

Literature Review on Corporate Financialization

Hang Zhang^{1, a}

¹School of Business, East China University of Political Science and Law, Shanghai 201620, China

^aEmail: 2012020706@ecupl.edu.cn

Abstract: The "de-realization" of entity enterprises is one of the hot issues in China in recent years, and an important micro-expression of this is the financialization of enterprises. This paper compares and analyses the literature on the definition, motivation and impact of corporate financialization, and gives directions for future research outlook to provide some reference and reference for subsequent research on corporate financialization.

Keywords: Corporate financialization, Motivation, Impact.

1. Introduction

Since the 21st century, while the financial industry has maintained rapid development, many entity enterprises have gradually separated from their main business and invested a lot of funds in the field of virtual finance. The problem of capital "departing from real to virtual" is becoming more and more serious, which has aroused extensive attention of scholars on the financialization of enterprises. The report of the 19th National Congress of the Communist Party of China pointed out the need to "deepen the reform of the financial system and enhance the economic capacity of financial services entities." In order to prevent financial risks and ensure the smooth operation of the economy, it is necessary to conduct in-depth research on corporate financialization. Therefore, the research on the definition, motivation and impact of corporate financialization in this paper has a certain significance for preventing the economy from "departing from the real to the virtual" and promoting the stable development of the economy.

2. Meaning of Corporate Financialization

With the advancement of globalization, various industries have begun to seek cooperation, and diversified business operations have emerged as the times require. The entity enterprise mixes the main industry with the financial industry, which reduces the manufacturing and circulation activities of the enterprise's commodities, and the financial market activities gradually become the mainstream. This process is called enterprise financialization (Dore, 2002). Kripper(2005) believes that the financialization of enterprises means that the profits obtained by enterprises through financial channels increase and the profits obtained through commodity production and sales channels decrease. In the 1990s, the term "financialization" appeared in China, and it was believed that financialization refers to the phenomenon in which funds are separated from the real economy and turned into a "virtual economy" (Xu Dandan and Wang Rui, 2011). Or interpret corporate financialization as the trend of increasing the proportion of financial instruments or financial assets in the real economy, and the larger the proportion, the greater the degree of financialization (Wang Hongjian et al., 2017). Some scholars believe that financialized enterprises mainly rely on the financial field to obtain financial benefits, and then divide

up the profits of the financial industry (Qian Shengdao et al., 2018; Ma Hong et al., 2019). Generally speaking, scholars mainly define corporate financialization from two aspects: assets and profits.

3. Motivation for Corporate Financialization

Scholars have put forward views on the motivation of corporate financialization from different perspectives. In general, scholars' research on the motivation of corporate financialization mainly focuses on the following aspects: precautionary saving motivation, profit-seeking, management characteristics and "entity intermediary".

3.1. Precautionary Saving Motivation

Scholars believe that the financialization of enterprises is a precautionary motive, that is, the capital reserves that enterprises make for their own business development. Because financial assets are highly liquid, enterprises maintain the liquidity of funds by holding financial assets in case of emergencies in the development of enterprises. Tornell (1990) believed that when an enterprise invests in financial assets with high liquidity, it can provide financial support for the future development of the enterprise. Demir (2009) took Argentina's non-financial enterprises as a research sample and found that in order to cope with uncertain economic policies, enterprises have a precautionary saving motive and will choose to purchase financial assets. Duchin et al. (2017) took related enterprises in developed countries as research samples and found that the purpose of financialized enterprises is to reserve funds for future development. Brown (2011) pointed out that when there is a shortage of cash flow in business activities, the company will sell financial assets with strong liquidity to obtain funds to alleviate the financial distress of the company. Hu Yiming et al. (2017) empirically concluded that there is a significant positive correlation between corporate financialization and the statutory reserve ratio, which further proves that corporate financialization is mainly for the purpose of precautionary savings. Dai (2018) believes that companies will retain assets with higher liquidity in response to future economic uncertainty in the future. The more serious the financing constraints they face, the more financial assets the company will purchase based on precautionary motives. Zhang Zenglian and Mullin (2018) empirically found that funds generated by corporate

financialization can replace cash and alleviate financial distress.

3.2. Profit-seeking

Compared with the real economy, financial assets have the characteristics of high risk and high return, and enterprises will change the use of funds invested in the main business and change to the purchase of financial assets with a higher rate of return. Milberg (2008) argues that because increased investment in financial assets can yield high profits, large capital plus is more inclined to make financial investment the first choice. Chen Yulu (2015) believes that the rate of return on financial assets is high, and in the case of declining profit margins in traditional industries, more and more companies are using funds to purchase financial assets. Ramos and Raquel (2017) argue that the motivation for financialization is to accumulate wealth, and the purpose is no longer to finance production and trade. Xu Gang and Wu Wenzhong (2018) found that the difference in operating profits between the real industry and the financial industry is an important reason for attracting entity enterprises to invest in financial business, and entity enterprises make up for corporate losses and smooth corporate profits through arbitrage speculation. Zhang Sicheng et al. (2016) believe that the mismatch of returns on financial assets will cause enterprises to reduce their investment in fixed assets, and the greater the number of financial assets purchased, the more this inhibition effect will be strengthened. Xu Pingxiang et al. (2019) believe that the financialization of enterprises squeezing out the real economy is a manifestation of enterprises' pursuit of high profits. Xu et al. (2021) argue that the pursuit of profit by companies dominates the financialization behavior.

3.3. Management Characteristics

Managers, as the main decision makers of enterprises, have a more direct impact on the trend of corporate financialization. Therefore, existing research attempts to study the impact on corporate financialization by starting from the different characteristics of executives. Davic et al. (2016) found that private entrepreneurs have relevant experience "within the system" can increase their sensitivity to policies, identify and grasp policy opportunities, and promote enterprises to enter the real estate industry to "make quick money". Subsequent political linkages have taken advantage of policy opportunities to strengthen these implications. Yan Haizhou et al. (2018) believe that management overconfidence and diversification can increase corporate financial assets. Duchin et al. (2017) and GanShengdao et al. (2018) also found correlations between high-risk financial assets and managers' overconfidence. Du Yong et al. (2019) found that CEOs with financial backgrounds will significantly increase the holding of financial assets of enterprises, especially CEOs who have served in banks. Du Yong and Wang Ting (2019) believe that managers' financial crisis experience has a significant role in improving the level of financialization of enterprises, and managers' self-confidence and managers' capital arbitrage motivation are the mechanisms of action. Li Wengui and Shao Yiping (2020) believe that if the founder serves as the chairman or general manager of the enterprise, the level of corporate financialization will be significantly reduced.

3.4. "Entity Intermediary"

Some enterprises obtain funds from banks or other financial institutions to lend to other enterprises with

financing difficulties, effectively playing the role of financial intermediaries. For companies with different risk heterogeneity, banks have different lending tendencies (Peng Yuchao and Huang Zhigang, 2018). The financing constraints of unlisted private enterprises and small and medium-sized enterprises are more common and serious, but they are in urgent need of external financing to promote the development of enterprises. In contrast, the advantages of listed companies and state-owned enterprises in terms of credit and collateral are usually preferential to banks, facing less financing constraints, and the risk of investment projects is not high. As a result, large enterprises will lend funds obtained from banks to small and medium-sized enterprises with financing difficulties, etc., and these enterprises will play the role of financial intermediaries. Xu Junhui (2013) found that some companies that invested low-interest loans from banks to make profits from entrusted loans and other trust products actually undertook the function of "shadow banking". Du et al. (2017) found that some companies lend their spare funds to enterprises with financing difficulties through the shadow banking system, resulting in corporate financialization. Wang Shanping (2018) believes that many listed companies and large state-owned enterprises lend cash beyond the part of their main business to small and medium-sized private enterprises, which is the behavior of entity intermediaries.

4. Impact of Corporate Financialization

For the impact of corporate financialization, scholars mainly discuss from the aspects of innovative research and development, financing constraints and entity investment, which can be summarized into three views. One believes that corporate financialization can promote enterprise development. By allocating financial assets, obtaining possible profits from financial assets, improving financing capacity, and promoting the development of the real economy (Khanna & Yafeh, 2007; Bonfiglioli, 2008; Gehringer, 2013). Holding financial assets for savings purposes is convenient for reserve funds and conducive to the stable development of enterprises (Zhong Xianbing, 2018; Wu Jun, 2018). The financialization of entity enterprises has a significant role in improving the conversion rate and sustainability of enterprise R&D investment (Yang Songling et al., 2019). Another view is that corporate financialization inhibits corporate development. Corporate financialization can significantly increase the share of executive income and the relative income share of capital factors (An Lei et al., 2019), reduce the cost bonus rate and profit sharing of entity enterprises, and finally inhibit the share of labor income (Wang Bo et al., 2019). There is also a view that the impact of corporate financialization on firms is not a monotonous linear relationship, such as a U-shaped relationship between corporate financialization and leverage ratio (Li Cheng and Zhao Yijie, 2019), a U-shaped relationship with operating rates of return (Song Jun and Lu Yang, 2015), an inverted U-shaped relationship with sustainable total factor productivity (wang et al., 2021), and an inverted U-shaped relationship with the investment efficiency of entity enterprises (Gu Haifeng and Zhang Huanhuan, 2022).

5. Conclusions and Outlook

Through a review of the literature on corporate financialization, this paper finds that the motivations for

corporate financialization are mainly from four perspectives: precautionary savings motives, the pursuit of high returns, management heterogeneity and "entity intermediation". The question of whether corporate financialization is beneficial to enterprise development has not been unanimously concluded. Some scholars argue that the financialization of entity enterprises facilitates the saving of capital, improves financing capacity and thus promotes firm development; others argue that the financialization of firms inhibits the share of labour income and is detrimental to firm development; others argue that the impact of the financialization of entity enterprises on firms is not monotonically linear. Future research could focus on the impact of macro policy making on the financialization of firms. For example, what policies can be adopted to avoid excessive financialization of firms, while promoting financial stability and sound economic development.

References

- [1] Gu, Haifeng & Zhang, Huanhuan. "How does enterprise financialization affect entity investment efficiency: Evidence Based on Chinese A-share listed companies." *Journal of Management*. 35.01(2022):86-101.
- [2] Du Y, Xie J & Chen JY. "CEO's financial background and the financialization of entity enterprises." *China Industrial Economics*. 05(2019):136-154.
- [3] Gehring, Agnieszka. "Growth, productivity and capital accumulation: The effects of financial liberalization in the case of European integration." *International Review of Economics & Finance* 25 (2013): 291-309.
- [4] Duchin, Ran, et al. "Precautionary savings with risky assets: When cash is not cash." *The Journal of Finance* 72.2 (2017): 793-852.