
Shadow Banking: Transaction-level Analyses Of Entrusted Loans

Shadow banking can be defined as a group of financial intermediaries facilitating the creation of credit across the global financial system where the activities are outside the traditional banking system. It has grown exponentially in the last decade in China. There are two types of entrusted loans which are affiliated and non-affiliated. The purpose of this study is to perform transaction-level analyses of entrusted loans which is the largest component of shadow banking in China. Besides, researchers also able to observe the types of investments these loans fund and to study their pricing efficiency. Supporters see shadow banking as an innovation that can enhance the economy's financing channels and contributes to a more market-oriented financial system. However, the critics stated that shadow banking might lead to higher debt levels and less transparent debt where it will bring risk to the stability of China's financial system and economy. There are some problems or issues that arise in this study. One of the issues is who makes entrusted loans and when. Besides, which firms are borrowing, and at what price also one of the issues in this study. The third issues that arise by researchers is the pricing of the loans and the last issues in this study is wealth effects of entrusted loans. Therefore, these issues were examined by the researchers. In this study, the scope of study basically focused in China including at cities, coastal are and inland areas.

Researchers chose primary data by collecting their sample and data manually. They searched for the keyword "entrusted loan" in all public non-financial firms' annual reports during 2004-2013. They also supplement the data with entrusted loan announcements. They get their primary data through collecting data on a borrower's industry, headquarters location and whether it is an SOE based on information provided by the lender or by their own manual search. In addition, the researchers also used secondary data to obtain additional information about the lenders from Wind Database which provides accounting and return data for listed firms. However, they have limited information about borrowers because in their sample the majority of borrowers which is 99% are private firms. Based on the study, the researchers' sample includes 2,995 entrusted loans where it was made by 498 unique firms that correspond to 1,107 firm years from 2004 to 2013. They observed the determinants of loan decisions through a sample which include 18,003 firm for all the listed non-finance Chinese firms during 2004 to 2013. The researchers analysed the data by using Loan dummy as the dependent variable to run logit regressions and run Tobit regressions using Loan amount/asset as the dependent variable. They also run multivariate regressions to explore the determinants of the loan decisions.

The first issues that related to "who makes entrusted loans and when" had investigated by the researchers. They found out that when lender's size and credit is tight in the economy, affiliated and non-affiliated loans will increase. This shows that entrusted loans are market reactions to credit shortage, and allow privileged firms access to capital to channel funds to less privileged firms at cheaper rate. Nonetheless, there is a difference between affiliated and non-affiliated loans' lenders. Lenders of affiliated loans more likely to be SOEs, have high sales growth and have raised new debt recently but lenders of non-affiliated loans tend to have lower growth rates and debt ratio. Lender of affiliated loans do not mind raising new capital to finance the loans other than good profit. For the non-affiliated loans, they use the loans as a new channel to

generate profits and growth.

Next, researchers also examine in the second issues, which firm are borrowing and at what price. To get the result in this issue, researchers calculated the adjusted interest rate as the difference between the loan rate and the official bank loan rate which is specified by the central bank. They revealed that affiliated loans charge about the same rate as official bank loans which means the borrowers pay the same rate as the lenders' cost of borrowing. In contrast, non-affiliated lenders charge a market rate which is higher compare to the official bank loan rate since it acts as credit intermediaries. This reflects official banking system is quite distorted. The shadow banking growth continuously is due to the low bank loan rates and the restricted access to the banking system for the more productive private sector. In addition, researchers stated that most of the affiliated loans are within-industry loans. In the other words, the amount of entrusted loans going to the real estate and construction industry is not high and is lower than that of bank loans. On the other hand, non-affiliated loans have a much larger portion of money flows into the real estate and construction industry. Affiliated loans are mostly concentrated in the two biggest cities which are Beijing and Shanghai and both cities are directly controlled by the central government. Generally, affiliated loans are made by SOEs and especially large SOEs, are headquartered in Beijing or Shanghai. According to the WIND database, the five provinces or areas that lend most are Shanghai, Beijing, Zhejiang, Guangdong and following by Shandong in terms of disposable income per capita in 2013. For non-affiliated loans, it more likely to occur between parties from the same area or from the same city and it most active in Zhejiang province. Thus, non-affiliated loans can be said that mostly happen in prosperous areas with already active commerce and economic activities. Moreover, researchers presented a summary statistic where it is consistent with prior studies by showing that affiliated loans tend to have greater credit availability and lower collateral requirements. They also stated that the percentage of SOE borrowers for non-affiliated loans and the proportion of same-industry loans is much lower than affiliated loans.

Apart from that, the third issues is related to pricing of the loans. The result disclosed that the pricing of both non-affiliated loans and affiliated loans depends on borrowers' fundamental risk and information risk. Non-affiliated loans are still much more sensitive to informational risk even the borrower is in the same city or same industry as the lender the rates. Lenders have good information about affiliated parties regardless of whether they are from the same city. This evidence suggested that affiliated lenders are less sensitive to risk. The interest rate of non-affiliated loans strongly predicts future loan performance. This is concept actually based on that riskier loans are charged with a higher interest rate ex ante and end up with more defaults ex post. Non-affiliated loans are priced in a fairly efficient way and its rate incorporate risk in a more efficient way.

Furthermore, the last issues in this study is wealth effects of entrusted loans. Researchers found out that announcement returns suggests that affiliated and non-affiliated loans are fairly-compensated investments. The result proposed that affiliated does not create value or destroy value. Investors view affiliated loans as a form of investment that will receive a fair compensation in the future rather than inefficient subsidization although the rates of affiliated loans are lower than market interest rate. On the other hand, non-affiliated loans either destroys value or send negative information about the lender. Investor respond negatively even though the firms' first non-affiliated loans show that lenders' poor investment opportunities in their main businesses.

In conclusion, the researchers had done the study in a proper way and the literature review is sufficient. They chose different types of methodology such as using primary and secondary data to collect data and using regression to explore the determinants of the loan decisions. Various type of methods in collecting data can create a more efficient result. The study conducted by these researchers is quite unique compare to past study. They are the first person who studied the pricing and wealth effects of affiliated loans and also non-affiliated loans. There are some new findings that can be found throughout this study such as what kinds of firms tend to make entrusted loans, at what prices are both loans provided and how does it compare to the official bank loan rate, and last but not least is related to the affiliated loans and non-affiliated loans create or destroy value.