

Supplier relationships and small business use of trade credit

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Abstract

This paper establishes some unique descriptive statistics about supplier relationships and the use of trade credit among minority small businesses and documents the importance that ethnic and geographic supplier ties play. Using data from a survey of small businesses in two Chicago neighborhoods, we find that the importance may differ across communities. Working with a nearby supplier and, in cases where language appears to be an issue, with a Hispanic supplier are associated with more credit for Hispanic-owned firms. However, no comparable relationships are observed for Black-owned firms. These patterns are generally confirmed using nationally representative data. In addition, the national data suggest that ethnic differences in trade credit outcomes can be partly accounted for by the presence of ethnic- and geographic-based supplier relationships.

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Characterizing access to capital and credit for small businesses is complex because capital, credit, and insurance markets are not complete and frictionless. In response to these market imperfections, economic agents and organizations have devised a great variety of

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contractual arrangements—explicit and implicit, formal and informal. While there is much to learn, both empirically and theoretically, about these arrangements, it is hard to theorize in the absence of clear facts. For example, much remains unknown about the prevalence and importance of relationships between small businesses and other economic agents or networks of agents. Similarly, the role that ethnicity and geography play in relationships is not fully understood.

The value of relationships or networks has been emphasized in many settings, including markets for employment, education, crime, and civic participation.¹ To take one notable example, a large literature has developed around labor market networks. The pioneering work of Granovetter [19] emphasizes the degree to which social connections matter, particularly for less credentialed workers such as urban youth (O'Regan and Quigley [28]). Borjas [9] and Gonzalez [18], among others, investigate the extent to which ethnic enclaves have a causal impact on immigrant wages. Moreover, these social networks, or lack thereof, can derive from physical or geographic separation. That is, for dwellers in secluded inner-city neighborhoods, particularly those that are minority or immigrant-dominated, employment opportunities appear to be harmed by spatial isolation or mismatch (e.g. Sjoquist [32] and Stoll [35] for recent evidence).

Our study explores the importance of social relationships, including geographic and ethnic ties, for urban, minority small businesses accessing non-bank credit lines. From an urban development perspective, it is important that we know more about small business finance given the widely accepted view that small businesses are essential if urban local economies are to be and remain vibrant. Many policy efforts, such as the Community Development Financial Institution initiative, seek to promote small business access to capital and credit in inner-city communities, where such businesses are believed to be a conduit for neighborhood revitalization efforts (Bates [2]).

This paper's particular focus is on the availability of trade credit, which is credit provided by a supplier. Trade credit is an important part of the balance sheets of many small businesses.² Results of a national survey show that it accounted for 31.3 percent of the total debt for small businesses in 1993, and 60.8 percent of the firms had outstanding credit from suppliers.³ Trade credit is also interesting because it is a good place to look for the effects of relationships and networks. For example, in a world of imperfect information, a supplier may learn about a firm's creditworthiness and future prospects in the course of their ongoing business relationship. Thus, the strength of the ties between a business and its suppliers may play a role in the terms upon which trade credit is offered or whether it is offered at all.⁴

¹ See Glaeser et al. [17] for a review of the social capital literature.

² See Mian and Smith [25], Petersen and Rajan [30], and Ng et al. [27] for more discussion of the theory and practice of trade credit.

³ The figures come from the 1993 National Survey of Small Business Finance (tabulated in Table A.2 of Cole and Wolken [13] and Table 1 of Berger and Udell [3]) which defines small businesses as those with fewer than 500 employees.

⁴ Supplier relationships in the developing world have recently received some attention, as Fafchamps and Minten [15] and McMillan and Woodruff [26] find that relationships play an important role in access to trade credit in Madagascar and Vietnam, respectively. This finding is analogous to the result that relationship measures

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