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The Impact of Customer Concentration on the Financial Performance of a Business

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Abstract

Manufacturing is the foundation of China's economic development, but with the rise of manufacturing plants in Southeast Asia and the rise of Western reindustrialization strategies, China's manufacturing industry is facing unprecedented challenges. Manufacturing enterprises urgently need transformation and upgrading, and service-oriented innovation provides new ideas for the transformation and upgrading of enterprises. How to manage the supply chain relationship and how to have a positive impact on the development of enterprises is the core issue of supply chain relationship management in the current operating environment where the relationship network is getting closer and the competition between enterprises is shifting to competition between supply chains. Based on the perspective of supply chain and transaction cost theory, this paper discusses and summarizes the relationship between customer concentration and enterprise performance, analyzes and summarizes the existing literature, and provides suggestions for enterprise development.

Keywords

Customer Concentration; Financial Performance; Enterprise Development.

1. Introduction

Enterprises cannot survive and develop without the support of various resources. The resource base view believes that an enterprise is an organic combination of a series of resources. However, only by possessing certain unique resources, or being able to fully and appropriately use the resources they have, can enterprises gain competitive advantages and achieve rapid development. In addition to various tangible resources, enterprise resources also include many intangible resources, and customer relationships are one of the important ones. The business relationship between the buyer and the seller in the product market constitutes a customer relationship, and the larger the proportion of a buyer's purchase to the total sales of the enterprise, the more important the customer relationship is. Customer relationship resources form a special resource for enterprises because they are difficult to imitate. With the intensification of competition in the external environment, this special resource has gradually become an important resource for enterprises, and its impact on enterprise performance has attracted the attention of scholars.

According to the Guidelines for the Content and Format of Information Disclosure by Companies Offering Securities to the Public No. 2 - Content and Format of Annual Reports issued by the China Securities Regulatory Commission (CSRC), China does not have any mandatory requirements for the sales shares of the top five major customers disclosed by listed companies (before 2012); The "voluntary disclosure" was revised to "mandatory disclosure" (after 2012), and the disclosure content of "whether it is related to a listed company" and "customer name and sales" was expanded. It can be seen that relevant regulators and market participants such as the CSRC are paying more and more attention to the disclosure of customer information, and require that the customer information to be disclosed is richer and more

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detailed. As a result, the increasing availability of customer information provides a good opportunity for us to discuss the impact of customer focus on corporate behavior. But research on how to protect large customers can bring great value to the business has emerged for two very different reasons. One concept holds that a firm can only create greater competitiveness and market value than independent operation through the integration of resources in the supply chain and coordination with other trading partners; Another idea is that because you must share your value with other members of the supply chain, the closer you are to your main customers, the more you damage the value of the company, and this predatory nature depends on the bargaining power of each other.

2. Literature Review

In recent years, with the increasingly detailed and standardized disclosure of customer information of listed companies in China, scholars have also begun to pay attention to in-depth research on the concentration of customer groups and business consequences, and these research results are also relatively fruitful. There are currently two main views on the concentration of customers and the study of corporate financial performance.

2.1. Customer Concentration Improves Business Financial Performance

The higher the concentration of customer groups, the higher the integration of resources in the supply chain, the higher the proportion of major customers and revenue, indicating that the closer the connection between enterprises and upstream and downstream customers, and timely information and communication between upstream and downstream customers can be ensured, which can help reduce and reduce trade expenses and costs between buyers and sellers, and create favorable conditions for further improving the company's performance. The higher the concentration of customers, the more synergistic relationship will be formed between enterprises and customers, that is, "value creation theory".

Some professional scholars are trying to study the causal relationship and the mechanism of corporate role from different professional perspectives to study the degree of customer concentration of enterprises and the mutual influence between the impact on business performance. Lirong Wang et al. (2017) through the above research and analysis results can find that although the high concentration directly plunders the business performance of the entire enterprise to a certain extent, but the direct trade cooperation and business trade activities with other large customers of other enterprises can not only directly reduce operating costs, but also directly improve the comprehensive management and daily operation efficiency of the entire enterprise. Concentration above large customers is also still beneficial for improving the operating performance of enterprises. Yafeng Huang and Quanwu Zhao (2008) believe that due to the large customer demand and the large number of purchases, the inventory management of suppliers will become more efficient and can help them obtain good profits; Kulp (2002) generally believes that because of the good partnership between customers and companies, and the economic ties are relatively close, if the two can communicate and communicate in a timely manner, this can greatly reduce the degree of inventory holding by both parties and improve the turnover rate of inventory between both parties. The company's main customer group is high, and the transaction of products is mainly concentrated in some relatively wide range of large customers, which can reduce the cost of the company using these trading partners to find other commodity trading objects, and at the same time, due to the frequent commodity transactions between the enterprise and the main customers, both parties will establish a common management structure to reduce the cost of both parties, which is more conducive to improving and enhancing the company's performance (Liu Changhua and Tian Zhilong, 2015). Yunsen Chen (2010) also proposed that the degree of centralized management of customer information is very high, which will be considered by the

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society to help effectively promote and strengthen long-term cooperation between customers, help buyers and sellers strengthen mutual trust between each other, enhance the effective communication of trade information, and reduce the commodity trade and investment risks brought to buyers and owners on both sides due to asymmetric trade information.

The higher the concentration of customer groups, the closer the relationship between the enterprise and the customer, and the stronger the correlation between the transaction costs of the two parties and the performance of the enterprise. Businesses with high customer agglomeration are likely to have more stable customer relationships, lower chances of reduced and falling demand and less risk of bad debts, and fewer product prices. The partnership increases the coordination of the supplier's product production, and the transaction is mainly concentrated on the customer, which will make the structure of the company's product become more balanced, which can reduce the difficulty of the company's product development and design work. At the same time, the proportion of major customer procurement from the side fully shows its strength, can be in technology or research and development directly guide suppliers, so as to promote further cooperation between the two sides through the product more counterpart, on the other hand, the strength of the main customer represents its mainstay position in the entire industry, good customer relationship will help to improve the degree of information resource sharing, promote buyers and sellers to create a good brand effect, and then promote the performance growth between upstream and downstream companies. Jie Xu et al. (2018) found through analysis that when the higher the concentration of an enterprise's customer group, the stronger the interdependence between the enterprise and its target customers, the lower the risk of enterprise management, and the more beneficial it is to improve the performance of the entire enterprise.

2.2. Customer Concentration Reduces Business Financial Performance

The higher the degree of customer concentration, the main factor is that the bankruptcy or default of the customer will lead to the greater demand and uncertainty faced by the enterprise in the future, which will adversely affect the profitability of its enterprise, and there is a game relationship between the enterprise and the customer, that is, the "value predation theory".

Porter (1979) has clearly pointed out that due to the high market customer group concentration, these enterprises often have a lot of attachment and trust to the customer groups in the main market, resulting in strong bargaining power, in the negotiation with upstream suppliers often have more right to speak, affecting the competitive advantage of enterprises, customers often reduce the cost and gross profit of upstream suppliers by influencing the price of the market, and eventually hinder the further improvement of supplier and enterprise performance. Galbraith and Gastiles (1983) agree that if a product supplier (management consultant) has strong actual bargaining power and management service capabilities, bargaining can directly reduce its competition and enable the capital gains of the enterprise to be realized. The market research staff of Balakrishnan (1996) and Gosman (2009) generally believe that the higher the degree of centralized market management of customer consumer groups, customers have the opportunity to fully use their own strong market bargaining management technology and their capabilities to constantly require product suppliers to reduce the company's product prices through negotiation, give them more product commerciality and reputation, and ensure the quality of the company's products, which are not conducive to the bargaining terms of the entire company. It robs the entire company's overall profit improvement space, and the company's overall profit control ability becomes weaker and weaker. Listed companies with a high degree of customer concentration are likely to face greater market demand and uncertainty, which directly leads to low investment efficiency. Irvine et al. (2016) argue that if a high degree of customer focus will prey on the huge value generated by the enterprise, the predatory development of this predatory development is more pronounced at an early stage of the relationship between a firm and its main customers. Yuejun Tang (2009) proposed that the higher the concentration of customer groups, the lower the bargaining power of the enterprise itself, and the worse the profitability of the enterprise. Empirical research by Zuguang Wu et al. (2017) shows that the higher the customer group aggregation rate, the worse the ability of the enterprise to raise funds within the enterprise, thus affecting the normal operation and production and operation of the company.

On the other hand, some experts and scholars generally believe that the stronger the concentration of customer groups, the higher the proportion of sales revenue of major customers, which will greatly affect the independence of the company and bring major management risks to other enterprises, which in turn hinders the improvement and enhancement of corporate performance. A study by Galbraith (1983) shows that the main customer groups have the advantage of concentrated customers, and the company's investment and ordering target intentions for other large customers cannot be fully clear, which will greatly increase the management and operational risks of the enterprise, which is not conducive to its performance. The results of Sheng Zhang (2013) show that once an enterprise only relies on a few customers, it will have the opportunity to adversely affect the asset management structure of the entire enterprise, and the less actual cash holdings of the enterprise will be and the less liquid assets will be, thereby greatly increasing the normal operation and financial risks of the enterprise. Itzkowitz (2013) has found that key customers play a key role in the performance of enterprises, and many companies tend to retain more of their cash in order to prevent the risk of customer loss. The results of Dhaliwal et al. (2013) show that when an enterprise's customer base is highly concentrated, customers are likely to ask other companies to extend commercial credit, and the company is likely to face serious cash flow and loss risks in the coming years.

Further, customers can set up dedicated investments to suppliers and enterprises as required, and such dedicated investments, once established, are very difficult to transfer, and can easily lead to sunk costs. Joskow (1988) believes that due to the high concentration of customer groups, its products are likely to be designed for specific user groups, resulting in the lack of diversification of products, resulting in their specificity and enhanced trust and dependence on customers. Williamson (1991) has clearly pointed out that according to the theory of asset transaction costs, the exclusivity of assets will lead to an increase in the level of various expenses of enterprises in the governance of the market economy, because the concentration of customer groups is high, and opportunism will greatly increase the operating costs of enterprises. Proprietary investments in customers and suppliers will lead to closer supplier-customer connections and increased interdependence, and a reduction in the number of orders from customers and suppliers or the bankruptcy or business transformation of major customers will most likely adversely affect the performance of the entire enterprise. Therefore, when our enterprises rely heavily on major customers, it is easier and easier to form their exclusive assets, such as fixed assets such as industrial production equipment, and when we lose these major customers, the exclusive investment of the enterprise may gradually become a rapid loss of value due to sunk costs, increasing the risk of operation.

In summary, the research on the direct impact of the degree of customer concentration on the financial performance of enterprises is mainly analyzed from the perspective of enterprise resources and talents and enterprise customers, and lacks analysis from the aspects of enterprise management ability and enterprise scale.

3. Conclusion

In the context of the era of supplier-customer relationship theory, supplier-consultant is an important socio-economic information resource of the company, and in the face of many

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changes and uncertainties in the current market environment, many companies have strengthened the management of the supply chain. Customer groups as the downstream of the entire enterprise supply chain, is the main profit stakeholders of the entire enterprise, the normal production and operation of the entire enterprise will have an important impact, buyers in the market environment, due to the current many listed companies in China, a small number of customers sales revenue accounted for a very high percentage of total sales revenue, therefore, these major customer groups will have an important impact on the company's performance.

In order to help our customer relationship management staff, the following suggestions are provided: First, enterprises should strengthen the management of customer relationships, integrate customer resources, investigate customer information and financial status, etc., avoid business risks brought to enterprises due to the loss of customers, and establish long-term cooperation and support partnerships with capable customers; Secondly, to optimize their own customer architecture, enterprises should strive to develop small and medium-sized customer resources, let small and medium-sized customers play their role, in the negotiation will have more powerful chips, enhance their bargaining power, avoid the passivity caused by heavy dependence on major large customers, and make the customer structure more quality and reasonable; Finally, enterprises should allocate resources reasonably according to their own conditions, but also learn to learn and innovate, in the process of operation will choose whether to carry out differentiation strategy or cost leading strategy, can not rest on their laurels, to carry out R & D and innovation to meet customer needs, in order to turn passive into active, to obtain the right to speak in the market.

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