

Trade Credit Supply, Market Power and the Matching of Trade Credit Terms

By

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***Small Business Finance –What Works,
What Doesn't?***

What are the objectives of the paper?

- ◆ Examines the decision of firms to extend trade credit and its implications
- ◆ Investigates the impact of trade credit on financing and its link to short-term assets and liabilities
- ◆ What is the impact of external factors on the extension of trade credit.

Why is this important?

- ◆ Firm financing goes beyond just bank loans and debt from the financial markets, firms have other alternatives in financing.
- ◆ What is the impact of industry competition and supplier/customer relationships on trade credit extension?
- ◆ Is there a relationship between the receipt of trade credit and the extension of trade credit for a firm?
- ◆ Is trade credit a substitute for bank credit?

What do they find?

- ◆ Firms that face more competition in the product markets are more likely to extend trade credit
- ◆ Firms that receive extension of trade credit are likely to extend trade credit – match payables and receivables.
- ◆ The matching is more prevalent in firms that both face strong competition in the output market and have strong market power in the input market

Approach

- ◆ Sample of 2,500 Chinese firms from the 2003 World Bank Enterprise Survey
- ◆ Detailed set of questions about firm relationships and receipt and extension of trade credit
- ◆ Database also has payment performance data on both sides, i.e., payables and receivables
- ◆ Firm level characteristics are used for controls

Issues - Arguments

- ◆ What determines credit terms?
 - Market Power?
 - Industry/geographic norms?
 - Relationships?
- ◆ How does the development of banking sector impact the supply chain financing?
- ◆ How much of the supply chain financing is driven by firm choice and how much is imposed by the market?

Issues - Results

- ◆ What are the relative sizes of the firms and location? Are these local or national firms?
- ◆ Why not a more explicit measure of market competition such as Herfindahl Index?
- ◆ What is "other" financing?

Recommendations

- ◆ Discuss in more detail the hypotheses that are being tested with possible competing hypotheses.
- ◆ Discuss more firm level, industry, regional and relational details in the results
- ◆ What are the general implications of the paper in countries with different levels of capital market development.
- ◆ Pecking order theory?

Conclusion

- ◆ Overall this is an interesting paper that looks more broadly at the issue of trade credit than is done in other similar studies
- ◆ The paper presents more insights into the actions of firms in the presence of differing financing environments