

Credit Debate Needs to Get Down to Businesses

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As the small business center of California, Los Angeles drives the largest economy in the United States.

The economic engine in our region is remarkably deep and wide – high-end restaurants, hotels and garages, gift shops and grocery chains, small and medium manufacturers and retailers, and a virtual catalog of other enterprises – and it all depends on a system of business-to-business credit that is absolutely vital.

Elected officials and policy makers in Washington are ignoring that system of credit. Leaders in Sacramento don't even talk about it. Until their focus shifts to business-to-business credit, our economy will not heal.

The L.A. economic system, much like the rest of the American economic system, is based on a strong and resilient foundation of faith and trust between free merchants who engage in unsecured business-to-business credit, otherwise known as trade credit. This credit moves goods and services, and it relies on trust that invoices will be paid after a brief period of time – a period that we call credit. Credit derives from the Latin word for trust and when that trust is broken, the entire system suffers unfortunate consequences.

Unlike consumer credit, business-to-business credit paves the roads under the trucks that carry the goods from the Port of Los Angeles to farms, factories, distribution centers, retail stores and small businesses.

When Joe Smith makes tables, he purchases raw wood. Joe buys that wood on credit from the wood supplier. He gets about a month to pay for it. No special security is required, unlike the mortgage on your house, secured by the property on which you live. Joe enters into purchase order agreements with retailers who want to buy his furniture on unsecured credit terms; typically, they pay Joe at least a month after he ships them the furniture. He trusts he will get paid. He has to get paid, or his wood supplier won't get paid and may not get new orders from Joe if Joe's customers do not pay him.

Running tables

Joe's tables are important. His employees earn their wages making his tables, the truck drivers who deliver his products to retailers depend upon Joe and the retailers make their profit only when they sell Joe's tables. All those jobs feed the economy so families can purchase tables or chairs or countless other products. This is a beautiful, complete circular flow of commerce, but if one component breaks down, the entire flow can break down, leading to lower wages, lost jobs and a weak economy.

You get the picture. Business-to-business credit literally creates the kitchen table around which families sit each month to pay their bills and figure out what they'll spend. However overworked the image may be, the American economy rises and falls around that table.

We applaud lawmakers and policy makers in Washington and New York for taking steps to improve the banking and regulatory systems. We sincerely hope that leaders in Sacramento can overcome their legendary bickering and devise a rational, compassionate way out of the mess that is our state budget. At the same time, we offer a stern warning. Until and unless overall trust is restored (and liquidity is a function of trust), no matter what policy makers do, the economy will continue to lag and the recovery will take that much longer.

Treasury Secretary Timothy Geithner has said that "credit is the oxygen of the economy." We agree, if he meant the entire credit system and not just secured bank lending or consumer credit. Geithner and other policymakers must understand the critical role of business credit in any normal economic recovery.

The focus in Washington has to shift away from only pouring money into banks and brokerage houses. We need Sacramento leadership to shift away from programs that put great stress on painful cuts and none at all on progress. The focus needs to shift to Joe, and that includes a forceful call for national policies that focus on the restoration of business-to-business credit. That will revive the economy in our region. As Southern California goes, so goes the state. As California, one of the largest economies in the world, goes, so goes the nation.

We can lead the recovery, but only when we shift the focus.

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