Effects of Collateral on Loan Repayment: Evidence from an Informal Lending Institution

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Abstract
We examine the effect of the collateral informal lenders use to ensure loan repayment. Specifically we measure how the use of movable and immovable assets affects loan repayment and delinquency rate, and assess the extent to which guarantorship and relationship-lending act as collateral to improve loan repayment. With a dataset of 835 individual borrowers drawn from an informal Tanzanian lending institution, we run descriptive and econometric models. The results suggest that movable assets increase the likelihood that borrowers perceived to be less creditworthy will obtain loans from informal sources and repay them. We also find a small proportion of customers to have pledged immovable assets as collateral when borrowing from informal lenders. The results also show the positive effect of referral, which implies that relationship lending and social collateral is key to increasing access to finance through informal lenders. Our results contribute to the advancement of economic theory, specifically in the ex-ante and ex-post-related literature.

Keywords:
Collateral, loan repayment, informal lending, delinquency, Tanzania,