Trading Companies as Financial Intermediaries in Japan

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Abstract

This paper explores a financial role of Japanese general trading companies (GTCs), which act as a central point in a distribution network among group firms. I examine Meltzer’s conjecture, which holds that financially strong companies like GTCs increase trade receivables and reduce trade payables to shield their trading partners from a monetary squeeze. First, I investigate the trade credit granted to each other by GTCs and all its trade partners. The panel estimation demonstrates that both trade receivables and trade payables decrease during periods of monetary tightness and increase during those of monetary ease. In response to a change in a bank-lending indicator, there is little difference between trade receivables and payables. Thus GTCs become neither net-credit providers nor net-credit takers from this behavior. In other words, interfirm financing passing through a GTC’s balance sheet positively correlates with banking financing. Therefore, the Meltzer hypothesis does not hold for transactions between GTCs and all their trade partners. Instead, gross trade credit functions as a *complement* to macroeconomic bank lending.

Second, I examine trade credit by dividing GTCs’ trading partners into related companies (i.e., subsidiaries and associate firms) and non-related companies. In terms of the reactions of trade credit to market financial indicators, I did not find statistically significant evidence that the Meltzer hypothesis works in either case. No matter with whom a GTC trades, interfirm financing passing through the GTC’s balance sheet moves positively in concert with banking financing. A major difference between related and non-related companies lies in the way in which trade receivables react to a GTC’s individual financial situation (that is, a firm’s individual interest expense rate minus a market’s interest rate). An increase in the interest gap induces a GTC to incur extra expenses over the market rate. In this situation, a GTC reduces trade receivables to non-related firms, but not those to related firms. This behavior eventually works as a shield, protecting their related companies from sharing the parent company’s interest costs.