

Impact of Entity Financialization on Corporate Performance

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Abstract: This paper uses the annual financial data of A-share listed non-financial enterprises from 2016 to 2020 to investigate the impact of enterprise The results show that: (1) holding short-term financial assets can improve corporate performance. (2) Enterprises holding long-term financial assets will inhibit the improvement of corporate performance. (2) Enterprises holding long-term financial assets will inhibit the improvement of corporate performance. (3) According to the nature of enterprise (3) According to the nature of enterprise property rights and industries, the impact of enterprise short-term financialization on corporate performance is more significant in manufacturing (3) According to the nature of enterprise property rights and industries, the impact of enterprise short-term financialization on corporate performance is more significant in manufacturing and non-state-owned enterprises, while the impact of enterprise long-term financialization on corporate performance is more significant in state- This paper analyzes different types of financial assets, and the research conclusion has important enlightenment for entity This paper analyzes different types of financial assets, and the research conclusion has important enlightenment for entity enterprises to reasonably allocate financial assets and government departments to strengthen financial supervision.

1. Introduction

Currently, real firms are in a disadvantageous development position due to unfavorable factors such as overcapacity and declining corporate profitability [3,11]. Under the heavy pressure of external profitability pressure and the shift of shareholders' values, more and more non-financial firms choose to hold financial assets with short cycles and high returns, and tend to rely more on profiting from financial channels [7]. This cross-industry profit-seeking behavior of real enterprises has led them to continuously deviate from their main business scope, and the resulting financial risks and operational uncertainties have caused serious impacts on corporate performance and even endangered the development of the real economy [4], thus triggering widespread concern in the community. With the slowdown of macroeconomic growth and the decline of industrial investment

rate, China's real enterprises have shown a serious tendency of "de-realization to deficiency" [19], and the financialization of real enterprises has become an objective fact.

Considering that there are certain differences between different types of financial assets in terms of liquidity, risk and return, and that firms allocate long-term financial assets mainly to take advantage of the high yield of financial assets for market arbitrage, while short-term financial assets are mainly for preventive savings purposes to achieve asset preservation and appreciation [9], firms' allocation of long-term and short-term financial assets may have a have different impacts on firm performance[1]. In view of this, this paper subdivides the financial assets held by firms into two types: long-term financial assets and short-term financial assets, and examines the effects of long-term and short-term financialization on firm performance, respectively. At the same time, the paper further analyzes whether there is heterogeneity in the allocation of financial assets among enterprises with different property rights and different industries, and finally draws conclusions based on the empirical test results and puts forward more targeted policy recommendations[2].

The possible marginal contributions of this paper are: first, compared with the macro framework-based analysis in existing studies, this paper takes the financialization phenomenon of micro firms as the entry point and explores the impact of financialization of real firms on firm performance by constructing a fixed-effects model, which makes the research findings more directional and application-oriented[11]. Secondly, this paper divides the types of financial assets, further investigates the impact of enterprises' allocation of different types of financial assets on firm performance by subdividing long-term financial assets and short-term financial assets, and examines the heterogeneity of the relationship between the two types of enterprises, which not only enriches the study of the economic consequences of financialization of real enterprises in theory, but also provides a reference for the reasonable holding of financial assets by real enterprises in practice[12].

2. Review of the Literature

A systematic review of the existing literature reveals that there are two main views on the financialization behavior of enterprises. Some scholars believe that firms allocate financial assets for precautionary saving motives, and invest idle funds in financial assets when they have abundant funds, which can help improve the utilization rate of funds. Selling financial assets when the company is facing financial crisis can alleviate the company's financial difficulties and smooth out investment fluctuations, i.e., there is a "reservoir effect" [6,18]. Other scholars hold the opposite attitude, arguing that financial assets will have a "crowding-out effect" on industrial investment. Under the effect of capital profit-seeking and short-sightedness, the purpose of holding financial assets by listed companies will change from preventive reserve to separate arbitrage [8], and enterprises will shift funds that should be invested in the real economy to financial activities, which will reduce the proportion of productive investment and significantly inhibit the innovation investment and innovation efficiency of enterprises [10]. Regarding the impact of financialization of real firms on firm performance, only a small number of scholars believe that there is a positive contribution[13]. Accordingly, more scholars believe that financial assets, while satisfying the liquidity funding needs of real enterprises, also bring the risk of financial system instability, and that non-financial enterprises' detachment from their main business and continuous involvement in high-risk financial investment activities will have serious impacts on firm business performance. In the long run, this will not only increase business risks, but also inhibit the future growth of the company's main business performance, which is not conducive to the improvement of the company's performance. Moreover, the more relaxed the monetary policy environment is, the more significant the crowding-out effect of financialization on the company's main business operating

performance is [3]. It is not difficult to find that the results of the above literature only study the effect of corporate financialization on firm performance as a positive or negative effect, and little literature distinguishes between long-term and short-term financial assets used to portray long-term and short-term financialization and consider their effects on firm performance separately. Focusing on different types of financial assets, this paper not only explores whether this effect is positive or negative, but also dissects the causes of this effect [14].

3. Research Hypothesis

Enterprises holding financial assets have a "pooling effect" and "crowding out effect".

In the investment and financing activities of enterprises, the "pooling effect" of financial assets is mainly manifested in short-term financial assets such as trading financial assets, which are highly liquid and easily converted into monetary funds, thus alleviating the high cost of capital brought about by financing constraints and thus achieving the purpose of preventive reserve of enterprises [15]. Enterprises increase their holdings of short-term financial assets when they are rich and sell them when they lack funds, and the funds invested in the field of financial assets will eventually flow back to the field of main business investment, which not only does not reduce the investment rate of enterprises' main business, but also plays the role of regulating the flow of funds of enterprises [18]. In addition, because there is a certain cyclicity in the operation of real enterprises, when the macroeconomic downturn, the decline in the return on real investment, and the decline in corporate performance, the investment income from financial assets can buffer the negative impact of the decline in corporate performance, and the profitability of enterprises in the financial channel will improve corporate profitability and make the company's balance sheet improve [19], which will attract investors to inject more capital and help the business performance of enterprises to rise. Therefore, the reasonable allocation of short-term financial assets by firms is conducive to reducing business risks and improving the profitability of funds, which may positively contribute to the improvement of firm performance.

Based on the above analysis, this paper proposes hypothesis H1: the allocation of short-term financial assets by enterprises is mainly manifested as a "reservoir effect", which will have a positive impact on firm performance.

The "crowding-out effect" of financial assets is mainly reflected in long-term financial assets, such as investment properties, which are usually difficult to liquidate and have a long investment cycle. Enterprises use funds to invest in long-term financial assets at the expense of investments in the real economy [6,14]. found that investment in financial assets of real enterprises is essentially a kind of market arbitrage, and financialization can crowd out corporate innovation and hinder the growth of the main business of real enterprises, which in turn reduces corporate performance. At the same time, long-term financial asset investments are characterized by high uncertainty and volatility, and once they are significantly impaired, it may lead to a series of chain reactions, resulting in elevated uncertainty in corporate operations [9]. The high investment yield of financial assets will bring excess profits to enterprises, and once enterprises have tasted sweetness from the field of financial investment, they tend to form a financialized inertia, which will lead to a significant reduction in the willingness of enterprises to invest in physical capital and a squeeze on their operational business, ultimately weakening the sustainable competitiveness of the company and the improvement of production and operational performance [16]. Therefore, the holding of long-term financial assets by firms can shift the focus of business operations and crowd out investments in physical capital, which may have a negative impact on the growth of firm performance.

Based on the above analysis, this paper proposes hypothesis H2: the allocation of long-term financial assets by enterprises mainly shows the "crowding-out effect", which will have a negative

impact on firm performance.

4. Econometric Model Setting

4.1. Sample Selection and Data Sources

This paper selects the annual data of all A-share listed companies from 2016-2020, and the data of the sample companies are obtained from the wind database, and the data are processed as follows: (1) this paper aims to study the impact of financialization of real enterprises on corporate performance, and financial enterprises are supposed to allocate financial assets reasonably as their main business, so the samples from the financial and insurance industry are excluded; (2) the samples that are ST, ST* and PT (2) companies with "special treatment" face high delisting risks and their corporate performance may be affected by this abnormality, therefore, the samples of ST, ST* and PT in the sample period are excluded; (3) the samples with undisclosed information on key indicators and missing values are excluded, and the final sample of 22555 valid samples is obtained. All data processing procedures in this paper are done by stata[17].

4.2. Model setup and Variable Definition

To examine the effect of corporate financialization on firm performance, the following fixed effects model is constructed.

$$ROA_{i,t} = \beta_0 + \beta_1 \text{Finlong}_{i,t} + \sum \text{Control}_{i,t} + \sum \text{Industry} + \sum \text{Year} \quad (1)$$

$$ROA_{i,t} = \beta_0 + \beta_1 \text{Finshort}_{i,t} + \sum \text{Control}_{i,t} + \sum \text{Industry} + \sum \text{Year} \quad (2)$$

where i represents individual firm; SSt represents fiscal year; ROA represents firm performance; Finlong represents long-term financialization; Finshort represents short-term financialization; Control represents series control variables; Industry represents industry effect; and Year represents time effect.

Explained variables. Since return on assets measures the ability of all assets of a firm to generate profits, which can reflect the profitability and overall operating efficiency of all assets of a firm, this paper refers to the research results of Xu, Shan (2019) and uses ROA to measure the explanatory variable firm performance.

Explanatory variables. The explanatory variables in this paper are long-term financialization and short-term financialization of enterprises, denoted by the symbols Finlong and Finshort . First, in order to reduce the metric error of key indicators, this paper refers to the majority of existing empirical studies [3, 13] of research, and selects the scope of financial assets described in this paper, including trading financial assets, derivative financial assets, held-to-maturity investments, available-for-sale financial assets, investment properties, long-term equity investments, and other six categories. Considering the different effects that holding different types of financial assets may have on company performance, this paper divides financial assets into long-term financial assets and short-term financial assets, where long-term financial assets include held-to-maturity investments, available-for-sale financial assets, investment properties and long-term equity investments, and short-term financial assets include trading financial assets and derivative financial assets, and constructs Finlong and Finshort two variables represent long-term financialization and short-term financialization, respectively.

Control variables. Referring to the existing literature [5,6], this paper controls for indicators related to both company operation and corporate governance structure levels. Specifically, the firm operation level includes firm size (Size), gearing ratio (Lev), operating income growth rate

(Growth), firm nature (Nature), and firm age (Age), and the corporate governance structure level includes board size (Board) and the shareholding ratio of the top three shareholders (H3). Year dummy variables (Year) and industry dummy variables (Industry) are also introduced to control for year fixed effects and industry fixed effects. The specific definitions and calculations of the variables are shown in Table 1.

Table 1. Definition table of main variables

Variable Name	Variable Symbols	Calculation method
Company Performance	ROA	Net income after tax/[(Total assets at the beginning of the year + Total assets at the end of the year)/2]
Long-term financialization	Finlong	(Financial assets held for trading + derivative financial assets)/average total assets
Short-term financialization	Finshort	(Held-to-maturity investments + available-for-sale financial assets + investment properties + long-term equity investments)/average total assets
Company Size	Size	Logarithm of total assets
Gearing ratio	Lev	Total liabilities / total assets
Growth capacity	Growth	Operating income growth rate
Nature of business	Nature	Whether the enterprise is a state-owned enterprise, is a state-owned enterprise to take the value of 1, otherwise 0
Company Age	Age	$\text{Ln}[1+(\text{current year} - \text{year of incorporation})]$
Board Size	Board	Logarithm of the number of board members in the year
Shareholding Concentration	H3	The sum of the shareholding ratio of the top three shareholders

4.3. Descriptive Statistics

Table 2 reports the descriptive statistics of the main variables. the minimum value of ROA is -744.61 and the maximum value is 158.94, which shows that there is a significant difference in the strength of profitability of the enterprises. 23.6% of listed companies in the sample are state-owned enterprises, and the average shareholding ratio of the top three shareholders of listed companies is 46.86%.

Table 2. Descriptive statistics

VARIABLES	(1) N	(2) mean	(3) sd	(4) min	(5) max
ROA	21,798	7.943	11.72	-744.6	158.9
Finlong	22,243	0.0222	0.0698	-0.000179	0.809
Finshort	22,243	0.0481	0.0899	-4.99e-05	0.953
Board	22,545	2.104	0.217	0	2.944
Nature	22,555	0.236	0.425	0	1
H3	22,555	46.87	23.80	0	100.0
Growth	21,747	24.50	290.9	-130.9	26,375
Lev	22,555	0.415	0.211	0	2.290
Size	22,243	21.94	1.657	17.12	31.14
Age	22,555	3.009	0.322	1.099	4.190
SA	22,555	4.464	2.088	-0.150	18.60

5. Analysis of Empirical Results

5.1. Baseline Regression

This paper uses a fixed-effects model that further controls for industry effects and time effects based on a series of control variables. Table 3 shows the results of the benchmark regression. The regression results show that the effects of different types of financial assets on firm performance are diametrically opposed. The effect of a firm's allocation to long-term financial assets (Finlong) on firm performance is significantly negative at the 1% level, while the allocation to short-term financial assets (Finshort) is significantly positive at the 1% level.

Table 3. Corporate Financialization and Firm Performance

VARIABLES	(1) ROA	(2) ROA
Finlong	-4.222***	
	(-3.42)	
Finshort		11.223***
		(12.24)
Board	-0.620*	-0.613
	(-1.65)	(-1.64)
Nature	-1.098***	-1.110***
	(-5.53)	(-5.62)
Growth	0.000	0.000
	(0.60)	(0.57)
Lev	-10.666***	-11.505***
	(-24.27)	(-26.68)
Size	-0.532***	-0.421***
	(-8.29)	(-6.53)
Age	-4.519***	-4.115***
	(-17.72)	(-16.04)
H3	0.036***	0.034***
	(10.76)	(10.35)
Constant	37.274***	34.887***
	(17.71)	(16.55)
Observations	21,086	21,086
r2_a	0.102	0.107
F	83.21	88.52
Industry	yes	yes
Time	yes	yes

Possible reasons for this situation are: the motives and purposes of enterprises' allocation of financial assets are different. Short-term financial assets, due to their own strong liquidity and high turnover speed, can be used as a tool for enterprises to store funds for a short period of time, and can be quickly liquidated to meet the liquidity needs of enterprises in case of future crises such as operational difficulties or broken capital chains, when enterprises hold short-term financial assets for precautionary savings motives. It is beneficial for enterprises to revitalize their funds and alleviate their financial difficulties, which will have a positive impact on corporate performance. Hypothesis 1 is verified.

Although companies can obtain excessive returns in the short term by participating in financial investments, if they hold financial assets for the purpose of arbitrage speculation and invest too much money in long-term financial assets in pursuit of high profits, it will lead to excessive financialization of companies. Under the background of excessive financialization, managers have a strong incentive to use the high returns on financial assets to whitewash the company's real operating performance based on its main business. In the long run, this will inevitably squeeze out the productive capital and R&D investment of the company, affecting innovation efficiency and innovation output, and then shake the foundation of the main business development, leading to financial risks and fluctuations in the company's performance, and bringing incalculable negative impact to the real economy. Hypothesis 2 is verified.

5.2. Endogeneity

This paper may have an endogeneity problem caused by mutual causality. To address this issue, this paper regresses again using a one-period lag, and the test results are still significant, indicating that the findings of this paper on corporate financialization and firm performance are still robust after considering the endogeneity problem as shown in Table 4.

Table 4. Financialization of firms and firm performance in the lagged period

VARIABLES	(1) ROA	(2) ROA
Finlong	-3.866*** (-3.00)	
Finshort		11.608*** (10.87)
Board	-0.606 (-1.41)	-0.596 (-1.40)
Nature	-0.958*** (-4.18)	-0.987*** (-4.32)
Growth	0.000 (0.10)	0.000 (0.11)
Lev	-11.894*** (-23.24)	-12.757*** (-25.51)
Size	-0.362*** (-4.84)	-0.244*** (-3.25)
Age	-4.447*** (-15.39)	-4.044*** (-13.92)
H3	0.047*** (11.80)	0.045*** (11.42)
Constant	34.009*** (16.57)	32.074*** (15.62)
Observations	17,357	17,357
r2_a	0.0992	0.105
F	66.90	71.08
Industry	yes	yes
Time	yes	yes

5.3. Heterogeneity Analysis

As mentioned earlier, corporate financialization can have a negative effect on firm performance, in which different types of financial assets differ, with long-term financial assets hurting firm performance and short-term financial assets improving firm performance in the short term. Considering the different external environment and corporate characteristics of different listed companies, this paper conducts grouping regressions based on the industry in which they are located.

5.3.1. The Effect of the Nature of Ownership on Corporate Financialization and Firm Performance

SOEs can easily obtain financing from external markets due to their soft budget constraints and access to financing advantages, and their abundant capital flow can meet the daily production and operation needs of enterprises, so SOEs have low willingness to hold financial assets that damage corporate value and hinder the development of the company's main business. The effect of crowding out real investment is more obvious than that of non-SOEs, and even if SOEs allocate short-term financial assets, it will have a negative impact on company performance. In contrast, non-SOEs have less policy support and have difficulty in obtaining credit, but the government's management of them is relatively lax and they can more easily escape the supervision of regulators and investors' attention, thus non-SOEs generally tend to invest in short-term financial assets with low holding costs but certain yield capacity, such as trading financial assets, to meet liquidity needs and alleviate their financing difficulties.

Table 5. Regression based on grouping of property rights nature

VARIABLES	(1) ROA	(1) ROA	(1) ROA	(1) ROA
Finlong	-6.782***		-5.417***	
	(-2.75)		(-3.86)	
Finshort		-3.280***		13.581***
		(3.30)		(11.47)
Board	1.241**	1.232**	-0.835*	-0.745
	(2.49)	(2.48)	(-1.83)	(-1.64)
Growth	0.014***	0.013***	-0.000	-0.000
	(9.86)	(9.70)	(-0.01)	(-0.02)
Lev	-12.950***	-13.006***	-10.160***	-11.079***
	(-25.26)	(-25.35)	(-18.28)	(-20.42)
Size	0.594***	0.608***	-0.960***	-0.790***
	(8.30)	(8.47)	(-11.36)	(-9.29)
Age	-0.932**	-0.739*	-4.535***	-4.162***
	(-2.50)	(-1.96)	(-14.61)	(-13.37)
H3	0.033***	0.033***	0.033***	0.032***
	(6.46)	(6.47)	(8.44)	(8.10)
Constant	-2.972	-4.184*	47.041***	44.435***
	(-1.28)	(-1.81)	(20.63)	(19.45)
Observations	5,108	5,108	16,131	16,131
r2_a	0.151	0.152	0.0898	0.0963
F	34.63	34.77	55.86	60.28
Industry	yes	yes	yes	yes
Time	yes	yes	yes	yes

Table 5 shows the empirical results of the impact of corporate financialization on firm

performance for different firm properties, columns (1)-(2) are for state-owned enterprises and columns (3)-(4) are for non-state-owned enterprises. The regression results show that long-term financial assets (Finlong) are significantly negative at the 1% level for both SOEs and non-SOEs, short-term financial assets in (Finshort) are significantly positive at the 1% level for non-SOEs, and short-term financialization is significantly negative at the 1% level for SOEs. And the regression results indicate that the significant coefficient of short-term financialization of non-state enterprises is greater than that of state-owned enterprises, and the significant coefficient of long-term corporate financialization of state-owned enterprises is greater, which indicates that the effect of short-term corporate financialization on firm performance is greater in non-state enterprises, while the effect of long-term corporate financialization on firm performance is greater in state-owned enterprises.

6. Conclusion

Financialization is a proactive choice made by firms in response to changes in the market environment and price signals. Under conditions of economic policy uncertainty due to environmental changes, the effect of deeper corporate financialization shows non-uniformity. Using annual financial data of A-share listed companies from 2016-2020, this paper empirically examines the effects of corporate financialization on firm performance in the long and short term, respectively. It is found that (1) the allocation of short-term financial assets by listed companies has a positive impact on firm performance, which indicates that the short-term financialization of enterprises mainly holds financial assets for precautionary reserve motive, which is manifested as the "reservoir effect". The result indicates that the long-term financialization of the listed companies has a negative impact on the performance of the companies, which indicates that the long-term financialization of the companies mainly pursues the high investment return of the financial assets and holds the financial assets for the motive of market arbitrage, which is manifested as the "crowding-out effect". After the robustness test, the above conclusion still holds. (2) The corporate performance of non-state enterprises facing more credit constraints and manufacturing enterprises rooted in the development of the real economy is more sensitive to the negative effects of corporate financialization.

Combining the above findings, the following robust policy insights and recommendations can be obtained: Based on rational choice, financialization provides more possible ways for real enterprises to obtain profits, and the high profitability of financial assets attracts many enterprises with low financing constraints to financialize in search of high growth. However, enterprises should focus more on their long-term development under the premise of grasping the changes of financial market information, scientifically judging and timely adjusting their investment decisions on financial projects, and strictly controlling irrational and excessive financialization investment motives.

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