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Small Business Research Summary

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Bank Credit, Trade Credit or No Credit: Evidence from the Surveys of Small Business Finances

Rebel Cole, Chicago, IL 60602. 48 pages. Under contract no SBAHQ-08-M-0464.

The availability of credit is one of the most fundamental issues facing a small business. Its importance can be seen by the significant level of academic research attempting to understand and identify the gap in small business financing. This study compares firms that use credit (leveraged firms) with those that do not (unleveraged firms), and examines which kind of credit the leveraged firms use—bank credit (loans or lines of credit), trade credit (from suppliers), or both. The study investigates whether the two types of credit used by small firms in this study are substitutes or complements. The knowledge of how lending institutions meet the credit needs of small firms is of importance to small businesses, their suppliers, and policymakers.

Why is this analysis of importance? Small firms are vital to the U.S. economy. According to the Office of Advocacy's most recent estimate, there were 29.6 million businesses in 2008. Small businesses accounted for half of all U.S. private-sector employment and produced 64 percent of net job growth between 1993 and 2008.Therefore, a better understanding of who uses credit and from where they obtain financing can help policymakers to take actions that will lead to more jobs and faster economic growth.

Overall Findings

The researcher finds that small firms that use no credit are significantly smaller, more profitable, more liquid, and have better credit quality; yet they hold fewer tangible assets. On the other hand, those that use credit are larger, and the amount of credit used as a percentage of assets is positively related to the firm's liquidity. In addition, three-fifths of the small firms that use credit, use trade credit.

Highlights

- One-fifth of small firms do not use credit; one-fifth use only trade credit; another one-fifth use bank credit (bank); while two-fifths use both bank and trade credit.
- Unleveraged firms are less likely to be organized as corporations, are younger, and have less desirable credit scores. Owners of these businesses are older, more likely to be female or black, have at least a college degree, and are likely to be in the services industry.
- Leveraged firms are more likely to be organized as corporations, have less financial slack, are less profitable, and report more firm delinquencies and are more likely to be located in are urban areas. The owners of such firms are younger, less likely to be female, and more likely to be found in the construction, manufacturing, and wholesale trade industries.
- Small businesses using trade credit are larger, more liquid, of worse credit quality, and are less likely to be in the services industry.
- Firms that use bank credit are larger, less profitable and liquid. The amount of bank credit used as a percentage of assets is positively related to the firm's liquidity, and profitability, but negatively related to its tangible assets.
- The researcher also uncovers new information on the two types of credit (bank credit and trade credit) used by small firms; the evidence strongly

suggests that they are complements as two-fifths of small firms consistently use both types of credit simultaneously.

Scope and Methodology

This study uses data from the Federal Reserve Board's Surveys of Small Business Finances (SSBF) for the years 1993, 1998, and 2003. The firms in the survey are a nationally representative sample of small businesses with fewer than 500 employees operating in the United States.

Firms are classified into one of four categories by their type of borrowing practices (unleveraged firms, bank credit only, trade credit only, and both bank and trade credit). Descriptive statistics are then used to examine leveraged and unleveraged firms. The study uses both univariate and multivariate techniques to analyze the data. Logistic regression analysis is used to examine the differences between firms that use each of the three credit types and those that do not use credit for 1993, 1998, and 2003. Weighted least-squares regression analysis is used to examine the type and amount of credit used.

This report was peer reviewed consistent with the Office of Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at **advocacy@sba.gov** or (202) 205-6533.

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