Trade Credit and Financial Strength

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Abstract:

This study examines a crucial managerial choice for firms: identifying when upstream trade credit enhances internal operational and financial preparedness, and when relying more on such financing leads to decreasing returns on value. Using a large-scale sample of U.S.-listed firms, we examine how supplier trade credit and firms' internal operational–financial preparedness interact to influence market valuation. Methodologically, the study employs Trade Credit and Financial Strength Jhang, Cheng & Chiang firm-, industry-, and year-fixed effects models, supplemented by thorough robustness and endogeneity tests, to ensure the validity of findings. Results indicate that supplier trade credit is generally associated with higher firm valuation outcomes. However, this positive association weakens as firms' internal operational–financial readiness improves, suggesting that the incremental value of upstream trade credit decreases with internal capacity enhancement. Additional analyses reveal that this trade-off varies across different decision contexts, including distinctions between value and glamour firms and firms with different levels of customer dependence. Decomposing the fundamental strengths of firms shows that market valuation benefits more from improvements in profitability and operational efficiency, whereas changes related to funding needs do not consistently correlate with higher firm value. Overall, the findings contribute to understanding the conditions under which upstream trade credit acts as a beneficial complement to internal resources and when its value diminishes, providing managers with actionable insights into aligning supply chain financing strategies with internal operational conditions.

Keywords:

Supply chain finance, Fundamental strength, Firm value, Buyer-supplier relationships, Regression analysis, Secondary data.