

## Abstract

### Monetary Policy, Business Cycles and the Behavior of Small Manufacturing Firms

We present evidence on the cyclical behavior of small versus large manufacturing firms, and on the response of the two classes of firms to monetary policy. Our goal is to take a step toward quantifying the role of credit market imperfections in the business cycle and in the monetary transmission mechanism. Our results indicate that small firms contract substantially relative to large firms after tight money. The difference between small and large firm behavior accounts for a significant portion of both the overall decline in manufacturing sales and the overall decline in manufacturing inventories. An important reason that small firms contribute disproportionately to the decline in inventories is that they maintain a fairly stable inventory/sales ratio. Large firms, on the other hand, let their inventory/sales ratios rise in bad times. Relatedly, short term credit flows to small firms contract sharply after tight money, while they actually rise for large firms. Thus, large firms appear to obtain funds to smooth the impact of declining sales, while small firms do not. Finally, we show that the differential effect of tight money on small firms is asymmetric over the cycle, stronger in bad times than in good times. Overall, the broad array of facts we present is compatible with theories that emphasize financial propagation mechanisms.

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