Function of Collateral

When Asset Class is Account Receivables and Inventory:

A Comparative Analysis of Japanese and US Bank Inspection Manuals

Aki Kinjo (Kansai Gaidai University)

Why do lenders seek collateral? Is collecting cash from the disposal of assets in the event of default the only function of collateral, when the asset class is not real estate? This question is relevant today because loans that use business assets such as accounts receivable and inventory as collateral have been recently introduced to Japan. They are typically called "moveable assets and credit collateral loans" (dosan saiken tanpo yushi) or Asset Based Lending (ABL).

This paper conducts a comparative analysis of inspection manuals for banks in both Japan and the US to analyze the function of collateral in such type of loans. The manuals provide empirical evidence in not only the regulatory framework, but also the thinking of the regulators on the expected behavior of banking practitioners in both countries.

By carefully examining the manuals and supplementary documents, it becomes evident that both US and Japanese regulators recognize the importance of collateral as a medium to gain comprehensive and timely understanding of the borrower. Such function of collateral, in addition to providing liquidation value to mitigate potential losses, is one that cannot be expected when real estate is used as collateral.