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Collateralized borrowing around the world: Insights from the World Bank Enterprise Surveys

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Abstract

Despite an important role of collateralized borrowing in corporate finance and financial economics, there has been little empirical research that systematically documents the prevalence and correlates of collateralized borrowing across countries. We filled this gap by investigating firms' collateralized borrowing in 131 countries between 2005–2017 using the World Bank Enterprise Surveys. Overall, 77% of loans require collateral, and the median loan-to-collateral value is 60%. While small firms and loans from non-bank financial institutions are less often associated with collateral, when collateral is pledged, the type of collateral assets is strongly correlated with the loan-to-value ratio. When more illiquid and indivisible assets such as land and buildings are pledged as collateral, higher collateral value is required.

KEYWORDS

access to finance, collateralized borrowing, financing constraints

1 | INTRODUCTION

Collateralized borrowing is a widespread practice for both households and firms. Early evidence suggests that for the U.S.' domestic bank lending, nearly 70% of commercial and industrial loans are made in a secured basis (Berger & Udell, 1990). Collateralized borrowing is designed to overcome market friction arising from information asymmetry, which is where, banks cannot distinguish good from bad borrowers (i.e., as in Stiglitz & Weiss, 1981). Collateralized borrowing allows creditors to recover, at least partially, loans made to debtors in cases of default.

Collateralized borrowing, on the other hand, has also been identified as central in a mechanism that could transform relatively small shocks into large fluctuations of output and investment. Furthermore, it can help transmit shocks across sectors and countries. A seminal paper by Kiyotaki and Moore (1997) explains how the mechanism theoretically works. It shows that if debt needs to be collateralized by the value of a firm's productive assets,

then a small shock that reduces the firm's asset value could also reduce its borrowing capacity. Thus, the firm's investment declines, and this further depresses its asset value and tightens its credit constraint. The mutual feedback between the declines of asset prices and the collapses of investment and output, explains how a small shock can be amplified.

After Kiyotaki and Moore (1997) and Bernanke, Gertler, and Gilchrist (1999), there has been an enormous set of literature that links collateral constraint-based frictions to the amplification and transmission of negative shocks across sectors and countries. Notable examples include Paasche (2001), Iacoviello (2005), Pavlova and Rigobon (2008), and Mendoza (2010). The literature is further motivated by the 2008–2009 global crisis and has been growing substantially to address different policy questions on over-borrowing (Bianchi, 2011), macroprudential policies (Bianchi & Mendoza, 2010, 2018; Jeanne & Korinek, 2020), and the transmission of negative shocks (Devereux & Yetman, 2010). Most of the papers are theoretical, although some have tried to test