### Characteristics of Trade Credit:

- This credit is created by the transaction (buying & selling) of goods and services on credit.
- The buyer must purchase the goods and services for reselling. In other words credit purchase for consumption will not create a trade credit.
- There is no interest or service charge for this credit.
- Mutual trust is the basis of this credit.
- This credit is very much informal and easy to deal.
- No security is required for this credit.

### Benefits of Trade Credit

The major advantages of trade credit are as follows:

**Easy availability:** Unlike other sources of finance, trade credit is relatively easy to obtain. It is almost automatic and does not require any negotiations. The easy availability is particularly important to small firms which generally face difficulty in raising funds from the capital markets.

**Flexibility:** Trade credit grows with the growth in firm's sales. The expansion in the firm's sales causes its purchases of goods and services to increase which is automatically financed by trade credit. In contrast, if the firm's sales contract, purchases will decline and consequently trade credit will also decline.

**Informality:** Trade credit is an informal, spontaneous source of finance. It does not require any negotiations and formal agreement. It does not have the restrictions which are usually parts of negotiated sources of finance.

### Determinants of amount of trade credit:

1. Nature of the buying firm.
2. Size of the buying firm.
3. Attitude of the borrower (if aggressive ATC high , if conservative attitude low)
4. Payment capacity of the borrower firm.
5. Seasonal variation of demand & supply.
6. Availability of other sources of credit.
7. Sellers condition about the financial condition of the buyer.
8. Attitude of the seller.
9. Regular payment of debt.
10. Nature of the market (perfect competition)

## Who bears the cost of Trade Credit?

Since the use of funds over time is not free someone must bear the cost of trade credit. It may be borne by the supplier or the buyer or by both the parties.

- The supplier may be able to pass the cost on to the buyer in the form of higher prices.
- The supplier may not, of course, be able to increase the price of a product.
- In such a case he may bear most of the cost of trade credit.
- He may pass the cost on to the buyer in case the demand for the product is inelastic.

So, the buyer should determine who is bearing the cost of trade credit. If he finds that he is bearing the cost of the trade credit, he may want to consider other suppliers to see if he can do better elsewhere.

## How line of credit is different from revolving credit agreement under short term bank loan?

**Answer:** The line of credit is different from revolving credit agreement under short term bank loan. There are some differences between this two. These differences are shown below-

| Topics | Revolving credit | Line of credit |
|---|---|---|
| **Definition** | Revolving credit agreement is a formal legal commitment to extent credit up to come maximum amount over a stated period of time. | Line of credit is an informal agreement between a bank and its customer specifying the maximum amount of unsecured credit the bank will permit the firm to owe at any one time. |
| **Agreement** | Revolving credit is a legal & formal agreement. | Line of credit is an informal agreement. |
| **Nature** | Revolving credit is a medium-term nature financing. | Line of credit is the short term nature financing. |
| **Use** | A part is used, so other portion is unused. | Full amount is to use. |
| **Interest & Commitment Fee** | Revolving credit, the borrowers pay interest on the utilized amount of loan and pay commitment fee on the utilized loan. | Line of credit, the borrowers pay interest on the utilized amount of loan and do not pay any commitment fee on the utilized loan. |
| **Cost** | The cost of revolving credit is high due to commitment fee. | The cost of line of credit is low due to absence of commitment fee. |

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|---|---|---|
| **Borrower** | Both types of borrower can use it. | Regular borrowers can use it. |
| **Renew** | Automatically renewed. | Normally may not be renewed. |
| **Amount & Firm** | Maximum amount but minimum firms use it. | Minimum amount but maximum firms use it. |
| **Balance** | At the end there may be some balance here. | At the end no balance is existed. |