

# **Expanding Business Credit Using Movable Property as Collateral**

By **Allen Welsh**

International Consultant

Secured Finance

Institutional Reform and the Informal Sector (IRIS)

University of Maryland, College Park, USA

In modern commerce, access to credit often requires the effective use of movable property to secure payment of obligations. Movable property can be used as collateral to secure a loan, much as immovable property can be collateral in the purchase of a home or business property. Movable property should be considered as good as immovable property to secure business credit, under appropriate circumstances. Legal reform can help Bangladesh to take advantage of the opportunity that movable property financing offers. These opportunities unfold many hidden areas of job creation and ease the life of consumers.

A modern law provides security for loans to equip new and old factories with machinery that meet today's commercial standards. Sellers of computers, trucks, tractors, office equipment, and other necessary business equipment frequently need credit to buy the goods that they sell in their stores. A modern collateral law gives them wider access to credit for business inventory. A modern collateral law also permits more Bangladeshis to purchase consumer goods, such as automobiles, televisions, and household appliances. This benefits consumer, but also creates jobs for small businesses that sell, maintain, and repair consumer goods.

Accounts created by the sale of goods and services can be used as collateral for business loans, or they can be bought and sold by factories. This form of financing offers great possibilities to create new businesses and expand existing businesses. Bangladeshi businesses can import, export, and transport goods more safely and at a lower cost by strengthening the law relating to the use of documents of title as collateral. Crops, livestock, and farm machinery provide greater access to agricultural credit to improve agricultural production and efficiency. Farmers, food processors, seed and fertilizer dealers, and other producers and sellers of agricultural products will benefit from a modern collateral law, reducing reliance on imports and increasing domestic production.

Movable property is often used to improve immovable property. New electrical generators, water tanks, pumps, elevators and other building improvements can be purchased more easily and at lower interest rates with a modern collateral law. The state of Bangladesh may use movable property as collateral to purchase equipment for road building, street maintenance, dock improvements, and other important state responsibilities.

Bangladesh has many laws governing the use of movable property as collateral, such as pledge, financial lease, charge, and hypothecation. Unfortunately, these devices are based on the commercial practices of the 19<sup>th</sup> century and before. Bangladeshi creditors generally take movable property as collateral only after immovable property has also been mortgaged. The

requirement of immovable property excludes many worthy businesses from the credit market. As for the businesses that have both immovable and movable property to offer as collateral, they get little in return. The reasons are simple: creditors do not have adequate assurance that their rights in collateral are secure against other creditors, and they cannot be certain of their right to get value from the collateral in the event of the debtor's default. Bangladeshi creditors have rightly concluded that the law does not provide the certainty they need to protect their rights in collateral. There can be very little credit without this certainty, and what credit there is must come at a higher price.

Current law does not adequately warn potential creditors of existing claims against many types of movable collateral. A creditor who lends money based on movables may find that the collateral is already the subject of a lease, a charge, or other security interest. Current law does not contain precise rules to resolve disputes that arise when other creditors obtain claims to the secured creditor's collateral. If a debtor fails to pay taxes, loses a lawsuit, or goes bankrupt, other creditors may seek to take movable property, including the secured creditor's collateral, to satisfy the claims. The secured creditor's rights against these competing creditors are not spelled out in Bangladeshi law.

A central notice system is needed in Bangladesh to solve this problem. A simple filing office containing notices of secured claims in movable collateral can effectively warn prospective creditors of existing claims. The filing of a notice should establish a priority date for the secured creditor's interest in the collateral. If a competing creditor's interest is publicized in the notice system before the notice is filed, the creditor is warned in advance and the creditor's claim to the collateral will be subordinate to the competing claim. But if the competing claim is published after the date of the filing in the notice system, then the secured creditor's right in the collateral should be enforceable to secure repayment of the secured debt, before the collateral is used to satisfy the competing claim.

A great deal of credit can be unleashed in Bangladesh by this simple reform, and the interest rate paid by debtors will be lower. Lenders will be much more happy to lend if they know that there are no prior claims to collateral, and if they are certain that their collateral is safe against the claims of other creditors whose interests arise later.

Still more needs to be done, however, to assure greater access to business credit. A modern secured financing law must offer effective options by which the secured creditor may take control of the collateral, and dispose of it to satisfy the secured debt. Judicial process leading to judicial sale of collateral is expensive, it takes too long, and the outcome is unsure.

When the debtor defaults on the obligation, the secured creditor's remedy must be inexpensive, fast, and certain. There should be no need for judicial action if after default the debtor agrees in writing to surrender the collateral to the secured creditor's control. A modern secured financing law should permit the secured creditor to take and sell the collateral under such circumstances, with the buyer taking full right and title to the collateral.

If the debtor's consent cannot be obtained, the secured party should be given an expedited and inexpensive administrative or judicial means to take control of the collateral and dispose of it to satisfy the secured debt.

If absolutely necessary, the secured party may proceed by judicial action, to obtain an order for surrender of the collateral to the secured creditor for disposition. As a last resort, the secured creditor may proceed by judicial action, seeking judicial foreclosure upon the collateral and judicial sale to offset the secured debt.

It is most important that there be no excessive court fees or assessments associated with the recovery and sale of the collateral. High costs have a strongly negative impact on commerce. Why? Because every creditor must factor the possible cost of enforcement into each and every lending decision. The results are devastating to business credit. The amount of credit is necessarily decreased for everyone, even those who pay their debts on time. The potential cost of enforcement causes high interest rates to reflect the risk of high enforcement costs. In the end, the costs of enforcement is paid indirectly by those borrowers who pay their bills on time, and not by the debtor in default.

These reforms will cost little to enact, and offer much greater access to credit for Bangladeshi businesses, large and small. From the starting entrepreneur to the modern factory, movable property is the basis for the majority of business loans in developed economies. Bangladesh can prosper by taking greater advantage of this opportunity.

*The JOBS Program, supported by USAID/Bangladesh, is implementing an advocacy program that addresses the issues discussed in this article. For more information or to explore options for participation in the program, please contact the JOBS Office (House 1A, Road 23, Gulshan 1, Dhaka-1212).*