flexibility as a medium. The supply chain relationship is also included as an environmental factor into the research on the relationship between financial flexibility and corporate value. At present, Chinese market information asymmetry barriers and imperfect legal protection mechanisms have increased the difficulty for companies to find customers in the market, increased transaction costs between companies, and made companies have more control over the upstream and downstream transaction channels they obtain. The increasing reliance on enterprises has weakened the negotiating power of enterprises relative to key customers and undermined the stable state of upstream and downstream relationships in the supply chain. Enterprises rely too much on the sales of key customers. Once key customers are lost, they will not only lose their existing sales share, but the negative impact will also be transmitted to other customers, prompting them to switch suppliers (Kai et al., 2012). The loss or bankruptcy of key customer resources will also bring more serious cash flow risks and bad debt risks to supplier companies. At the same time, existing research has also found that the higher the customer concentration, the weaker the supplier's bargaining power. Therefore, in order to prevent the loss of sales caused by customer transfer, suppliers will be more inclined to provide commercial credit to increase barriers to customer transfer. However, large customers will request more commercial credit financing from weak suppliers based on their strong market position (Ma Lijun et al., 2012), so that the remaining suppliers will be invaded by strong customers. Zhang Jie et al. (2008) found that many large enterprises have maliciously defaulted on the commercial credit of small and medium-sized enterprises by taking advantage of their own position. This behavior has even caused the original domestic enterprises to switch to export because of fear of credit default. Bao Xiaolan (2020) found that the higher the customer concentration, the greater the company's risk exposure. The above research shows that excessively concentrated customer relationships will distort the supplier's capital turnover process, thereby increasing the probability of suppliers' financial distress, and at the same time strengthening the ability of customers to transmit business risks and moral hazards under supply chain conditions. In companies with relatively high customer concentration, with the precipitation of suppliers' commercial credit, their financial flexibility is transferred to large customers through the

ISSN: 2688-9323

supply chain as a medium, and suppliers' investment willingness and ability to invest will also decline rapidly as a result. They use financial flexibility to grasp investment Opportunities and the ability to increase value are therefore reduced, that is, the value effect of financial flexibility will be suppressed. Therefore, we propose hypothesis H2.

H2: Relatively dispersed customer relationships are an important "medium" for financial flexibility to exert its value-added function, while excessively concentrated customer relationships will weaken the value-added effect of supplier financial flexibility.

3. Research Design

3.1. Sample Selection and Data Sources

This article takes the A-share listed manufacturing companies from 2009 to 2019 as the initial sample and refers to the existing literature. The sample data is processed as follows: (1) Eliminate ST companies; (2) Eliminate missing values of related variables. In the end, 5052 samples were obtained. In order to eliminate the influence of outliers, continuous variables are processed with 1% tailing. The data comes from the CSMAR database.

3.2. Model Setting

This paper constructs model (1) to test the influence of financial flexibility on enterprise value; constructs model (2) to establish the influence of customer concentration on the relationship between financial flexibility and enterprise value.

$$MB_{i,t} = \alpha_0 + \alpha_1 FF_{i,t} + \alpha_2 LNFIX_{i,t} + \alpha_3 GROWTH_{i,t} + \alpha_4 LH\_10_{i,t} + \alpha_5 NTRATE_{i,t} + \alpha_6 DUM\_DUAL_{i,t} + \alpha_7 YEAR_{i,t} + \alpha_8 INDUSTRY_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$MB_{i,t} = \alpha_0 + \alpha_1 FF_{i,t} + \alpha_2 TOP5_{i,t} + \alpha_3 TOP5_{i,t} \times FF_{i,t} + \alpha_4 LNFIX_{i,t} + \alpha_5 GROWTH_{i,t} + \alpha_6 LH\_10_{i,t} + \alpha_7 NTRATE_{i,t} + \alpha_8 DUM\_DUAL_{i,t} + \alpha_9 YEAR_{i,t} + \alpha_{10} INDUSTRY_{i,t} + \varepsilon_{i,t} \quad (2)$$

3.3. Variable Definition and Description

3.3.1. Enterprise Market Value

The measurement method of the company's market value is the ratio of the market value of the company's assets to the book value.

3.3.2. The Level of Corporate Financial Flexibility

Existing literature uses a single indicator for the judgment of financial flexibility, such as cash holdings or leverage level (Ran, 2010; Ozgur et al., 2014), or a combination of multiple indicators of the two to measure the level of corporate financial flexibility (Zeng Aimin et al., 2013). This paper adopts a combination of multiple indicators to decompose financial flexibility into debt financing flexibility and cash flexibility. Financial flexibility = cash flexibility + debt financing flexibility, where cash flexibility = corporate cash holdings-industry average cash holdings, debt financing Flexibility = Max (0, industry average debt ratio-enterprise actual debt ratio).

3.3.3. Customer Concentration

This article uses the sales revenue of the top five customers and the proportion of the company's total annual sales revenue as a measure of customer concentration, that is, TOP5. The larger the proportion, the more concentrated the customers.

Refer to Table 1 for the specific definitions and descriptions of variables in this article.

ISSN: 2688-9323

Table 1. Variable definition and description

Variable	Description	Measure
MB	Market-to-account ratio	(Year-end closing price × number of tradable shares + net assets per share × number of non-tradable shares + book value of debt) / book value of assets
FF	Financial flexibility	Cash flexibility + debt financing flexibility
TOP5	Customer concentration	The sum of the sales proportions of the top five customers
LNFIX	Fixed assets scale	Ln(Net value of fixed assets at the end of the year)
GROWTH	Operating income growth rate	(Operating income of the current year-operating income of the previous year)/Operating income of the previous year
VOLRET	Stock return volatility	Standard deviation of stock returns in the previous 12 months
LH_10	Shareholding ratio of the top ten shareholders	Number of shares held by the top ten shareholders/total number of shares
NTRATE	Proportion of non-tradable shares	Non-tradable shares/total shares
DUM_DUAL	Two jobs in one	The same person as the general manager and chairman takes 1, otherwise 0

3.4. Descriptive Statistics

Table 2 is the descriptive statistics of the main variables. From the data in the table, during the sample period: (1) The average value of the company's market-to-book ratio is 2.1123, the minimum is 0.9024, and the maximum is 8.1370. This shows that the overall corporate value is relatively reasonable, but there are large differences between different companies. (2) The average value of financial flexibility is 0.0826, the maximum value is 0.7464, and the minimum value is -0.2073, indicating that the overall financial flexibility of the enterprise is relatively reasonable, but there are large differences between different enterprises. (3) The average value of customer concentration is 0.3035, the maximum value is 0.9154, and the minimum value is 0.2494, indicating that the overall customer concentration of the sample enterprises is not high, but the gap between companies is relatively large, and the statistics of other variables are relatively reasonable.

Table 2. Descriptive statistics

Variable	N	MEAN	SD	MIN	P50	MAX
MB	14,400	2.1123	1.2641	0.9024	1.7041	8.1370
FF	14,400	0.0826	0.1948	-0.2074	0.0303	0.7468
TOP5	14,400	0.3035	0.1980	0.0348	0.2494	0.9154
LNFIX	14,400	20.2991	1.3814	16.9904	20.1701	24.0642
GROWTH	14,400	0.1783	0.3861	-0.4713	0.1156	2.5375
LH 10	14,400	0.5838	0.1461	0.2288	0.5928	0.8879
NTRATE	14,400	0.2529	0.2576	0.0000	0.1759	0.8023
DUMDUAL	14,400	0.2893	0.4534	0.0000	0.0000	1.0000

Note: ***, **, and * indicate the significance levels of 1%, 5%, and 10%, respectively, and the values in parentheses are the t-statistics of the corresponding coefficients.

4. Outcome of Practice

4.1. Financial Flexibility and Corporate Value

From the results in column (1) of Table 3, we can see that in the full sample, financial flexibility is significantly positively correlated with corporate value. This result shows that financial

ISSN: 2688-9323

flexibility has a value-added effect under the control of other factors. Then, according to whether it is greater than the mean value of financial flexibility as a standard, we divide the samples higher than the mean value of financial flexibility into the high financial flexibility sample group, and divide the samples below the mean value of financial flexibility into the low financial flexibility sample group. The results in columns (2) and (3) show that in the sample of high financial flexibility, the coefficient of financial flexibility is significantly positive at the level of 1%, indicating that corporate reserves of financial flexibility can prevent the impact of the external environment, and Enterprises win more favorable investment opportunities and bring value-added effects. In the low financial flexibility sample in column (3), the coefficient of financial flexibility is not significant, indicating that the financial flexibility with less corporate reserves cannot bring value-added effects to the company. These results verify the hypothesis H1 in this article.

Table 3. Financial Flexibility and the Return of Enterprise Value

Variable	(1)	(2)	(3)
	Full sample	High financial flexibility sample	Low financial flexibility sample
FF	0.493***	0.295***	-0.001
	(10.33)	(3.00)	(-0.01)
LNFIX	-0.395***	-0.409***	-0.382***
	(-53.26)	(-29.12)	(-45.82)
GROWTH	0.193***	0.292***	0.126***
	(8.77)	(6.75)	(5.22)
LH_10	0.871***	1.292***	0.633***
	(12.87)	(10.15)	(8.39)
NTRATE	-1.843***	-2.426***	-1.358***
	(-45.94)	(-34.81)	(-28.64)
DUM_DUAL	0.041**	0.079**	0.037*
	(2.17)	(2.41)	(1.68)
_cons	10.413***	10.685***	10.135***
	(62.49)	(33.82)	(54.42)
Industry, annual	control	control	control
N	14361	5669	8692
F	213.269	94.399	119.224
r2_a	0.399	0.420	0.380

Note: ***, **, and * indicate the significance levels of 1%, 5%, and 10%, respectively, and the values in parentheses are the t-statistics of the corresponding coefficients.

4.2. Financial Flexibility, Customer Concentration and Corporate Value

The coefficient of FF×TOP5 in Table 4 is significantly negative, which shows that when the key customers of an enterprise are relatively scattered, it is more conducive to the integration of the value chain between the enterprise and the customer, achieving a win-win benefit, promoting better growth of the enterprise, and bringing more to the enterprise The value added. The over-concentrated customer relationship will distort the capital turnover process of the supplier company, increase its business risk, reduce its investment willingness and investment ability, and thus the value effect of financial flexibility is suppressed, and it is difficult to bring the value-added effect of the company. This proves The hypothesis H2 of this article is given.

ISSN: 2688-9323

Table 4. Financial flexibility, customer concentration and the return of corporate value

Variable	MB
FF	0.628***
	(7.80)
TOP5	0.398***
	(7.96)
FF×TOP5	-0.407**
	(-2.06)
LNFIX	-0.383***
	(-50.78)
GROWTH	0.186***
	(8.42)
LH_10	0.863***
	(12.79)
NTRATE	-1.852***
	(-46.23)
DUM_DUAL	0.044**
	(2.38)
_cons	10.109***
	(59.28)
Industry, annual	control
N	14361
F	206.480
r2_a	0.402

Note: ***, **, and * indicate the significance levels of 1%, 5%, and 10%, respectively, and the values in parentheses are the t-statistics of the corresponding coefficients.

4.3. Robustness Check

Replace the measure of financial flexibility. This article chooses to use dummy variables to measure financial flexibility, in order to test the robustness of the previous analysis using continuous variables. When the financial flexibility is positive, the financial flexibility FF_dum is defined as 1, otherwise it is 0, and the research results are still stable after inspection.

Replace the measurement method of enterprise value. This paper chooses the rate of return on total assets to measure the value of the enterprise to conduct a robustness test, and the test finds that the research results are still robust.

Since financial flexibility is an advanced reserve for the uncertainties that may be faced in the future, its impact on performance may have a long time lag. Therefore, the financial flexibility is lagged by one and two periods respectively and regressed again. It is found that the research results are still stable.

ISSN: 2688-9323

Table 5. Robustness test regression

	(1)	(2)	(3)	(4)	(5)
	MB	ROA	ROE	MB	MB
FF		0.094***	0.103***		
		(37.45)	(19.43)		
FF_dum	0.168***				
	(9.40)				
L.FF				0.572***	
				(10.76)	
L2.FF					0.460***
					(8.15)
LNFIX	-0.403***	0.004***	0.010***	-0.390***	-0.415***
	(-55.53)	(11.30)	(12.17)	(-45.76)	(-43.55)
GROWTH	0.185***	0.032***	0.066***	0.210***	0.150***
	(8.40)	(27.52)	(27.13)	(7.97)	(5.05)
LH_10	0.893***	0.067***	0.114***	0.959***	0.966***
	(13.21)	(18.74)	(15.21)	(12.70)	(11.65)
NTRATE	-1.826***	-0.003	-0.014***	-1.781***	-1.695***
	(-45.61)	(-1.32)	(-3.09)	(-37.51)	(-28.51)
DUM_DUAL	0.043**	0.001	0.001	0.041*	0.059**
	(2.31)	(1.09)	(0.68)	(1.91)	(2.42)
_cons	10.499***	-0.097***	-0.207***	9.619***	10.019***
	(63.41)	(-11.06)	(-11.17)	(50.63)	(47.37)
Industry, annual	control	control	control	control	control
N	14361	14361	14361	11290	9280
F	212.587	90.317	46.584	176.225	148.544
r2_a	0.399	0.219	0.125	0.400	0.400

Note: ***, **, and * indicate the significance levels of 1%, 5%, and 10%, respectively, and the values in parentheses are the t-statistics of the corresponding coefficients.

5. Conclusion

As an important financial strategy of the company, financial flexibility and customer management have an important influence on the realization of the company's value. Based on the 2009-2019 China A-share manufacturing listed companies as a research sample, this article examines the micro-logic that financial flexibility affects corporate value from the perspective of customers. Research shows: First, financial flexibility can bring significant value-added effects. Second, high customer concentration will hinder financial flexibility from exerting positive value effects, while low customer concentration will bring value compensation to suppliers. In the transmission logic, the over-concentrated supply chain relationship leads to the misappropriation of the supplier's commercial credit, which in turn reduces the supplier's financial flexibility value, which weakens the supplier's financial flexibility and its value compensation function. This research indirectly proves the existence of a buyer's market in Chinese economic development, and provides an empirical reference for enterprises' internal decision-making on financial flexibility.

ISSN: 2688-9323

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