Volume Title: The Quality of Trade Credit

Volume Author/Editor: Martin H. Seiden

Volume Publisher: NBER

Volume ISBN: 0-87014-401-4

Volume URL: http://www.nber.org/books/seid64-1

Publication Date: 1964

Chapter Title: Front matter, The Quality of Trade Credit

Chapter Author: Martin H. Seiden

Chapter URL: http://www.nber.org/chapters/c1858

Chapter pages in book: (p. -24 - 0)

OCCASIONAL PAPER 87

THE QUALITY OF TRADE CREDIT

MARTIN H. SEIDEN

NATIONAL BUREAU OF ECONOMIC RESEARCH

1964

Library of Congress Catalog Card Number: 64-15175

Price: $3.00

Printed in the United States of America
by Woodhaven Press Associates Corp.

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This study, part of the National Bureau's Quality of Credit Program, was made possible by funds granted by the Merrill Foundation for Advancement of Financial Knowledge, Inc. The Merrill Foundation is, however, not to be understood as approving or disapproving by virtue of its grant any of the statements made or views expressed herein.

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Acknowledgments

My greatest debt is to James S. Earley, director of the Quality of Credit Program. His valuable advice and criticism contributed considerably to the form and substance of this study. I am also grateful for the excellent suggestions of James W. Angell and Geoffrey H. Moore. I should like to thank Victor Zarnowitz for permission to use the results of his study of credit ratings in Chapter 6, and Jacob Mincer, Richard T. Selden, Gary S. Becker, Harold Barger, and Thor Hultgren for their helpful comments.

Many persons in business and government provided data and assistance. Space permits the mention of but a few: J. Wilson Newman, Wilbur Bingham, and Rowena Wyant of Dun & Bradstreet; J. L. McCauley and J. T. Powers of the American Credit Indemnity Company; the London Guarantee and Assurance Company; Herbert R. Silverman of James Talcott, Inc.; William Drake of the National Commercial Finance Conference, Inc.; Arthur Schwartz of the *Commercial Bar;* Robert Morris Associates; Allyn M. Schiffer; Stephen Taylor of the Flow-of-Funds Section of the Board of Governors of the Federal Reserve System; and John F. Neary, Jr., of the Credit Research Foundation.

I should also like to thank Nadeschda Bohsack, Julie Mendlow Conger, David Laidler, Hannah Petzenbaum, Estelle Reichner, and Madeline Schiller for their aid in the compilation of the data; James F. McRee, Jr., and Marie-Christine Culbert for their careful editing of the final manuscript; and H. Irving Forman for the preparation of the charts.

Foreword

Martin Seiden's study of trade credit is part of the National Bureau's Quality of Credit Program, initially financed by a grant from the Merrill Foundation for the Advancement of Financial Knowledge and later by other special grants and general funds of the National Bureau. Begun in late 1959, Seiden's work for the Bureau resulted in a doctoral dissertation at Columbia University. Professor James Angell of Columbia University therefore shared with me the supervision of the larger study of trade credit, of which this paper is a part. The more extensive study can be consulted at Columbia University and at the National Bureau.

The financing of business by nonfinancial enterprises has been of growing importance in recent years. A larger share of the working capital and equipment needs of business has been financed outside the normal channel of commercial banks. A portion of this nonbank finance has been provided by expanded operations of other financial institutions, but a growing amount has been trade credit extended directly from business sellers to business buyers.

The credit extended between business firms has been until now a neglected area of financial study, yet changes in its quantity and quality should foreshadow changes in the quality of the credit structure as a whole that cannot be detected clearly or promptly in credit extended by financial institutions. Trade credit probably undergoes sharper quality changes than most other types of credit. This hypothesis underlies this study.

Part of Seiden's work consists of pioneering measurement of the volume and composition of trade credit for economic sectors, stages of the economic process, and by size of creditor and debtor firm. With the help of the Flow-of-Funds Section of the Federal Reserve Board, Seiden has developed revised estimates of trade credit volume and composition. The detailed data in the *Source Book* of the U.S. Treasury formed the major basis of these new estimates. Although still more data are needed, Seiden's quantitative work represents substantial progress in this matter.

The main focus of this publication, however, is on the *quality* of trade credit. Here Seiden has gathered and analyzed a great variety of data not readily available before. The Treasury *Source Book* was a major new source of information on the financial ratios of business concerns. A number of private agencies—Dun & Bradstreet, the Credit Research Foundation, the Robert Morris Associates, the National Commercial Finance Conference, the American Credit Indemnity Company, and others—provided key data and valuable counsel. An earlier study of Dun & Bradstreet's credit ratings and the structure of insurance premiums and losses on insured receivables, made by Victor Zarnowitz as part of the Bureau's Quality of Credit Program, also forms an important ingredient of this paper.

The findings and conclusions will speak for themselves in the following pages. Although, as in the case of most ground-breaking work, the conclusions are tentative and mainly highlight the need for further data-gathering and analysis, Seiden's study constitutes a substantial stride toward adequate knowledge in this important field.

JAMES S. EARLEY
Director, Quality of Credit Program

Seiden, Martin H

The quality of trade credit. [New York] National Bureau of Economic Research, 1964.

xx, 129 p. illus. 23 cm. (National Bureau of Economic Research. Occasional paper 87)

Bibliographical footnotes.

1. Credit. I. Title. (Series)

2,006,209

National Bureau of Economic Research, Inc.

Seiden, Martin H

The quality of trade credit. [New York] National Bureau of Economic Research, 1964.

xx, 129 p. illus. 23 cm. (National Bureau of Economic Research. Occasional paper 87)

Bibliographical footnotes.

1. Credit. I. Title. (Series)

MATERIAL SUBMITTED BY PUBLISHER.