

Institutional investor shareholdings and corporate financialization behavior

Zankai Wang*

University of Strathclyde, Glasgow, England

*Corresponding author: zankai.wang.2020@uni.strath.ac.uk

Keywords: Financialization, Institutional Investors, Shareholder.

Abstract: The increasing financialization of the Chinese economy has had a significant impact on both the expansion of financial markets and the development of business operations. Research has shown that institutional investors' shareholdings can be strongly correlated with the financialization of a business. The paper is divided into three parts. First, this essay collates the influence of institutional investors on corporate governance, corporate performance and corporate innovation. Secondly, it reviews the context of corporate financialization and its impact on the management of private sector funders, multiple large shareholders and house price volatility. The paper then presents the existing literature on the connection between board age and corporate innovation. Ultimately, according to all the literature, the paper outlines that the results may vary in capital markets at different levels of development; and that it may be possible to analysis the link between institutional investors and the financialization of firms by cutting through the business model of family firms and digital finance.

1. Introduction

Corporate financialization refers to companies becoming endogenous to the capital markets through restructuring and listing. It uses the bridge of listed companies to bring business and finance closer together and has a significant impact on the flow of capital and financial policy of society as a whole. It is therefore particularly important to explore the factors that influence the financialization of businesses. Specifically, studies have been conducted on corporate financialization in China and worldwide. In addition to this, corporate financialization is influenced by the management of private company founders, the existence of multiple major shareholders and fluctuations in house prices.

Institutional investors are legal entities that use their original funds or funds raised from the public to carry out securities investment activities. It has been shown that institutional investors have an influence on corporate governance, from institutional investor cooperation to promote executive overpayments and institutional investors to induce listed companies to make more short-term loans and long-term investments. However, there is little literature that has systematically analyzed the connection between institutional investors and business financialization. Based on the existing literature, this paper explores the impact of institutional investors on the financialization of firms. In summary, the relationship between the above two can be broadly divided in the existing literature into the following two areas. On the one hand, institutional investors contribute to companies' financialization. Guo pointed out that, in both mature and declining firms, institutional investors relax the constraints of corporate financialization and achieve dividend yield objectives through the effects of intermediation [1]. Meanwhile, Xiao showed institutional investors' shareholding remains positively related to corporate financialization and excessive financialization. This allows them to play a vital monitoring role in how firms restructure their financial assets [2]. In addition, Jiang have also shown that a higher shareholding of institutional investors leads to a higher allocation of short-term financial support and, conversely, a lower distribution of long-term financial assets [3]. On the other hand, the literature suggests that institutional investors can also hurt corporate financialization. For example, xu notes that pressure-resistant institutional investors can have a more substantial effect on corporate financialization resistance [4]. Secondly, Gu has shown in his literature that the inhibitory impact of

organizational investors' shareholding on the financialization of non-financial firms is more pronounced in firms with decentralized shareholdings than in state-owned businesses [5].

2. Studies related to institutional investors' shareholding

This section deals with changes in corporate governance by institutional investors, including an examination of overpayments and the phenomenon of short-term loans and long-term investments. As well as exploring the positive influence of investors from the institutional sector on corporate performance and corporate innovation.

2.1 The impact of institutional investors on corporate governance

The essay concludes that the existence of institutional investors has facilitated changes in corporate administration and worsened executive overpayments, particularly in state-owned companies. The phenomenon of short-term loans and long-term investments are also more pronounced due to the presence of non-independent institutional investors.

The presence of institutional investors can alter the approach to corporate governance. For example, institutional investors play a vital role in corporate governance and maintain the stability of the securities market. Cheng discovered countermeasures to encourage the participation of institutional investors in corporate governance to stabilize the securities market and promote effective corporate governance [6].

Secondly, by constructing a common shareholding network of institutional investors and identifying the network groups, Liu et al examined the governance effects of institutional investor grouping from the perspective of executive overpayments. They further explore the differences in governance behavior of institutional investor groups in terms of the nature of corporate ownership and executive power and find that the effect of institutional investor groups on executive overcompensation is more pronounced in state-owned enterprises and businesses with more powerful executives than in other firms [7].

Dong and Chen found that institutional investors' shareholdings led to more short- and long-term investment in listed companies in China and that this effect was more pronounced in non-state-owned companies. Further study found that this effect was significant only when the institutional investors were non-independent and that the number of institutional investors also exacerbated the short- and long-term investment [8].

2.2 Institutional investors' influence on company performance and innovation

Institutional investors have a catalytic effect on the quality of corporate internal controls and alleviate financing constraints. And the increase in their shareholding raises the number of corporate patents.

Zhang pointed out that the financial performance of firms is significantly and positively related to the shareholding of institutional investors; within institutional investors, pressure-resistant institutional investors have a more significant effect on firm performance; additionally, the shareholding of institutional investors helps to improve the quality of internal control and alleviate the financing constraints of firms; at the same time, higher quality of internal control and lower level of financing. The shareholdings of institutional investors and company performance have a mediating influence. The findings of this study open up new perspectives for improving the quality of internal control, alleviating financing constraints and promoting corporate development, and provide evidence for institutional investors' practice of "shareholder activism" [9].

Based on the data of 2,621 listed companies with total R&D investment and number of patents granted in China from 2007 to 2017, Yang discovered that increasing the ownership ratio of organisational investors can dramatically boost R&D investment and the number of patents granted by publicly traded Chinese companies; among the heterogeneous institutional investors, independent institutional investors can significantly promote the innovation capability of listed companies, but non-independent institutional investors have no significant impact. Among the diverse institutional

investors, autonomous institutional investors can considerably boost the innovation ability of listed companies, but non-independent ones have no significant effect; the effect of the investment ratio of institutional investors differs according to the nature of the corporate entities; the rise in the shareholding ratio of organizational investors can substantially promote the innovation investment and the number of patents granted by private companies, but has no significant effect on the R&D investment and the number of patents granted by state-owned listed companies. Diverse institutional investors have varying influence on the quality of innovation in publicly traded companies, with independent institutional investors promoting radical innovation and inhibiting incremental innovation, while non-independent institutional investors only promote incremental innovation; financing constraints play a part in the influence of institutional investors as a whole and independent institutional investor on the innovation capability of enterprises [10].

3. Studies related to the factors influencing the financialization of enterprises

This section contains a background study of corporate financialization in China and worldwide. It is also influenced by private sector managers, multiple major shareholders and rising house prices.

3.1 Background analysis of the financialization of business

This section analyses corporate financialization from the particular perspective of its causes, including the development of China's corporate financialization and the growth of the modern business.

(1) Analysis of the context of financialization in China

Specifically, the development history of the financialization of Chinese enterprises has not been smooth. Geng found that after the outbreak of the sub-prime crisis in 2008, the domestic economy was hit, and the return on tangible investment fell sharply, while the profitability of the financial sector remained high and the willingness of capital to invest in the industry declined. At the Central Economic Work Conference at the end of 2015, General Secretary Xi Jinping made a judgement on China's economic reality, saying that "a large amount of capital flows into the virtual economy, causing asset bubbles to inflate, financial risks to gradually emerge, and the overall cycle of production, circulation, distribution and consumption in social reproduction to be poor". At the Central Economic Work Conference at the end of 2017, General Secretary Xi Jinping further pointed out that "to fight the battle to prevent and resolve major risks, the focus should be on minimising and mitigating financial risks, serving the mainline of systemic supply-side reform, promoting the formation of a virtuous cycle between finance and the real economy, finance and property investment, and within the monetary system, and doing a good job of risk prevention and disposal in key areas. Resolutely break down on illegal and irregular monetary operations, and strengthen the construction of a regulatory system for weak links." The positioning of the progress of the financial industry to return to its roots and serve the real economy is also emphasized once again in the report of the 19th Party Congress [11].

(2) Analysis of the world financialization context

As a result of the quick advancement of modern industry, financialization has also developed rapidly worldwide and has had a multifaceted impact on the development of the social economy. Liu's study found that the financialization of listed companies disconnected capital accumulation from the real economy through a series of ways, thus causing a dampening effect on the development of the real economy, making the defects of financialization further exposed and seriously hindering the development of the real economy [12].

3.2. Analysis of the factors affecting the financialization of enterprises

The financialization of businesses has been negatively impacted by the increase in business credit facilitating founder management. The presence of multiple majority shareholders inhibits corporate financialization due to the alleviation of secondary agency costs, reduced separation of powers and an improved external information environment for the firm. And the rise in real estate raises corporate

financialization, due to reduced overnight financing constraints and the creation of new profit-seeking investment opportunities.

(1) The impact of private company founder management on corporate financialization

First of all, in the context of the tendency of Chinese enterprises to "de-realize", it is urgent and important to study the influence of the founders' management on the financial investment behavior of private enterprises. Based on a sample of private manufacturing companies listed in China from 2007 to 2019, Han et al found that founders' involvement in management significantly reduces the level of corporate financialization, while the increase in business credit strengthens the inhibitory effect of founders' management on corporate financialization. Further analysis found that the inhibitory effect of founder management on corporate financialization was only reinforced by business credit under conditions of low market competition, high separation of corporate power and high economic policy uncertainty. Mechanistic tests find that founders reduce the financialization of firms by increasing the level of real investment and alleviating agency problems [13]. At the level of listed companies, the degree of financialization is also noteworthy. Chen found that the average non-state listed company places the most importance on growth strategy, usually by investing in other projects to enhance its competitiveness, rather than blindly expanding its market size. For state-owned holding companies and large listed companies, more importance is placed on scale expansion, and the influence of significant shareholders on final decisions is weaker. As the management environment changes, the investment impulses of managers and the power conflicts of major shareholders become increasingly evident, so that specific delegation relationships influence the decision-making behavior of companies [14].

(2) The impact of multiple major shareholders on the financialization of a business

Multiple major shareholders also impact the financialization of the business. Zhao et al find that multiple large shareholders have a dampening effect on the financialization of real firms, and the dampening effect on long-term financial assets is more significant. Further analysis shows that the greater the number of non-controlling majority shareholders, the greater their relative capacity and the better the legal environment in which the firm is located, the stronger the disincentive to financialization; in terms of economic consequences, the disincentive to financialization by multiple majority shareholders can promote real investment. In terms of the economic consequences, the suppression of financialization by multiple major shareholders can promote real investment [15].

(3) The impact of house prices on the financialization of businesses

The factor of rising house prices has a dampening effect on the financialization of firms. Based on house price data for 206 prefectural-level cities in China and microdata for non-real estate and non-financial listed enterprises from 2009-2017, Wang et al find that a sustained rise in house prices tends to trigger excessive corporate financial investment. We should continue to adhere to real estate regulation and control and at the same time actively focus on the financialization of enterprises to guide them to "move away from the real world"[16].

4. The influence of institutional investors on the financialization of companies is investigated.

This section is an analysis of both the positive and negative aspects of corporate financialization by institutional investors.

4.1 The role of institutional investors in expediting the financialization of companies

Some studies point to a considerable positive relationship between organizational shareholding and the degree of financialization of firms. Specifically, Guo found that institutional shareholding in mature and declining firms increased financialization, while institutional shareholding in growing firms inhibited financialization. The difference in the relationship between institutional ownership and financialization across life-cycle firms is due to a 'valve' mechanism. In mature and declining stage firms, institutional investors relax the "valve" of financialization and achieve their dividend yield objectives through a mediating effect; in growth-stage firms, institutional investors tighten the "valve" of financialization and achieve their dividend yield objectives through a masking effect. Institutional

investors achieve their dividend yield objectives in growth companies by tightening the "valve" of financialization with a masking effect. There is no significant negative relationship between the checks and balances of executive shareholding and corporate financialization, i.e., executive shareholding does not inhibit institutional investors' contribution to corporate financialization in mature and declining stage firms [1]. Xiao found a significant positive relationship between institutional investor shareholding and firm financialization, but a significant negative relationship between institutional investor shareholding and excessive financialization, suggesting that institutional investors play an influential supervising position in firms' allocation of financial assets. The diverse of institutional investors has different effects on the level of corporate financialization; fund shareholding can effectively inhibit corporate allocation of financial assets, QFII, insurance and securities are significantly positively related to the level of corporate financialization, which indicates that organizational investors play an influential supervisory role in the commercial allocation of financial assets, and there is heterogeneity among institutional investors [2].

Besides, the presence of institutional investors directly impacts the financialization, performance, and innovation of firms. There are direct and indirect channels through which institutional investors influence firms' financial asset allocation decisions. Based on relevant data from WIEGO for the period 2010-2019, Jiang finds that institutional investors' shareholding directly affects the level of financialization of firms, with the higher the shareholding of institutional investors, the higher the proportion of firms' short-term financial assets allocation and the lower the proportion of long-term financial assets allocation. At the same time, institutional investors' shareholding also indirectly affects financialization by influencing the relationship between corporate finance and the size of corporate financial asset allocation. The higher the ownership of institutional investors, the weaker the correlation between the size of debt financing and the size of corporate financial asset allocation. The stronger the positive correlation between the size of equity financing and corporate short-term financial asset allocation behavior [3].

4.2 The inhibiting effect of institutional investors on corporate financialization

Some studies suggest that the overall shareholding of institutional investors inhibits the level of financialization of listed companies and is more pronounced in the sample group of overly financialized firms. Specifically, Xu found that pressure-resistant institutional investors have a more substantial effect on inhibiting financialization, while pressure-sensitive institutional investors have essentially no governance effect. The inhibitory effect of overall institutional investors and stress-resistant institutional investors on corporate financialization was more substantial in firms with higher marketisation levels than those with lower levels of marketisation. The inhibitory effect of overall institutional investor shareholding and stress-resistant institutional investor shareholding on the level of corporate financialization was more pronounced in state-owned enterprises compared to non-state-owned enterprises [4].

In addition, institutional investors' shareholdings show a significant dampening effect on the financialization of Chinese non-financial firms. Specifically, Gu finds that institutional investor ownership's inhibitory effect on non-financial firms' financialization is more pronounced among firms with fragmented shareholdings and state-owned businesses. The level of financialization and the effect of institutional investors' shareholding on their financialization decisions vary significantly between different industries in China due to the existence of different business characteristics and business objectives. The level of financialization is higher in high-tech industries. Institutional investors' shareholding shows a significant inhibitory relationship on the financialization of firms in traditional industries represented by manufacturing and high-tech industries. This inhibitory relationship is in the manufacturing and high-tech industries, institutional investors' shareholding has a significant inhibitory effect on the financialization of enterprises, and this inhibitory relationship is more robust in the high-tech industries. In contrast, in the business and service industries, institutional investors' shareholding has little effect on their financialization level [5].

5. Conclusion

Firstly, this paper collates the existing literature on the impact of institutional investors' shareholding on corporate governance, corporate performance and corporate innovation; secondly, this paper introduces the background of corporate financialization in China and worldwide based on the existing literature, and then analyses the factors influencing corporate financialization from the perspectives of private company founder management, multiple major shareholders' shareholding and rising house prices; finally, this paper lists the existing literature on the relationship between board age and corporate innovation. This paper lists two aspects of the existing literature on the link between board age and corporate creativity; finally, based on the above literature review and collation, this paper outlines the shortcomings of the existing research and possible feasible future research directions.

Based on the analysis of the above literature, this paper suggests the following directions for further investigation or analysis. For example, firstly, to investigate more about the factors influencing the financialization of firms, such as whether family-run corporate systems or digital finance impact the financialization of firms. Secondly, whether the effect of institutional investors on corporate financialization holds using on data from capital markets at different levels of development (emerging capital markets, developed capital markets), finally, the link between institutional investors and corporate financialization is robust, with both adverse and facilitating effects, so it is essential for management to weigh up the pros and cons that institutional investor brings to corporate governance.

References

- [1] Chengxin Guo. The mechanism of institutional shareholding on corporate financialization and the consequences of dividends [D]. Dalian University of Technology, 2021.
- [2] Huan Xiao. A study on the impact of institutional investors and corporate financialization [J]. Shanxi Agricultural Economics, 2020(13):148-151.
- [3] Chengcheng Jiang. The Impact of Institutional Investors on Corporate Financialization [D]. Zhejiang University, 2021.
- [4] Wen Xu. A study on the impact of institutional investors' shareholding on the level of financialization of enterprises [D]. Jiangsu University, 2020.
- [5] Gu Hongzhen. Research on the impact of institutional investors' shareholding on the financialization of non-financial enterprises [D]. Shanghai International Studies University, 2021.
- [6] Jia Cheng. A study on the participation of institutional investors in corporate governance [J]. Investment and Cooperation, 2021(08):94-95.
- [7] Liu Xinmin, Yifan Sha, Lei Wang, et al. Institutional investor huddles and executive overcompensation [J]. Finance and Economics Series, 2021(07):90-100.
- [8] Li Dong, Jinlong Chen, Institutional investors' shareholding and corporate short-term lending and long-term investment: inhibiting or facilitating [J]. Journal of Nanjing Audit University, 2021,18(06):92-100.
- [9] Qinyue Zhang. Institutional Investor Shareholding and Firm Performance [D]. Shandong University, 2021
- [10] Xiong Yang. Institutional Investor Shareholding and Corporate Innovation [D]. Shandong University, 2020.
- [11] Li Geng. A study of the connotations and causes of corporate financialization[D], 2019
- [12] Jiahao Liu. Analysis of the current situation of financialisation of enterprises in China[D], 2019

- [13] Zhongxue Han, Lina Duan, Keqi Wang. Founder management, business credit and corporate financialization [J]. Wuhan Finance, 2021(12):40-49.
- [14] Lan Chen. An analysis of the degree of financialization of listed companies in China. Business Intelligence, 2017
- [15] Yanfeng Zhao, Guizhen Wang, Zhuwei Hu et al. Can multiple major shareholders inhibit the financialization of real companies [J]. Modern Finance and Economics (Journal of Tianjin University of Finance and Economics), 2022, 42(01): 81-99.
- [16] Hui Wang, Qin Wang, Shu Xu. Are rising house prices fueling the financialization of business [J]. Economic Science, 2021(06):88-100.