

Collateral, Guarantee and the Corporate Finance System

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Abstract

It is often pointed out that the Japanese corporate finance system depends on collateral and guarantee so excessively that it adversely affects the business development of companies and financial intermediation of banks.

I believe that this issue should be analyzed by referring to broadly concerned topics, such as debt and equity, corporate reorganization, corporate accounting and so forth. I believe also that it is most realistic if we analyze the issue aiming at the information processing cost of the parties concerned.

In this article, I first survey related legislation from the viewpoint of its function as a tool for the economic activities of the parties concerned. I show financial instruments as the framework of trade-off between a change of right contents and an intervention for the borrower's management of a fund supplier, by comparing debt with equity. I also describe collateral and guarantee from the viewpoint of their functions in a corporate recovery.

Subsequently, I examine the information processing cost of the parties concerned, management discipline of a company, and the difference in information level between the parties concerned. It is discussed how collateral and guarantee might have adverse influence upon a corporation to make proactive business innovation or prompt business recovery in times of difficulty, while they work effectively for the reduction of information processing cost.

Furthermore, in this article, I describe how the current Japanese corporate finance system depends on collateral and guarantee too excessively to show sufficient function. The Japanese system is shown to be facing a turning point. In fact the civil legislation and the bank supervision related to the corporate finance system have been strongly reformed by the government. Following this reform on the governmental side, business practices on the private side are now changing. As a result, information processing between the parties concerned, such as grasping the business situation of a company, flow of information from a company to a bank, feedback of information from a bank to a company, business innovation and business recovery of a company have come to be done more promptly.

Finally, I discuss how development of private business such as corporate reorganization in the capital market or exploits of current assets as collateral is expected in the future of the corporate finance system in accordance with innovation of information technology.