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THE QUALITY OF TRADE CREDIT

MARTIN H. SEIDEN

NATIONAL BUREAU OF



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1964

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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,

Foreword

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*

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