

Motivation and Impact of Shadow Banking of Non-financial Enterprises

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Abstract: Corporate shadow banking is the act of non-financial enterprises using excess funds to engage in financial business (such as lending to enterprises with financing difficulties, earning financing differences, or purchasing financial products, etc.) to obtain additional economic benefits[1]. The results show that from the perspective of companies, the motives of shadow banking of non-financial enterprises mainly include corporate governance, speculative profit and risk prevention. On the one hand, in order to complete their management achievements, enterprise managers will choose short-term financial investment instead of long-term industrial investment, bringing about shadow banking of enterprises; On the one hand, enterprises choose to invest funds in the financial industry to improve the inefficiency of the real economy and obtain additional benefits; In addition, companies will also use shadow banking to enhance liquidity and avoid risks.

1. Introduction

In the context of the outbreak of the world financial crisis in 2008, the negative effects of the "four trillion stimulus plan" led to the emergence of Chinese-style shadow banking, which was active in the market in the form of entrusted loans, trust loans, and undiscounted bankers' acceptances (Liu Chun, 2020). In order to meet the needs of economic development for capital and prevent systemic financial risks, the government has strengthened the supervision of the national financial market. In order to circumvent strict regulatory policies, various financial innovation products have been born, and the scale of Chinese-style shadow banking has been expanding. At the same time, multiple micro factors such as market competition, corporate strategy, and corporate performance will also affect the choice of shadow banking of non-financial enterprises by real enterprises.[2-3]

As a "financial disintermediation" and "financial decentralization", shadow banking is the product of the two-way effect of financial innovation and avoidance of financial risks, which will have a great impact on the investment and financing behavior of macro financial markets, micro enterprises and capital markets (Zhu Ciyun, 2017). Previous studies have shown that the financialization of real enterprises will reduce the ratio of market money and social financing liquidity, and enhance the vulnerability of the financial system[3] (He Ping, 2017). From a micro point of view, the profit-seeking nature of enterprises will make real enterprises suffering from the downturn in the real economic market deviate from their main business and invest capital in the financial and real estate fields with higher and faster returns, reducing investment in the main business and inhibiting the development of the main business (Du Yong et al., 2017; Huang Xianhuan et al., 2018). At the same time, the financialization of real enterprises increases the daily financial risk and stock price collapse risk of enterprises, which is easy to cause business crisis (Huang Xianhuan, 2018).

Based on the research results of previous literature, this paper sorts out the reasons and motivations of shadow banking of non-financial enterprises in China and the impact of shadow banking of non-financial enterprises from the micro aspect.

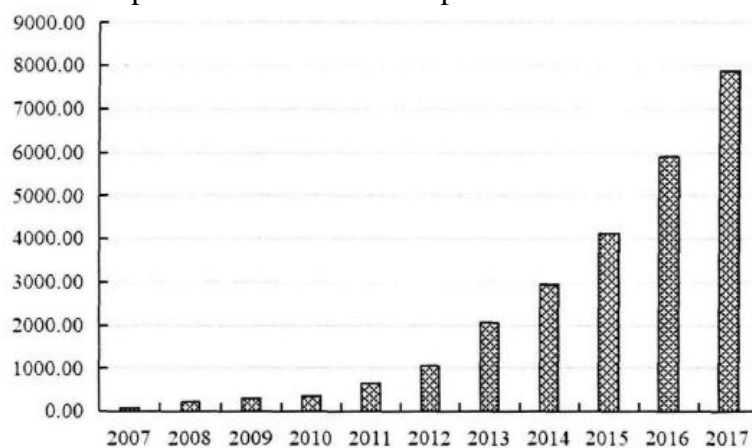


Figure 1. The scale of shadow banking financial assets allocated by non-financial listed companies (unit: 100 million)

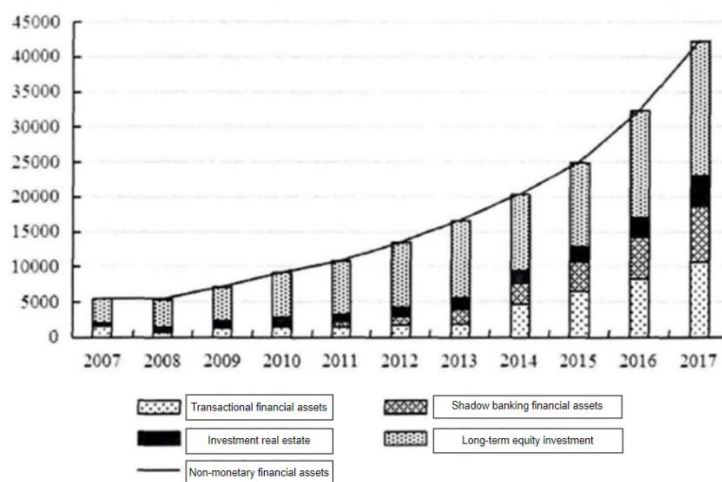


Figure 2. Total scale of non-monetary financial assets held by non-financial listed companies (unit: 100 million)

2. Concepts Related to Shadowing of Non-Financial Enterprises

2.1. Shadowing of Non-Financial Corporations

Corporate shadow banking is the act of non-financial enterprises using excess funds to engage in financial business (such as lending to enterprises with financing difficulties, earning financing differences, or purchasing financial products, etc.) to obtain additional economic benefits. With the rapid development of financial innovation and the emergence of financial products, finance is no longer a unique business of financial enterprises, and many listed companies have begun to act as shadow banking market entities, issuing loans to enterprises with restricted financing in a compliant or non-compliant manner. Under the motive of pursuing profits, listed companies take advantage of financing advantages to raise funds other than those needed for daily operations through various channels such as internal retention and bank loans and invest them in shadow banking, and participate in financial investment through multiple channels such as entrusted loans, private lending, wealth management product purchases and undiscounted bankers' acceptances. It is undeniable that the shadow banking of enterprises has revitalized idle assets that cannot bring profits and opened up the "second path" of profitability. Non-financial enterprises carry out shadow banking business mainly through two paths: direct participation of substantive credit intermediaries and indirect participation in the purchase of financial products. In fact, non-financial shadow banking is one of the most common branches of corporate financialization, and its high leverage also reflects the hollowing out of the economy and the "self-circulation" of finance [10], which seriously threatens the smooth operation of the economy. No matter what form of shadow banking, enterprises transfer assets invested by industrial enterprises to the financial sector, and the degree of financialization of enterprises continues to increase [16], the impact on the financial market becomes more and more intense, and the systemic risks of the financial system become more severe [15].

2.2. Term Mismatch

The large-scale outbreak of shadow banking in China mainly comes from the differentiation of credit rationing after the "four trillion stimulus plan", which is the result of obvious financial term mismatch. The so-called financial mismatch phenomenon refers to the mismatch between the asset side and the liability side of the enterprise, in other words, the source end of the company is short-term assets but must be invested in the long-term business cycle. The allocation flow of financial resources between different enterprises does not meet the Pareto optimality, and the efficiency of capital allocation does not reach the highest.[4] In the Chinese market, where financial repression and credit discrimination have led to most of the capital flowing to state-owned enterprises and governments, or off-balance sheet businesses in the real estate market, the problem of financing difficulties for private enterprises, especially small and medium-sized enterprises, continues to plague the development of enterprises[11]. While the total amount of social financing and the volume of off-balance sheet financing continue to rise, the growth rate of the real economy is slightly declining, resulting in the lack of internal capital chain of enterprises and limited financial support for transformation and upgrading.[5]

Previous studies have shown that the direct cause of the mismatch of corporate investment and financing terms comes from the short maturity of debt in the financial market, which increases the liquidity of funds among enterprises, increases the frequency of enterprise loan renewals and the frequency of creditors supervising enterprises, which is conducive to improving corporate governance (Bai Yunxia et al., 2016; Zhang Qiancheng and Fan Conglai, 2021; Ma Junlu, 2013; Liu Haiming and Li Mingming, 2020). However, at the same time, liquidity and agency problems

caused by maturity mismatch also aggravate the fragility of the capital chain, aggravate the short-term development of enterprise investment and financing, enhance the company's credit risk, and weaken the company's core competitiveness [4].

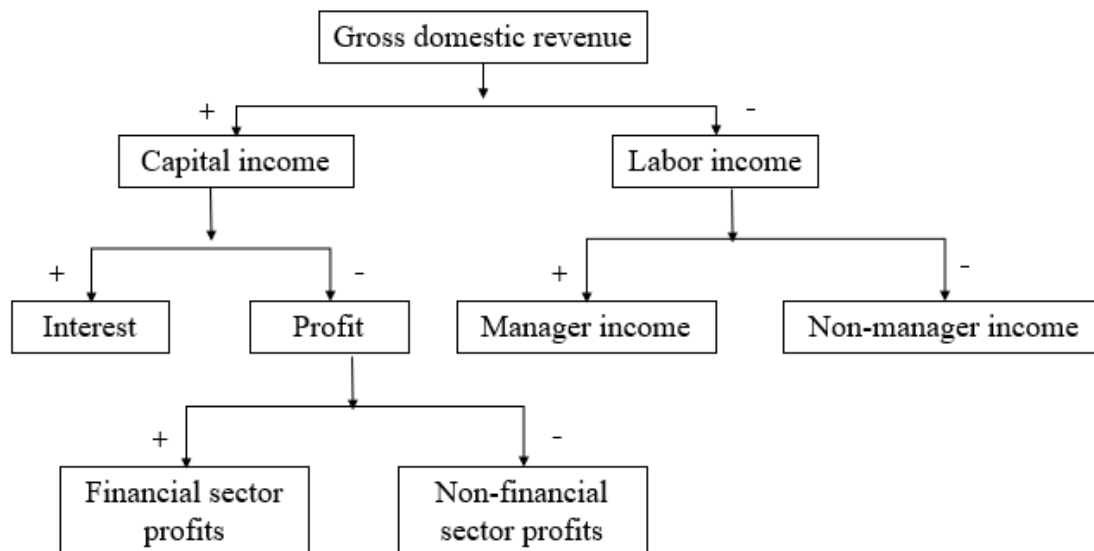


Figure 3. Financialization and income redistribution

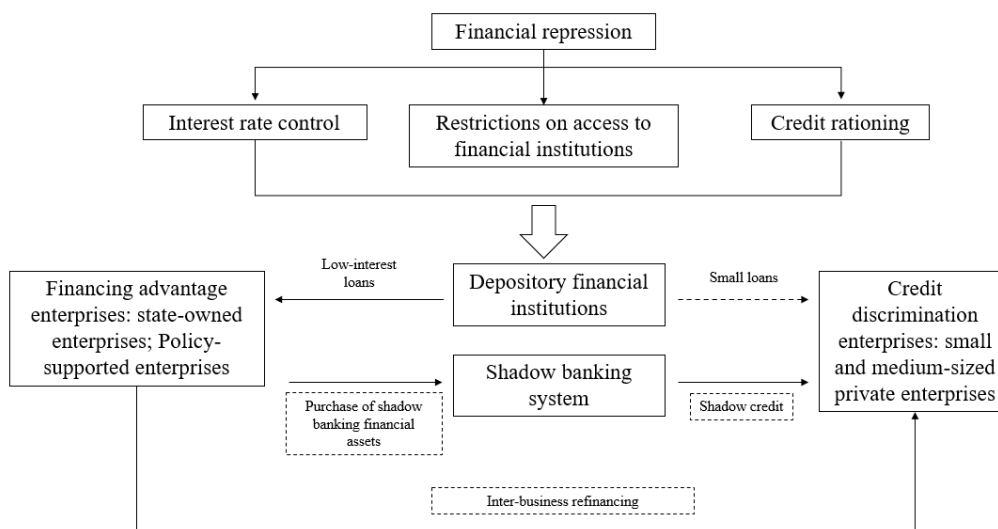


Figure 4. The business mechanism of shadow banking of enterprises

3. Exploring the Reasons for Shadow Banking of Non-Financial Enterprises

According to Keynesian monetary theory, residents' motivation for holding money has the following three points: transaction motivation, prevention motivation and speculative motivation, covering residents' consumption, life and investment. Based on Keynesian monetary theory, this paper divides the micro-level motivations of non-financial enterprises to participate in shadow banking into three categories, namely, corporate governance motivation, speculative profit motivation and risk prevention motivation.

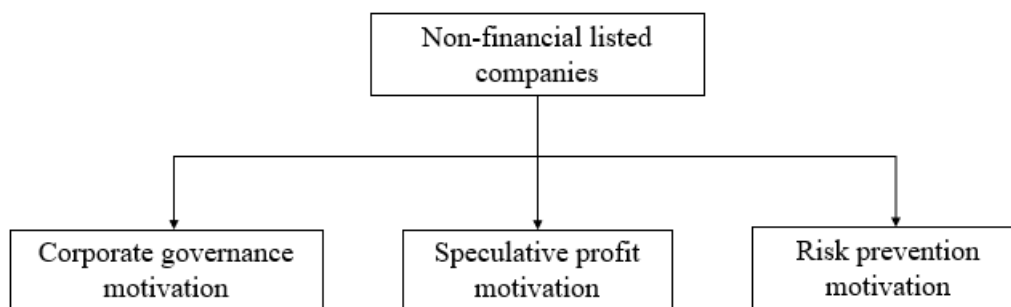


Figure 5. The reasons for shadow banking of non-financial enterprises

3.1. Corporate Governance Motivation

With the formation of the economic financialization pattern, the "separation of powers" of decision-making power, operation and management right and supervision and management right in the corporate governance structure is coordinated and mutually constrained by the shareholders' meeting, the board of directors and the board of supervisors to ensure the smooth operation of the company. However, in the context of the separation of ownership and management rights, the ultimate goals of owners and operators are inconsistent, and the maximization of corporate profits and shareholders' equity has led to the biggest problem in corporate governance - the problem of principal-agency. The emergence of such problems has also promoted the participation of non-financial enterprises in the relevant decision-making of shadow banking business[17,18].

For investors, the company's operating performance depends on the current operating profit. This enables enterprise managers and owners to take improving current profits and maximizing the company's stock price as their business goals, shift operating funds from industrial investment with long term and high net present value to financial investment with short term and low net present value, and accelerate the participation of non-financial enterprises in financialization business. In addition, the second type of agency problem can lead business managers to invest in short-sightedness. In order to maximize the benefits of enterprise managers, they are more inclined to reduce long-term value investment and turn to investment in financial assets with shorter investment horizons and faster returns, so as to improve business performance and enhance their own management value assessment [6-8]. The development of shadow banking business accelerates the liquidity of funds within enterprises, but excessive liquidity will increase the company's agency costs[5] and increase corporate operational risks. Jensen and Meckling (1976) believe that shareholders and managers of companies will choose to transfer the company's cash flow to investment in risky financial assets in order to increase the value of their own stocks, and on the surface, such motives are for better governance of the company, in fact, they are completely motivated by their own profit-seeking motives, and are more likely to sacrifice the interests of the company's creditors when the market environment is unfavorable.

3.2. Speculative Profit Motivation

Speculative profit refers to the increase in the rate of return on capital in the financial market, out of profit-seeking motives, non-financial enterprises reduce their expenditure on their main business and innovative research and development, and use funds for lending, investment and other financial behaviors, so as to obtain high returns and high returns. Due to the loopholes in China's financial market system, the structural problem of mismatch between supply and demand of financial

resources greatly affects the investment decisions of enterprises.[8-9] From the perspective of large enterprises, the supply of high-quality resources provided by formal financial institutions far exceeds the supply required for industrial production, resulting in redundant supply funds and low returns on industrial investment. From the perspective of small and medium-sized enterprises, especially small high-tech enterprises, because the supply funds are monopolized by large enterprises, they face the dilemma of difficult and expensive financing. The existence of problems such as credit discrimination and financial repression has seriously hindered the free flow of capital factors in the market, resulting in rising yields and savings of financial institutions and declining investment efficiency in the real economy, promoting the development of informal financial markets, and promoting the financialization and shadow banking of non-financial enterprises [10] Excessive monetary financing and uneven credit allocation will lead to overcapacity in the real economy, and the coexistence of "asset shortage" and "capital shortage" [18], which in turn will enhance the speculative motivation of enterprises, and promote enterprises with excess money and assets to participate in the arbitrage activities of shadow banking enterprises.

3.3. Risk Prevention Motivation

The liquidity preference theory holds that the greater the liquidity of a financial product, the less risky it is. Some scholars believe that the fundamental motivation for enterprises to participate in shadow banking is to prevent risks, cope with future uncertainties, and mitigate the impact of fluctuations in cash flow and changes in financing factors on the company's daily operations. At the same time, in participating in shadow banking investment and financing activities, enterprises will also choose to allocate some financial assets with strong liquidity to alleviate possible liquidity crises in the future and reduce corporate operational risks.

Generally speaking, the participation of enterprises in shadow banking business is mainly aimed at risk prevention in the macroeconomic environment, economic policy uncertainty, business environment and so on, and managers provide sufficient strong liquidity funds for enterprise risk prevention. [7, 9,12]. Several empirical studies have proved that when enterprises have a pessimistic view of the external business environment, the risk aversion of enterprises is strongly heated, and enterprises are more inclined to invest in relatively liquid financial assets and reduce investment in entities. From the perspective of yield data, the average yield and standard deviation of yield of financial assets held by Chinese non-financial enterprises are far lower than the average yield and standard deviation of fixed asset investment, and the financial assets allocated by real enterprises have the characteristics of "low return" and "low risk". This suggests that the motivation for shadow banking of non-financial firms is not only to make a profit on investment, but also to avoid risks.

4. The impact of Shadow Banking of Non-Financial Enterprises

From a positive point of view, the shadow banking system of non-financial enterprises can supplement the loopholes of the existing financial system, help regulate the flow of financial assets among different types of enterprises, meet the capital needs of enterprises with inferior funds, and alleviate the distortion of resource allocation under the current market[13,14]. It is helpful to improve the efficiency of overall economic resource allocation and reduce the friction of the financial market, which is the sub-optimal path of current financial resource allocation. At the same time, Zeng Jiaying [16] found through empirical evidence that the participation of non-financial enterprises in shadow banking can help expand the asset scale of enterprises, which not only plays a positive profit role in the profitability of the current period, but also affects the profitability of the next year.

But while we affirm shadow banking, we cannot ignore its negative impact on companies, the financial system, and the macroeconomy. For the enterprises themselves, non-financial enterprises have weaker risk identification and management capabilities for financial assets and shadow banking system than financial enterprises, and once there is a problem in the cash flow of participating in the shadow banking business, it is very easy to cause a shortage of investment funds in the main business in the operation of the enterprise, which increases the financial risk of the enterprise. For the financial system, when non-financial enterprises join the financial system of the market through shadow banking business, it will aggravate the coverage of systemic risks in the financial market, increase the risk of cross-contagion between the financial industry and the non-financial industry, increase the risk of corporate stock price collapse, and increase the operational risk of the financial market. For the macroeconomy, on the one hand, it intensifies the "hollowing-out" of the industry, resulting in more social funds flowing from the real economy to real estate and finance, resulting in the generation of "crowding out effect"; On the other hand, shadow banking of non-financial enterprises will aggravate financing problems such as credit discrimination and financing distortion, further deteriorate the efficiency of capital allocation, and lead to a decline in social welfare.

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Data Availability

Data sharing is not applicable to this article as no new data were created or analysed in this study.

Conflict of Interest

The author states that this article has no conflict of interest.

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