

# The Effects of Collateral on Small Firm Performance in Japan<sup>1</sup>

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## Abstract

This paper examines how collateral and personal guarantees affect firms' ex-post performance in the Japanese small business loan market. Based on a unique firm-level panel data set of about 1,000 small and bank-dependent borrower firms, we find the following. (1) Borrowers which newly provide collateral to lenders observe a more sizable reduction of riskiness than those without such security. (2) In contrast to the reduction of borrowers' riskiness, financial condition including lending attitude and monitoring frequency do not observe significant improvements. (3) Improvements in terms of riskiness are more sizable and statistically significant among physical collateral providers than among personal guarantee providers. These findings are consistent with the hypothesis that by providing collateral, borrowers curb their motivation for moral hazard to further reduce their riskiness.

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