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"In-Laws Effect" of the Enterprise and the Bank Equity Marriage

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Abstract. A good relationship between the enterprise and bank is important for the firms to obtain loan in the banking dominated financial market. How to resolve the financing difficulties for the enterprise financing channels blocked became a much more important proposition. This paper examines the effect of the holding bank on bank loan from the perspective of political alliances. Using correlation data of shareholding Banks and credit funds, this paper found that as the credit policy uncertainty increased, more and more companies use shareholding Banks to get good relationship with the fact. Further study found that financial institutions holding 5% stake in these companies get more long-term loans. In the presence of more uncertainty of the external financial policy background, relying on financial institutions based on the ownership of marriage "equity", this paper provide an new perspective for an enterprise to obtain the cash needed. This paper has contributed to understand the firm financing mechanism from informal institution perspective.

1. Introduction

Currently, as banks shrink the size of their capital and credit, companies generally face varying degrees of capital pressure. Private enterprises mutual insurance debt crisis of Wenzhou, Zhejiang and Jiangsu Sheyang Agricultural and Commercial Bank run[1] have again proved that informal financing channels exist huge financial risks. In the current background of limited credit resources provided by Central Bank, most enterprises have limited financing channels. Generally, the funds needed to maintain normal operations are mainly obtained from banks [1]. However, the pressure on today's banks is also considerable, such as performance evaluation, assessment of Basel II, etc. If enterprises want to obtain working capital through banks, they always can't apply for anticipated loan volume because more and more materials are need, and conditions are getting stricter. So for ordinary enterprises, especially enterprises not dominant in market, can they only feel powerless and frustrated about 'loan'? In fact, that is not the case. Our research finds that if enterprises can establish equity marriage with banks through equity participation, then financing environment can be improved effectively.

2. Thought of by "Political Marriage"

In ancient China, there always existed 'political marriage' to achieve political stability such as the well-known story *Zhaojun Going out of the Frontier*. The core of this kind of marriage is establishing genetic relationship between two countries through marriage to benefit mutual beneficiary cooperation and achieve political stability. The degree of mercerization of Chinese amount is relatively low, so there are obvious 'human loans' in the allocation of bank credit resources [2]. To this extend, large enterprise groups will always obtain relatively more bank loans. By contrast, small and medium-sized enterprises get much less bank loans than large ones and are on the 'edge' of financial market [3]. If enterprises can get inspiration from ancient 'political marriage' and apply marriage to obtaining bank loans, a good balanced financial plan for investment and financing will be made. The idea of 'financial marriage' is based on the fact that any enterprise shall satisfy the interests of shareholders [4]. Enterprises become shareholders of banks through participation in banking institutions. Then enterprises naturally get closer to banks, changing from the 'stranger' outside the door to 'family' inside the door. Since the establishment of 'in-laws' through equity marriage, enterprises surely enjoy 'proximity' in bank loan programs. Logically, it makes sense. But dose practice supports our hypothesis? Next, let's verify above hypothesis with objective facts.

3. 1/5 of Listed Companies Participate in Unlisted Banks

According to financial data terminal of Wind and data compiled by us, it shows that there are already 482 listed companies holding shares in unlisted banks and about 1/5 of listed companies participating in the marriage of bank equity[2] by the end of 2012. The number is growing further, showing that some listed companies have tasted the benefits of 'in-laws'. The database of Wind also shows listed companies such as AJ Securities, Luoniushan, Radius Support and Xinhu Zhongbao all own equity in more than 5 banks. Even if the large central enterprises with 'national names' considered to be 'well-to-do' such as Chinese Architecture, China Railway Engineering Corporation and Chinese China Metallurgical, they have equity investments in more than 7 banks. The data shows if enterprises can participate in the operation of banks and become a member of 'family meeting', they can get more benefits.

Table 1 Amount for Listed Company to Holding Banks

Year	Amount	Holding 5% Above
2006	254	40
2007	218	32
2008	281	48
2009	328	51
2010	349	57
2011	408	61
2012	482	85

According to the data, the proportion of equity investment of enterprises to banks is still relatively small, mainly because the share capital of banks is large. However, this doesn't affect enterprises' participation in equity investment of banks. The data in Table 1 is the statistics we have made for the enterprises holding more than 5% of the banks' share. Statistics show that there were only 40 enterprises holding more than 5% of the banks' share in 2006. However, that number doubled in 2012, up to 85 enterprises. It's worth mentioning here that there are many listed companies participating in securities, insurances, and trust and finance companies[3]. Equity participation in these financial institutions will provide listed companies with more help to solve financial problems. In 2003, Shenzhen Zhenye Group had a 21% stake in Shenzhen Energy Finance Company, which actually provided a strong fund operation platform for Zhenye Group. Finance companies, by nature, have the ability to bank credit. They just have specific clients.

It is worth mentioning that the topic of private bank pilot which is very popular recently is enterprises investing in finance to provide financial security for overall enterprise expansion by nature. For example, one of the initiators of private banks, CHINT ELECTRIC has participated in Bank of Hangzhou[1]. In the

[1]*The Fracture of Mutual Protection Chain of Capital Chain Leads to 'Runaway Tide' of Private Enterprises*, refer to http://www.cien.com.cn/html/Home/report/74650-1.htm, August 25th, 2014; *The Beginning and End of Run of Sheyang Agricultural Commercial Bank*, refer to http://kuaixun.stcn.com/2014/0327/11283513.shtml, March 27th, 2014.

[2]This paper investigates the non-financial listed companies holding shares in unlisted banks. But because listed banks have too much equity, ordinary enterprises are unlikely to hold more than 5% of shares. According to viewpoint of control theory, enterprises holding less than 5% of shares can't participate in operating decision of enterprises being held. Another research finds that the motivation to hold listed banks is mainly based on investment returns. At the same time, the liberalization reform of urban commercial banks also requires the introduction of strategic investors, which makes it possible for the public to hold shares of banks.

[3]Limited by the availability of data, data on holdings of non-bank financial institutions in financial database of Wind is less and incomplete. Meanwhile, banks are still leaders of financial resources in current financial market.

[4]By the end of October 13th, 2014, China Securities Regulatory Commission has approved the preparation of 5 private banks including Webank, KCB Bank, Wenzhou Civil and Commercial Bank, Zhejiang MYbank and Shanghai Huarui Bank.

[5]By the end of October 13th, 2014, China Securities Regulatory Commission has approved the preparation of 5 private banks including Webank, KCB Bank, Wenzhou Civil and Commercial Bank, Zhejiang MYbank and Shanghai Huarui Bank.

promotion period of current financial market reform, the state strongly encourages private capital to enter local, especially rural financial market reform, concentration of private idle fund to enter rural commercial bank and rural bank [5]. In the political context, if enterprises can catch the financial reform 'express', they will certainly be able to share a good 'reform dividend' in amount market reform.

4. Obtain More Bank Loans through Participation

Participation in banks makes enterprises 'closer' to banks. We are going back to the topic of 'political marriage' here. 'Political marriage' isn't marriage without political interest, which needs to get political returns. Enterprises' participation in banks is also 'premeditated'. The data in Table 2 shows that compared with the control group, long-term loans obtained by enterprises holding more than 5% of bank shares are obviously higher than loans of non-equity enterprises. Thus, we can clearly see the true 'attempt' of enterprises participating in banks, obtaining long-term loan needed by long-term investment actually. Long-term loans gained by participating companies are 3% higher than that of non-participating companies on average. Considering the large assets of listed companies, the long-term loans available to participating companies are considerable [6]. This further illustrates that participation in banks can indeed provide effective financial support for investment and operation of enterprises. At the same time, the larger the banks loan size, the larger the given margin of preference for interest rates.

Table 2 Credit Ability between Holding Bank and Non-Holding Bank

Year	Long-Term Bank Loan Ratio	
	Holding Bank	Non-Holding Bank
2006	0.09	0.06
2007	0.08	0.06
2008	0.08	0.06
2009	0.09	0.07
2010	0.09	0.06
2011	0.08	0.05

By being 'in-laws' through equity investment, enterprises can not only get more bank loans, but also likely get lower interest charges. Bank credit always adopts two modes: mortgage and guarantee, mainly because of information asymmetry between borrowers and lenders [7]. Enterprises have been 'familiar' with banks through participation, so the conditions have been relaxed naturally, leading to the acceleration of turnover of assets and efficiency of asset operation. The research of existing literature shows that even if banks have a risk assessment system, all things are just formalities [8] basing on 'nepotism' such as political affiliation. In terms of asset-backed loans, the historical information on the mortgage and review of the value of assets are 'formalized'. Therefore, it's not hard to see that enterprises can establish close atmosphere with banks through equity investment. Especially for enterprises that are discriminated against in financial market, equity marriage is one of favorable ways to 'get close to' banks. In the relationship-oriented environment of China, there are differences in attitudes towards 'strangers' and 'families' [9]. Therefore, enterprises need to connect with banks through equity to become families to obtain financing convenience.

This shows that the relationship between banks and enterprises can be effectively strengthened and enterprises can obtain funds needed by enterprise operation through enterprises participating in banks. There is similar operation experience to enterprises participating in banks or banks participating in enterprises in developed countries such as Japan and America. The mutual shareholding between banks and enterprises can effectively reduce information asymmetry between enterprises and banks [10]. At the same time, banks can effectively supervise fund usage of enterprises and understand normal production

[6]Holding more than 5% of shares is the minimum threshold for investors to participate in operating decisions. Generally speaking, the investment behavior of holding less than 5% of shares is defined as general securities investment behavior. According to regulations of *Accounting Standards for Enterprises 2006-Financial Assets*, the equity investment of holding less than 5% of shares is defined as trading financial assets or available-for-sale financial assets.

and operation of enterprises and the demand for funds through equity marriage. To some extent, it's an effective way for banks and enterprises to achieve win-win through equity marriage of participating in banks. In the current process of Chinese economic structure transformation and deepening reform in the financial sector, enterprises should make full use of the current positive policy advantages. Holding banks, especially in listed banks, can be regarded as a shortcut to resolve the shortage of funds.

5. Optional Ways and Methods of Participating in Banks

In the current positive period of banking reform, it will be a better opportunity to achieve a combination of production and finance if you can choose a better way to participate in banks. Then, which ways should enterprises choose to enter banking industry? This may be the answer most enterprise chief finance officer need badly. From the regulation policy of CBRC, mainly can choose from the following ways:

5.1 Purchase shares of listed banks through secondary market

According to financial database of Wind, there are 16 banks in Chinese banking industry being listed on two stock exchanges in Shanghai and Shenzhen by the end of 2013. In addition, Industrial and Commercial Bank of China, Bank of China and Agricultural Bank of China have been listed on The Stock Exchange of Hong Kong. The overall listing of banks provides a favorable investment channel for enterprises to participate in banking institutions. Enterprises become shareholders of listed banks by buying bank shares through secondary market. It's worth reminding here that according to rules of shareholders of listed companies, only the shareholders holding more than 5% of shares of listed companies are qualified to participate in discussion and decision-making of company matters. In other words, enterprises are qualified to be 'in-laws' of banks and 'bargain with' banks only when they hold more than 5% of shares of listed companies. Of course, 5% share of banking institutions is an enormous investment for ordinary enterprises. But it doesn't mean that enterprises need to invest separately in the project. The form of investment consortium is optional. For example, equity joint ventures can be formed with regional business partners or business partners with normal business dealings, to increase the share of banking institutions in the form of investment union and realize the purpose of obtaining bank loans through equity investment.

5.2 Participate in the reorganization and transformation of urban commercial banks

At present, the organization and transformation of urban commercial banks is in progress, providing favorable investment opportunities for enterprises to participate in banks. Generally speaking, urban commercial banks are main channels for enterprises to obtain loans [11]. Based on business connections and demand for funds, participating in commercial banks may be the preferred investment channel for enterprises. Based on past business connections, the relationship between enterprises and banks has a certain preliminary basis. Meanwhile, the transformation of commercial banks adopts the joint-stock system, which provides a legal way for enterprises to participate in banks. In practice, enterprises can choose banking institutions that have close business relations with them and have more bank loans as objects of investment and increase amount of shares invested as much as possible. Enterprises can also participate in the stock reform of several urban commercial banks at the same time to disperse investment share and sources of loans. Of course, enterprises should take the current reorganization and transformation of rural credit cooperatives into consideration and increase share of equity investment appropriately to find effective resources of funds for loans of subsidiaries in the future.

5.3 Jointly initiate the establishment of private banks

If enterprises have enough capital reserve, they may as well focus on private banks, the hot investment projects at present. According to the requirements of CBRC, the establishment of private banks must be initiated by two sponsors. So for enterprises with large capital requirements, especially for enterprise groups in capital-intensive industries, it's of important strategic significance to cooperate with other enterprises to establish private banks. It should be stressed here that the establishment of private banks can adopt multi subjects and industrial group internal bank commonly used by Japanese enterprises. The financing gap of industrial development can be effectively eased through the central banking model of industrial agglomeration [12]. If enterprises have limited financial resources, participating in private banks is also a good channel to enter financial industry. By contrast, generally the barrier for enterprises to enter private banks is much less than that of state-owned banks. At the same time, the size and interest rate of loans obtained from private banks will be considerable in the future.

5.4 Participate in the equity transfer and replacement of property rights exchange market

Now enterprises can participate in banks through property rights exchange market with the help of the system of multi-level capital market. The most typical one is new three board share transfer system. Enterprises can also participate in M&A activities of banking industry through property rights exchange market. Enterprises can participate in investment and operations decision-making of banking institutions by obtaining equity share of banking industry through property rights exchange market. Of course, at present the development of property rights exchange market is in the early stage, which requires enterprises to obtain timely and accurate information on equity transfer by own resources and information channel [13].

Generally speaking, there are many ways for enterprises to participate in banks. The financing problems can be effectively eased through equity marriage. For enterprises with strong capital demand, such 'in-laws effect' should be fully tried.

6. Conclusion

At present, financial liberalization reform of China is still in progress. It should be clear that the process of financial liberalization is long and tortuous. More importantly, it's hard to avoid 'human account' in emerging market country. It is of great value for enterprises to establish and maintain a good 'in-laws' relationship. The research in the paper has provided a realistic way for enterprises to optimize financing strategies under the background of overall regulation of external credit resources. Especially for those enterprises that have relatively few financing channels and higher financing costs, there will be a considerable 'in-laws effect' in the long run through cumulative equity investment. Therefore, enterprises with 'obstruction' in financing channels may as well participate in this kind of 'long-term investment' in the process of financial liberalization reform and get 'a slice of cake' in the allocation of credit resources.

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