Abstract

This paper shows that delinquent borrowers are willing to trade off a relatively large amount of consumption to temporarily improve their credit reputation. I measure the willingness to pay for an improved reputation by exploiting a natural experiment within a large department store in Chile. The store offered delinquent borrowers whose outstanding balance was higher than an arbitrary cutoff a renegotiation that transitioned them to good standing in the credit bureau. Borrowers above the cutoff that accept the renegotiation increase their cumulative net payments to the store by an amount that is roughly equivalent to their initial loan balance, relative to borrowers below the cutoff. The improved reputation allows borrowers above the cutoff to take on more debt with other lenders, specifically, mortgage debt from banks. Ex post, bank debt default rates are higher for borrowers above the cutoff relative to borrowers below the cutoff, suggesting that the bilateral renegotiations between the store and borrower impose a negative externality on banks by reducing the precision of information in the market. The results imply that reputation is a central concern for borrowers in default and that lenders may extract net payments from delinquent borrowers based on the value of reputation.