



# The Impact of Corporate Financialization Deviation on Corporate Financial Stability

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**Abstract.** Against the backdrop of a cooling real economy, the financialization tendency of non-financial enterprises has been growing. It is of great significance for maintaining the healthy and stable development of enterprises to reasonably define the appropriate level of corporate financialization and guide enterprises to properly and reasonably allocate financial assets. This paper measures the appropriate level of corporate financialization, constructs an index for the deviation of corporate financialization, and uses data from non-financial and non-real estate listed companies from 2013 to 2022 to test the impact of the deviation of financialization on corporate financial stability. The paper finds that the effect operates through the financing constraint channel. In addition, the paper also finds that loose monetary policy will enhance the adverse impact of the deviation of financialization on corporate financial stability.

**Keywords:** Corporate Financialization, Deviation of Financialization, Financial Stability

## 1 Introduction

In recent years, as China's economic growth has slowed down and structural issues in the economy have gradually emerged, the real economy faces situations such as supply-demand imbalance and narrowing profits. Driven by the high return rates of financial investments, non-financial enterprises have shown a trend of "financialization", choosing to increase the proportion of financial assets in their asset scale in hopes of increasing income and improving business layout. However, the financialization of real entities has a dual nature. On one hand, enterprises can improve their operating performance through financial investments, hedging the risks brought by the decline of their main business. On the other hand, the continuous deepening of financialization can lead to the "hollowing out" of real enterprises, squeezing the space for their main business, over-reliance on financial markets for returns, increasing profit volatility and reducing risk resistance. Therefore, determining the appropriate level of corporate financialization to achieve long-term stable development of enterprises is an issue that urgently needs to be addressed.

## 2 Literature Review

Financial assets have the dual attributes of liquidity storage and investment profit, so the impact of financialization on corporate financial stability varies depending on the purpose of investing in financial assets. On one hand, corporate financialization has a "reservoir" effect. Based on the precautionary savings motive, enterprises will hold a certain scale of financial assets. When the main business suffers losses or financial crises, enterprises will sell financial assets to fill the funding gap<sup>[2]</sup>, thereby improving the stability of long-term profits and reducing corporate operating risks. On the other hand, corporate financialization has a "crowding out" effect. Based on profit motives, enterprises tend to allocate most of their funds to financial assets, causing "hollowing out" of the enterprise and increasing operating risks<sup>[6]</sup>. These two effects are not mutually exclusive and can coexist. During the process of corporate financialization, these effects will show dynamic changes. When the level of corporate financialization is low, financialization mainly plays the "reservoir" effect. Increasing the level of financial allocation helps to improve operational stability. However, once the appropriate threshold of financialization is crossed, enterprises will face the crisis of excessive financialization, where the "crowding out" effect becomes dominant. Continuing to increase the level of financial allocation will worsen the financial indicators of the enterprise and lead the enterprise into operational difficulties. Therefore, this paper proposes Hypothesis 1,

H1: If an enterprise is in the stage of not being overly financialized, increasing the level of financialization will help reduce operating risks. However, if an enterprise has already exceeded the appropriate critical point of financialization, continuing to increase the level of financialization will exacerbate operating risks.

For enterprises that are not overly financialized, the increase in financial assets can store liquidity. When financing is needed, enterprises can obtain funds by cashing out financial assets, thereby reducing financing costs and alleviating the financing constraint problem, preventing cash flow shortages from leading to funding breakdowns<sup>[5]</sup>. The alleviation of financing constraints helps to support enterprises in carrying out long-term R&D activities, improves the enterprise's operating profitability, and reduces operating risks. The improvement in operating capabilities will also send out favorable signals to the outside world, reducing information asymmetry between enterprises and capital suppliers, thus enabling enterprises to reduce external financing costs or obtain more financing scale, reducing the uncertainty of capital turnover. For enterprises that are overly financialized, the scale of financial assets they hold has already exceeded the funds needed for future operations. When funds deviate from the main business and flow into the virtual economy, enterprises will gradually tend to "hollow out," weakening their innovation capabilities and long-term competitiveness<sup>[6]</sup>. In pursuit of high returns, enterprises may even increase leverage to invest in financial products. Based on this situation, the paper proposes Hypothesis 2:

H2: The impact of corporate financialization on operating risks has a financing constraint channel. For enterprises that are not overly financialized, increasing financial assets can alleviate financing constraints, thereby reducing the risk of operating de-

faults, while for enterprises that are overly financialized, increasing financial investments will exacerbate the financing constraint problems faced by the enterprise, thereby increasing the enterprise's risk-taking.

Currently, there is still controversy over the relationship between monetary policy and corporate financialization. This may be due to the fact that existing studies have not classified enterprises, failing to accurately identify the impact of monetary policy. In the face of liquidity brought by loose monetary policy, enterprises that are not overly financialized will make full use of the favorable financing environment to allocate capital across periods<sup>[4]</sup>, increasing their financial asset reserves, making the degree of financialization tend to be moderate, which helps to further reduce the operating risks of enterprises. However, enterprises that are overly financialized have a strong profit motive. The loose monetary policy environment will make enterprises have good expectations for future operations. The willingness of enterprise managers to avoid risks decreases, prompting enterprises to increase the level of investment in high-risk financial products<sup>[8]</sup>, pushing enterprises further away from the appropriate level of financialization and exacerbating the impact of financialization on enterprise risks. Accordingly, this paper proposes Hypothesis 3:

H3: For enterprises that are not overly financialized, loose monetary policy can further enhance the role of financialization in promoting corporate operational stability; for enterprises that are overly financialized, loose monetary policy will further increase the accumulation of risks due to financialization.

### 3 Data and Variables

#### 3.1 Constructing the Index of Corporate Financialization Deviation

This paper refers to the method of Fu et al. (2024)<sup>[3]</sup> to construct the appropriate level of financialization for each enterprise. Furthermore, this paper calculates the deviation of the enterprise's actual financialization level from the appropriate level of financialization. The specific construction process is as follows,

$$FIN_{ijt} = \beta_0 + \beta_1 TOBINQ_{ij,t-1} + \beta_2 LEV_{ij,t-1} + \beta_3 CASH_{ij,t-1} + \beta_4 AGE_{ij,t-1} + \beta_5 SIZE_{ij,t-1} + \beta_6 RETRUN_{ij,t-1} + \beta_7 FIN_{ij,t-1} + Year_t + Industry_j + \varepsilon_{ij,t} \quad (1)$$

Where  $FIN$  represents the ratio of financial assets to total assets, measuring the actual level of corporate financialization.  $TOBINQ$  represents the growth opportunity of the enterprise, measured by the Tobin's Q value.  $LEV$  represents the financial leverage ratio of the enterprise.  $CASH$  reflects the cash flow condition of the enterprise.  $AGE$  represents the listing years of the enterprise.  $SIZE$  represents the logarithm of the asset scale of the enterprise.  $RETURN$  represents the stock return rate of the enterprise. According to the estimation results of Equation (3-1), this paper calculates the predicted value of  $FIN(\hat{FIN})$ , which is the appropriate level of corporate financialization. The difference between the actual financialization level of the enterprise and the appropriate financialization level, the residual term  $\Delta FIN$ , is the deviation of the enterprise's financialization. When  $\Delta FIN$  is greater than 0, it indicates that the actual financialization level of

the enterprise is higher than the appropriate level of financialization, reflecting that the enterprise is in a state of excessive financialization, and when  $\Delta\text{FIN}$  is less than 0, it indicates that the actual financialization level of the enterprise is lower than the appropriate level of financialization, reflecting that the enterprise is at a level of non-excessive financialization. For ease of understanding, this paper takes the absolute value of  $\Delta\text{FIN}$ . The larger the  $|\Delta\text{FIN}|$ , the more serious the deviation of the enterprise's financialization level.

### 3.2 Other Variables and Data Sources

This paper uses data from non-financial, non-real estate, and non-ST listed companies in China from 2013 to 2022 as samples for the study. Micro-level data comes from the CSMAR database, and macro-level data comes from the database of the National Bureau of Statistics of China. Among them, the explained variable DDK measures the financial stability of enterprises, and the larger the value of DDK, the smaller the default risk of the enterprise and the better the financial condition. The channel variable SA index refers to the method of Usman (2022)<sup>[7]</sup>, using the scale and age of the enterprise to measure the degree of financing constraints. Higher SA index values are associated with greater financial constraints. Control variables include the enterprise's free cash flow (FCF), operating profit margin (PROFIT), the proportion of shares held by the largest shareholder (SHRCR), and the total salary of the top three senior management personnel (SALARY). The specific details are shown in the Table 1:

**Table 1.** Variable selection and descriptive statistics

Variable	Variable Definition	Mean	Std	Min	Max
FIN	Degree of financialization	0.07	0.11	0.00	0.97
$\Delta\text{FIN}$	Financialization residual term	0.00	0.08	-0.31	0.81
TOBINQ	Growth opportunity	2.18	2.86	0.62	259.15
LEV	Financial leverage ratio	0.43	0.21	0.01	4.03
CASH	Cash flow condition	0.05	0.11	-4.05	4.64
AGE	Company age	11.61	7.50	2.00	32.00
SIZE	Asset size	22.39	1.33	15.58	28.64
RETURN	Stock return rate	0.14	0.55	-0.82	14.28
DDK	Financial stability	1.00	2.92	-153.14	11.84
SA	Financing Constraints	-3.87	0.26	-5.69	-1.80
SHIBOR	Shanghai Interbank Offered Rate	2.16	0.53	1.46	3.32
FCF	Corporate Free Cash Flow	0.19	4.76	-180.57	295.05
PROFIT	Operating Profit Margin	0.29	0.19	-2.98	3.76
SHRCR	Shareholding situatio	33.28	14.80	0.29	89.99
SALARY	Salary situation	0.29	0.32	0.00	11.75

## 4 Empirical Methods and Results

### 4.1 Baseline Model

To test Hypothesis 1, this paper constructs the following model (4-1) for regression analysis. In Table 2, column (1) and column (2) show the regression results for enterprises with insufficient and excessive financialization, respectively. Column (1) results indicate that for enterprises with insufficient financialization, the financialization deviation degree  $|\Delta FIN|$  has a significantly negative impact on financial stability DDK, meaning that increasing financial asset investment in enterprises with insufficient financialization, reducing the deviation of financialization, can effectively improve the financial stability of the enterprise and reduce the risk of operating defaults. Column (2) results show that for enterprises with excessive financialization, the financialization deviation degree  $|\Delta FIN|$  also has a significantly negative impact on corporate financial stability DDK, which means that continuing to increase financial assets in enterprises with excessive financialization, increasing the deviation of financialization, will damage the financial stability of the enterprise and increase the risk undertaken by the enterprise.

$$DDK_{ijt} = \beta_0 + \beta_1 |\Delta FIN|_{ijt} + \beta_2 FCF_{ijt} + \beta_3 PROFIT_{ijt} + \beta_4 SHRCR_{ijt} + \beta_5 SALARY_{ijt} + Year_t + Industry_j + \varepsilon_{ij,t} \tag{2}$$

**Table 2.** The impact of corporate financialization deviation on financial stability

Variable	(1)	(2)
	Insufficient Financialization DDK	Over-Financialization DDK
$ \Delta FIN $	-0.7210* (-1.6925)	-0.5792* (-1.9098)
Control Variables	YES	YES
Year FE	YES	YES
Industry FE	YES	YES
Observations	12,290	7,359
R-squared	0.186	0.084

### 4.2 Financing Constraint Channel

This paper draws on the method of Duan et al. (2021)<sup>[1]</sup> and uses a two-stage regression to test the financing constraint channel through which the deviation of corporate financialization affects financial stability. In the first stage of the regression, as shown in Equation 4-2, this paper regresses the financing constraint degree SA on the corporate financialization deviation and control variables. Based on the first-stage regression results, this paper estimates the predicted value of the enterprise's financing constraint degree  $\widehat{SA}$ . In the second-stage regression, as shown in Equation 4-3, this paper tests

the impact of  $\widehat{SA}$  on corporate financial stability DDK. The regression model for testing the channel mechanism is set up as follows:

$$SA_{ijt} = \beta_0 + \beta_1|\Delta FIN|_{ijt} + \beta_2FCF_{ijt} + \beta_3PROFIT_{ijt} + \beta_4SHRCR_{ijt} + \beta_5SALARY_{ijt} + Year_t + Industry_j + \varepsilon_{ij,t} \tag{3}$$

$$DDK_{ijt} = \beta_0 + \beta_1\widehat{SA}_{ijt} + \beta_2FCF_{ijt} + \beta_3PROFIT_{ijt} + \beta_4SHRCR_{ijt} + \beta_5SALARY_{ijt} + Year_t + Industry_j + \varepsilon_{ij,t} \tag{4}$$

In Table 3, column (1) show that the regression coefficient of the financialization deviation is significantly positive, proving that increasing the scale of financial asset investment in enterprises with insufficient financialization, reducing the deviation of financialization, helps to reduce corporate financing constraints. column (2) results show that the predicted value of SA has a significant negative impact on corporate financial stability, reflecting that the reduction of corporate financing constraints helps to optimize the financial condition of the enterprise and reduce operating risks. Similarly, according to the results of column (3) and column (4), enterprises with over-financialization continue to increase the proportion of financial asset allocation, exacerbating the deviation of financialization, which will increase corporate financing constraints and further increase the risk undertaken by the enterprise. The above results indicate that the deepening of corporate financialization deviation will worsen the financial stability of the enterprise through enhancing financing constraints.

**Table 3.** Financing constraint channel

Variable	(1)	(2)	(3)	(4)
	Insufficient Financialization SA	DDK	Over-Financialization SA	DDK
$ \Delta FIN $	0.0380* (1.9286)		0.0412*** (4.0315)	
$\widehat{SA}$		-18.9740* (-1.6925)		-14.0764* (-1.9098)
Control Variables	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES
Observations	12,290	12,290	7,359	7,359
R-squared	0.888	0.186	0.841	0.084

### 4.3 Moderating Effect of Monetary Policy

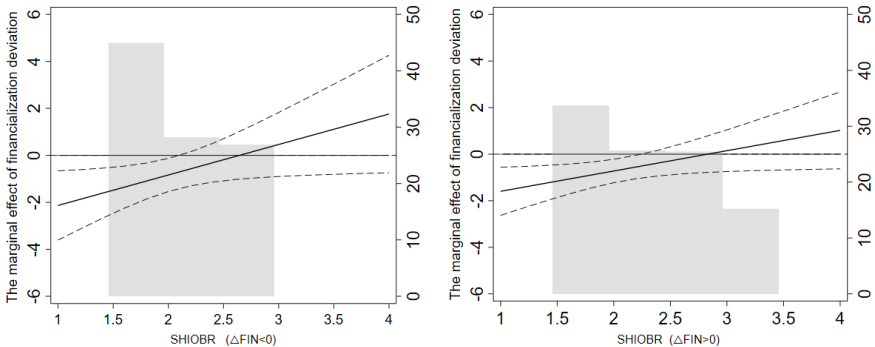
This section verifies the moderating effect of monetary policy by adding the interaction term of the monetary policy indicator SHIBOR and the corporate financialization deviation  $|\Delta FIN|$  to the baseline model, as shown in the specific model below.

$$DDK_{ijt} = \beta_0 + \beta_1|\Delta FIN|_{ijt} + \beta_2|\Delta FIN|_{ijt} * SHIBOR_t + \beta_3FCF_{ijt} + \beta_4PROFIT_{ijt} + \beta_5SHRCR_{ijt} + \beta_6SALARY_{ijt} + Year_t + Industry_j + \varepsilon_{ij,t} \tag{5}$$

In Table 4, column (1) show that the coefficient of the SHIBOR and  $|\Delta\text{FIN}|$  interaction term is significantly positive, which means that for enterprises with insufficient financialization, increasing financial asset investment (reducing the deviation of financialization) can improve the financial stability of the enterprise, and a loose monetary policy can significantly enhance the promoting effect of financialization on corporate financial stability. For enterprises with over- financialization, increasing the level of financialization (increasing the deviation of financialization) will worsen the financial stability of the enterprise, and a decrease in SHIBOR( a more lenient monetary environment), will further exacerbate the adverse impact of financialization on corporate financial stability. This paper visually presents the results of the moderating effect of monetary policy through Fig. 1. As shown in the figure, a loose monetary policy increases the negative marginal effect of the deviation of financialization on corporate financial stability, and as the monetary policy becomes more lenient, this effect becomes more stronger.

**Table 4.** Moderating effect of monetary policy

Variable	(1)	(2)
	Insufficient Financialization	Over-Financialization
	DDK	DDK
$ \Delta\text{FIN} $	-3.4318** (-2.1563)	-2.4666** (-2.2559)
$ \Delta\text{FIN} *\text{SHIBOR}$	1.2980* (1.7370)	0.8718* (1.7396)
Control Variables	YES	YES
Year FE	YES	YES
Industry FE	YES	YES
Observations	12,290	7,359
R-squared	0.186	0.085



**Fig. 1.** The marginal effect of financialization deviation

## 5 Conclusion

This paper finds that an increase in the deviation of corporate financialization will worsen the financial stability of the enterprise, and this impact is realized through the financing constraint channel. Furthermore, the paper discovers that loose monetary policy can enhance the promoting effect of financialization on the financial stability of enterprises with insufficient financialization and will also exacerbate the risk accumulation effect of financialization on enterprises with over-financialization. This paper proposes the following suggestions: First, policymakers should establish and improve corporate financialization monitoring, early warning and response mechanisms, pay attention to the potential channel of "financialization deviation - financing constraints - corporate financial stability". Second, when the central bank implements loose monetary policy, it should focus on the financial stability of enterprises with excessive financialization, formulate risk prevention and resolution plans in advance, guide enterprises to reduce the level of financialization, and avoid falling into financial difficulties.

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