The Trade Credit Clearinghouse: Liquidity and Coordination Failure

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Link to the draft.

Trade Credit is a Major Source of Risk

- Trade credit is the biggest source of short term financing for firms.
- Source of liquidity spillovers: delayed payment and default of trading partners
  - Real effects: bankruptcy, investment, employment, ...

We study the effects of a unique policy designed to alleviate these spillovers - a trade credit clearinghouse.

The Trade Credit Clearinghouse was recently implemented in Bosnia and Herzegovina

- Firms required by law to report late debt.
  - They report the identity of the creditor and the debt due date.
  - Late debt reaches up to 15% of GDP.
- The clearinghouse uses this information to perform gross multilateral netting of debts.
  - each firm can exactly offset its payables with its receivables provided it is in a debt cycle (circle).
- Cleared around 10% of GDP during 5 years of operation.

Research Question

What is the effect of clearing on firm financial and economic decisions and why?

Novel Empirical Design

- Changes in the debt network that are far away from firm i are exogenous to firm i but they affect i's clearing.
  - able to identify this because we replicated the clearinghouse algorithm and have the debt network data
- We define “far away” as actions of the node separated from i by two other nodes.
  - similar to the “friend of friend” assumption in social network literature (e.g. Bramoulle et al, 2007)

Testable implication: this variation is unrelated to 30 pre-treatment observables → plausibly exogenous

The Clearinghouse is an Exchange Mechanism

- clearing allows firms to use (potentially) illiquid receivables as a means of payment
  - helps avoid default due to late payment or default of trading partners
  - most users are SMEs that have little access to the financial sector
  - we find that clearing reduces default by 6% on average.
  - the effect is bigger for cash poor and financially distressed firms
  - clearing has real effects
    - investment and sales increase
    - cash rich firms reduce their precautionary cash holdings and increase investment

The Clearinghouse is a Coordination Technology

- potentially very costly to gather information in a decentralized manner on a complex debt network
  How to test this idea?
  - simple cycles of 3 can be more easily netted by firms communicating
  - firms in complicated networks will have trouble coordinating
  Evidence:
    - we find that clearing is less beneficial for firms that are in circles of 3
    - firms surrounded by many links benefit more from the clearinghouse

How do we contribute?

First to analyze the effects of a policy experiment that might have sizable real effects and that could be implemented in many countries.