Perceived problems with collateral: The value of informal networking

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Abstract

Many businesses in emerging economies are financially constrained due to their limited use of formal loans. Recent evidence suggests that negative perceptions discourage entrepreneurs from applying for loans. One of the main issues entrepreneurs mention is unattainable collateral requirements. In this paper, we contribute to this line of research by investigating the effect of networking with fellow entrepreneurs on perceived collateral problems. Drawing on quantitative and qualitative data originating from female entrepreneurs in Tanzania, we find that through networking, entrepreneurs are exposed to stories of their peers' experiences with loans which influence their perceptions of formal loans. While existing research suggests that networking generally eases access to finance, we find that the effect depends on the type of networking. Informal networking reduces problems with collateral while formal networking increases problems. Additionally, we find that once entrepreneurs come into contact with formal loans, they are less likely to report problems with collateral. Our results suggest that networking with fellow entrepreneurs, especially in a formal manner, leads to an overestimation of perceived collateral problems paving the way for borrower discouragement.