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# Shadow Banking and Commercial Banks: Mini Review

Josua Panatap Soehaditama[1*], Adler Haymans Manurung[2], Nera Marinda Machdar[3]
[1]Institut Keuangan Perbankan dan Informatika Asia Perbanas, Jakarta,
[2,3]Universitas Bhayangkara Jakarta Raya
**Corresponding Author:** Josua Panatap Soehaditama
josua.panatap@perbanas.id

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A B S T R A C T

The purpose of this article is to see the relationship between two variables from existing research results with review literature. The method used is qualitative with a literature review of scientific articles looking for relationships between variables used in this article. Literature review sources come from articles from journals, books, and scientific papers. Shadow banking and commercial banks are two things that exist in the banking world today, the results of research on this variable have not been too much so that with the results of research from this article finished adding a different reference and colour even with the description of several scientific articles from journals, books, and others. There is a significant influence from the results of several scientific articles, including (Tang & Wang, 2015), (Tan, 2017), and (Zhu et al., 2019). Other researchers may continue with the same research variables at some other time, and this article does not refute or counter, only add colour to the results.

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**INTRODUCTION**

In the global financial system, there are two sectors that have an important role in providing financial services, namely traditional banking or commercial banks and shadow financial institutions or shadow banking. Commercial banks are financial institutions that are regulated by financial authorities and are subject to established rules and regulations. The aim is to ensure that banks operate safely, fairly, and in accordance with sound financial principles (Soehaditama, 2023). On the other hand, shadow banking refers to a network of non-bank financial institutions that provide financial services similar to traditional banks, but operate outside of the same regulations and supervision. Shadow banking is a simple bank model of maturing changes in maturities to illustrate how sudden contractions in short-term funding in the shadow banking sector can and how the crisis may eventually spread to the commercial banking sector. In our model, commercial banks are protected by a safety net. Therefore, they are also subject to regulation, which incurs regulatory costs for banks. The shadow banking sector competes with commercial banks by also offering forward exchange services. Unlike commercial banks, shadow banking is not part of the safety net and is not subject to regulatory fees (Banking & Luck, 2014).

The shadow banking sector financed long-term real investments with large-scale short-term loans, asset-backed securities (ABS) financed by paper-backed commercial securities (ABCP), rising subprime interest rates created uncertainty about ABS yields, leading to the market crash of ABCP, the main short-term financial instrument of off-balance sheet banking (Krishnamurthy et al., 2014). In research from (Tang & Wang, 2015) stated that found evidence that the higher the performance of shadow banking, the higher the yields and risk-adjusted returns of Chinese commercial banks. The active risk of shadow banking leads to credit expansion and changes the conditions of traditional banks, which in turn makes credit offerings more sensitive (Meeks et al., 2013).

Shadow banking by commercial banks generates high-quality returns through information asymmetry and regulatory arbitrage. However, the effect of diversification is uncertain and is determined by the following factors: 1) risk, i.e. volatility and current performance of paid businesses. 2) Linkages between traditional lending activities and fee-based businesses. 3) Characteristics and regulatory system of the bank, such as its size, solvency ratio, location, etc. (Tang & Wang, 2015). According to (Tan, 2017) shadow banking also provides more funds to commercial banks to conduct other interest-free business activities, which is expected to increase the profitability of Chinese commercial banks, so the effect of shadow banking on the profitability of Chinese commercial banks is unclear. The problem that exists from some of the descriptions above, the lack of strict regulation and supervision compared to commercial banks (Goodhart, C. A, et al. 2016). Because they are not subject to the same regulations, higher risk practices may emerge within the sector. This can create instability in the financial system as a whole (Pozsar, et.al. 2013).

Lack of transparency and close supervision can result in instability in the financial system as a whole and a potential financial crisis if these risks are not managed properly, a problem that exists in shadow banking (Financial Stability Board, 2017). The purpose of this article is to see the relationship between two variables from existing research results with review literature.

## LITERATURE REVIEW

### Shadow Banking

Shadow banking is a banking activity such as credit, maturity, and liquidity changes that occur outside the regulated area without direct access to public sources of liquidity (Banking &; Luck, 2014), shadow banking handles traditional banking operations and transfers traditional credit relationships to securitized credit relationships (Adrian &; Ashcraft, 2012;Gennaioli et al., 2013)Shadow banking can meet the demand for money by issuing short-term bonds equivalent to money creation, and the demand for money stimulates the growth of asset-backed commercial paper markets (Sunderam, 2015).

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### Commercial Banks

According to (Saunders &; Cornett, 2008) Financial institutions that function as intermediaries in the economy by providing various financial products and services to the general public and companies. The main function of commercial banks is to collect funds from deposits received from customers and allocate them in the form of credit to borrowers who need funds. Commercial banks provide various financial services such as opening savings, current accounts, and time deposits, providing loans for the needs of consumers, companies, and investment projects, managing payments and transactions, and providing other financial services such as securities, insurance, and financial consulting services (Berger, A. N., et.al, 2016).

## METHODOLOGY

The method used is qualitative with a literature review of scientific articles looking for relationships between variables used in this article. Literature review sources come from articles from journals, books, and scientific papers.

## RESEARCH RESULT

The scientific articles found make a reinforcement and provide an answer there is research between these two variables that are related, to this scientific article is completed where there is some literature submitted and will be elaborated starting from the study of property (Banking &; Luck, 2014) with the results of the research submitted First, the relative size of the shadow banking sector determines the stability of the financial system. If the shadow banking sector is small relative to the secondary market capacity for shadow banking assets, shadow banking is stable. However, if the sector grows too large, it becomes fragile: an additional balance is created, which is characterized by a panic-driven run into the shadow banking sector. Second, if self-regulated commercial banks engage in shadow banking, the larger shadow banking sector will be sustainable. However, if the threat of crisis re-emerges, the crisis in the shadow banking sector will also spread to the commercial banking sector. Third, bank safety nets may not have prevented a banking crisis in the face of regulatory chaos. In addition, safety nets can be tested and may end up costly for regulators.

Subsequent studies from (Adrian & Ashcraft, 2012a) research results in an overview of the new shadow banking regulations and highlights their uneven impact on the likely future size of the shadow banking sector. While changes in accounting and capital requirements reduced the incentive of banks to engage in various arbitrage activities at the heart of the financial crisis. ABCP activity and securitization - the total level of capital and risk sensitivity increases significantly. provide strong incentives to finance credit intermediation outside the banking system.

Studies from (Tang & Wang, 2015) with the results of our study found that our preferred variables, such as shadow banking ratio, capital adequacy ratio, have a greater impact on risk-adjusted returns than ROAA. Taken together, our empirical evidence is generally consistent with the notion that shadow banking is associated with higher returns and risks in commercial banks.

The next study from (Tan, 2017) with the results of non-interest income market research is more competitive compared to the deposit and loan market. It was also reported that weakening competition in the deposit market will lead to an increase in the profitability of Chinese commercial banks. Finally, the results show that shadow banking increases the profitability of Chinese banks.

Subsequent studies from (Zhu et al., 2019) with the results of bank research require on balance sheet shadow banking business (OBS-SBB) to avoid capital requirements, ex post small banks significantly increase their OBS-SBB ex post, and the effect is greater among small and medium-sized banks and during periods of loose monetary policy.

From several articles related to the research of this scientific article, there are several findings or results from articles owned (Tang &; Wang, 2015), (Tan, 2017), and (Zhu et al., 2019) that have a significant relationship or impact between shadow banking and commercial banks. Another article corroborates this scientific article in giving different colours in the use of this variable.

## DISCUSSION

The importance of addressing problems in shadow banking and commercial banks is to maintain financial system stability and protect the interests of customers and the economy as a whole. Improvement efforts include improved regulation, tighter supervision, increased transparency, and coordination between regulators and relevant financial authorities. It aims to manage risks associated with shadow banking and commercial banks, as well as maintain financial system trust and stability. There are three variables that are directly significant and have been used in research.

## CONCLUSIONS AND RECOMMENDATIONS

Shadow banking and commercial banks are two things that exist in the banking world today, the results of research on this variable have not been too much so that with the results of research from this article finished adding a different reference and colour even with the description of several scientific articles from journals, books, and others. There is a significant influence from the results of several scientific articles, including (Tang & Wang, 2015), (Tan, 2017), and (Zhu et al., 2019). Other researchers may continue with the same research variables at some other time, and this article does not refute or counter, only add colour to the results.

## ADVANCED RESEARCH

Studies from this scientific article can be useful for science and knowledge, especially the variables used by giving colours different from existing results.

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