How the Use of Movable Assets as Collateral in Debt Financing Affects Trade Credit: Evidence from Collateral Law Reforms

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Abstract

Trade credit theory posits that firms rely on trade credit financing mainly because they lack access to bank financing. Law reforms that facilitate the use of movable assets as collateral thus are considered important ways for countries to enhance firms' access to bank credit. In this paper, we use the staggered adoption of collateral law reforms in Europe as a quasi-experiment to examine how enhancing banks' access to collateral affects firms' use of trade credit. Consistent with expectations, we find that firms in countries that have adopted such reforms significantly reduce their use of trade credit. Moreover, greater access to bank financing via collateralization decreases the availability of non-collateralized assets among defaulting borrowers, which raises the risk of credit losses for suppliers of unsecured trade credit. In further analyses, we find that the reduction in trade credit usage is more pronounced among firms in industries with more liquid movable assets, among firms that are more financially constrained, and in countries with strong law enforcement.

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