Curbing Shocks to Corporate Liquidity: The Role of Trade Credit[*]

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Abstract

Using data on liquidity shortfalls generated by the fraud and failure of a cash-in-transit firm, we demonstrate effects on firms' trade credit usage. We find that firms manage liquidity shortages by increasing the amount of drawn credit from suppliers and decreasing the amount issued to customers. The compounded trade credit adjustments are on average of similar magnitude as corresponding adjustments in cash holdings, suggesting that trade credit positions are economically important sources of reserve liquidity for firms. The underlying mechanism in trade credit adjustments is in part due to shifts in overdue payments.

Keywords: Liquidity management; trade credit; cash holdings; cash flow; risk sharing.

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