International Trade Finance and Learning Dynamics

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Abstract

Exporting firms face demand uncertainty and counterparty risk. We study how trade finance and long-term relationships facilitate international trade by allowing exporters to learn about these risks. Using micro-level Chilean data, we first document that new exporters are more likely to use cash-in-advance (CIA) arrangements and gradually switch to providing trade credit as they export. The switch is steeper in exporting to riskier destinations. We find that the initial use of CIA depends on firms' former exporting experience and the perceived riskiness of the destination. We consider a simple model with demand and counterparty risk and use it to explain our empirical findings and to determine the relative importance of demand and counterparty risk. Our model implies that exporters tend to initially use CIA and export low quantities to limit their risk exposure. As they learn about their counterparty and foreign demand, they switch to providing trade credit and expand their sales.