In-Kind Finance: A Theory of Trade Credit

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AMERICAN ECONOMIC REVIEW
VOL. 94, NO. 3, JUNE 2004
(pp. 569-590)

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Article Information

Abstract

It is typically less profitable for an opportunistic borrower to divert inputs than to divert cash. Therefore, suppliers may lend more liberally than banks. This simple argument is at the core of our contract theoretic model of trade credit in competitive markets. The model implies that trade credit and bank credit can be either complements or substitutes. Among other things, the model explains why trade credit has short maturity, why trade credit is more prevalent in less developed credit markets, and why accounts payable of large unrated firms are more countercyclical than those of small firms.

Citation

Burkart, Mike, and Tore Ellingsen. 2004. "In-Kind Finance: A Theory of Trade Credit." *American Economic Review*, 94 (3): 569-590.

DOI: 10.1257/0002828041464579

G32 Financing Policy; Financial Risk and Risk Management; Capital and Ownership Structure; Value of Firms; Goodwill