literature - namely, why firms persist in maintaining large stocks of accounts payable, even though some industries have substantial discounts for prompt cash settlement (see the survey evidence in Ng, Smith and Smith (1999)). A commonly encountered invoicing practice among U.S. firms is the so-called “2-10 net 30” contract, meaning that if the invoice is settled within ten days, there is a discount of 2%, and otherwise the invoice must be paid within 30 days (without discount). The implied interest rate for the additional 20 days of credit comes out at over 40% in annualized terms. However, within our framework, a firm may have an incentive to maintain accounts payable if early redemption raises the probability of failure through the violation of the incentive constraints of upstream firms.

There are many avenues of further research. One strand is the role of finance in economic development. In an economy where the SME sector is well capitalized, and financially sound, our model predicts that there are beneficial incentive effects of the SMEs supporting large balance sheets. As well as Japan, some European countries (notably Italy) have large and influential SME sectors. In contrast, the U.S. is known to be more vertically integrated than Japan or some of the European countries. In this context, Korea may be an even more glaring example of an economy that has extensive vertical integration. Of the forces that drive the push toward greater vertical integration, the incentive to overcome the shortage of working capital may be one of them.

Our paper represents a small step in the study of the interactions between industrial structure and corporate finance. The next steps are to use the insights we can gain in order to address the the diversity seen in cross-country studies of corporate balance sheets. The message of our paper is that industrial structure and corporate finance are inextricably linked.