

Does Institutional Investor Ownership Reduce Corporate Financialization? An Empirical Study for Chinese Enterprises

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ABSTRACT

In recent years, the financialization of real enterprises has gradually attracted extensive attention from all walks of life. In the period of rapid development of the financial industry at this stage, the funds held by enterprises are continuously withdrawn from the interior, poured into non-main financial fields, squeezed out R&D investment and fixed asset investment, and reduced the sustainable development ability of enterprises. Therefore, the problem of "from reality to emptiness" needs to be curbed urgently. It is urgent to restore and consolidate the pillar position of real industry in Chinese economy. Taking the A-share listed companies from 2007 to 2020 as the research sample, this paper studies the impact of institutional investor ownership on the level of corporate financialization. We find that institutional investor ownership can significantly reduce corporate financialization. This result is solid after re-estimating the regression model using the firm and year fixed effects model and adding more control variables into regression models. In addition, we also find that the effect of the constraints of institutional investors on corporate financialization is more pronounced in firms with Big 4 auditors.

Keywords: *financialization, institutional investors, Chinese enterprises*

1. INTRODUCTION

Financialization is one of the more innovative ideas to come out of the radical political economy in recent years and has often been deployed in analysing the crisis of 2007–2009. Its theoretical appeal lies in its ability to connect the current crisis to the secular growth of finance in recent years. More broadly, it can give insight into the structural transformation of capitalist economies during the last three decades, with its attendant social implications.

In recent years, China's real economy with manufacturing as the main body has slowed down significantly due to factors such as overcapacity, lack of endogenous development power and insufficient market demand at home and abroad. Therefore, it is facing the dilemma of declining profitability. In the same period, the virtual economy represented by the financial industry

has the characteristics of the short investment time limit and high rate of return, which has attracted a large amount of capital inflow. Driven by the capitalist profit motive, many enterprises give up the "main battlefield" of operation and use a large amount of capital for activities such as purchasing financial products. The international economic and financial crisis that broke out in 2008 tells us that letting capital pursue profits will lead to a new round of crisis.

Compared with other types of investors, institutional investors, as an important participant in corporate governance, have a strong professional analysis level and large capital scale and are based on the capital market with slightly better investment ability [1-5]. The research of Tian et al. [6] and Lin et al. [7] shows that enterprise-scale, profitability and the degree of information asymmetry will affect the investment behaviour of institutional investors [6-7]. Then, will the allocation of

financial assets affect the shareholding behaviour of institutional investors? If so, through what channels do they interact?

Based on this, this paper selects the empirical data of A-share listed companies in China from 2007 to 2020 to study the economic consequences of entity enterprise financialization from the perspective of institutional investors' investment behaviour. The contributions of this paper are as follows. Firstly, this paper expands the related research on the influencing factors of financialization and provides a new theoretical basis for restraining the excessive financialization of enterprises. At present, scholars have studied the macro influencing factors of financialization of enterprises extensively and richly, but relatively seldom discussed them from the perspective of micro corporate governance. This paper introduces the existing theoretical achievements, studies the influence on corporate financialization from the perspective of institutional investors, and deepens the understanding of institutional investors' shareholding and the level of financialization of enterprises. Secondly, it provides ideas for the government and other institutions to control the excessive financialization of enterprises and provides a certain reference for the market supervision departments and policy formulation. The theoretical basis and empirical conclusions provided in this paper can help stakeholders to understand and learn from the impact of institutional investors' shareholding behaviour on the excessive financialization of enterprises. It is conducive to the financial regulatory authorities actively guiding institutional investors to make the rational investment, helping the financial sector to effectively serve the real industry, and effectively promoting the process of financial system reform.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The significance for taking effective measures to prevent excessive corporate financialization or even excessive virtualisation. Existing studies mainly emphasise the definition and economic consequence regarding corporate financialization like the various motivations and relevant impacts of financialization supported with targeted policy and measures Cai & Ren [5] and Sawyer [6]; however, there is a paucity of literature regarding how to detect and regulate the real financial motives of corporate financialization for non-financial corporations (NFCs) effectively. Compared with the extant literature; consequently, this research has provided the following two contributions: i). empirically evaluates how institutional investors' shareholding may impact the excessive corporate financialization negatively, and ii). indicates subsequent constraints regarding the excessive corporate financialization in the capital market.

2.1. Definition and understanding of corporate

Financialization is one of the innovative ideas to come out of the political economy recently and has often been deployed in analysing the crisis of 2007 to 2009. Namely, its theoretical appeal focuses on its ability to connect the current crisis to the secular growth of finance. The insight regarding the structural transformation of capitalist economies might be provided through financialization during the last three decades based on its attendant social implications [7, 8]. Despite such a concept is still undeveloped, its significance may not be denied as well. There is no specifically agreed definition of financialization; however, there is a theoretical analysis of financialization situated within classical Marxist political economy [9]. There are three main interrelated features in terms of financialization regarding the systemic transformation of mature capitalist economies [10]. These incorporate fundamental elements that house owners may increasingly prefer the operation realm of finance as assets holders and debtors, plenty of financial capacities can be required by large enterprises and non-financial corporations which have relied less on bank finance loans as well as it has been more and more popular for banks choose to mediate in open capital markets and enhance financial activities regarding householders' transactions like lending to householders. Accordingly, the sources of capital profit can be altered under the financialization to the extent.

Based on the academic definition of financialization from Epstein [11], the connections and differences between corporate financialization and the new business cycle generated by corporate financialization may be starkly revealed by policy attitudes toward the trade deficits and would tacitly embed a monetary policy emphasising asset prices [12]. Namely, corporations must maintain growth through increasing indebtedness and asset prices within the macroeconomic system of corporate financialization. Tomas also indicates three main principal impacts of financialization and three different conduits of financialization operations [12], for instance, transferring income from the real sector to the financial sector would be one of the important impacts of corporate financialization, and the changes in economic policy and the structure and operations of financial markets would be one of the conduits of it. Under the financialization process, concerns with financial markets may not be neglected as there is a requirement to restore effective market controls and policy regulations respectively [13, 14].

Klinge et al. empirically evaluate how corporate financialization of firms specifically non-financial corporations (NFCs) across countries and sectors has been studied as an empirical phenomenon with related comprehensive reviews [15]. Thus, it is vital to argue that the corporate financialization combining different

indicators may be toward a more shareholder-oriented and market-driven corporate governance model [15-17].

2.2. Measurement of Corporate Financialization --- based on financial statements

The degree of corporate finance can be measured from two aspects, assets and profits, based on the definition of corporate financialization. Generally, the higher the corporate finance degree of the corporation is, the higher the proportion of financial assets held in the total assets is, and hence the higher the proportion of the income obtained through financial investment to the total profit is [18]. Therefore, the degree of corporate financialization of assets and profits based on the financial statement may be measured by the ratio of financial assets to total assets as well as the ratio of financial income to current operating profit, respectively. Relevant formulas are as follows:

Degree of Corporate Finance (Assets) = Financial assets / Total assets*100%

Degree of Corporate Finance (Profits) = Financial Profit / Total Profit*100%

However, there is a controversy between domestic and foreign research regarding the definition of financial assets and financial profits under these two measurement methods. For instance, cash, short-term investments, and other corporate investment elements have been selected and used by Demir as a measure of corporate financial assets [17]. Interestingly, investment in real estate has been chosen by Xie et al. [19] and Liu et al. [20] into the measurement of corporate financial assets (corporate financialization). Recently, there is a rapid development of shadow banking business while there are less relevant unified accounting regulations and rules. Consequently, the presence of plenty of new categories of financial assets or receivables like trust loans and bank wealth management may not be neglected when considering corporation financialization.

Both assets and profits for the measure of corporate finance would reflect the structure of corporate investment activities. The difference is that enterprises' subjective willing may be reflected objectively through the corporate finance measure by assets while the corporate finance measured by profits may incorporate related macro and market factors like risk and market price that may not accurately reflect the real financial investment willingness to the extent Wang [8] and Tori & Onaran [18].

2.3. Hypothesis development

The following hypotheses are mainly associated with prior studies regarding the role of institutional investors

and their degree of shareholding, excessive financialization and the policy disclosure of financialization in China. For instance, Gu states that institutional investors may effectively play the external supervisors' role in corporate governance, which is one of the positive impacts, ensuring the rationality of management decision for non-financial enterprises through disclosing information and improving the accuracy of related information as these corporations focus on their long-term development [21]. The quality of financial information disclosure and the reduction of information asymmetry can be enhanced as well [13, 22-24]. Accordingly, the excessive financialization of corporations could be inhibited due to the relevant impacts of these long-term stable institutional investors [25, 26]. Compared with these extant studies, the negative impacts of institutional investors in inhibiting the excessive financialization of enterprise are investigated. Like Hellman indicates that the inhibition effect of institutional investors' shareholding on corporate financialization is more significant in state-owned enterprises while the negative impact of pressure-sensitive institutional investors on the financialization of state-owned enterprises and non-state-owned enterprises is still limited [26]. Therefore, the financialization of enterprise, especially the excessive financialization, could be inhibited since the institutional investors' shareholding affects whatever they are positive and negative. These are primary consequences for the hypothesis establishment for this research.

Thus, two related hypotheses have been established as follows to investigate whether institutional investors' shareholding may inhibit the corporate financialization for Chinese NFCs from 2007 to 2020.

H1a. Ignoring other interference factors and keeping other things being equal, the institutional investors' shareholding inhibits corporate financialization.

H1b. Ignoring other interference factors and keeping other things being equal, the institutional investors' shareholding enhances corporate financialization.

3. RESEARCH DESIGN AND METHODOLOGY

3.1. Sample selection and data source

Our sample primarily comprised all firms listed on the SHSE and SZSE from 2007 to 2020. We choose 2007 as the beginning year of our sample period since the new accounting standards for business enterprises and auditing standards for certified accountants were implemented that year. The data of Chinese enterprises are mutually collected from annual reports and disclosed minutes of boards' and shareholders' meetings. Financial firms are excluded (like banks, insurance companies, and trust companies), since they account and report under

rules, which are different from other companies. Finally, we get an efficacious sample of 25196 observations, representing 996 companies that are invested by corporate investors.

We also use fixed effects of firm and year as the robustness check. The financial data applied in this essay are obtained from China Stock Market Accounting Research (CSMAR) system.

3.2. Key variables

Based on relevant literature like Wang [8], Liu & Ma [27] and Peng et al. [14], the percentage of institutional investors' shareholding (INST) has been selected as the independent variable and the corporate financialization measured by the degree of corporate finance has been chosen as the dependent variable for this empirical research to evaluate whether the institutional investors' shareholding impacts the corporate financialization for Chinese enterprises negatively. Specifically, the degree of corporate finance (FinRatio) is calculated through the asset measurement formula meaning that it equals financial assets divided by total assets for NFCs in China from 2007 to 2020. Furthermore, relevant detailed descriptions of all variables including test and control variables for this research have been provided according to prior studies like Du et al. [28] and Albers [29]. For instance, one of the control variables, the corporation book-to-market ratio (BM) is defined by the book value of equity divided by the market value of equity in year t. The corporation profitability measured by ROA equals net profits divided by the book value of total assets. Also, two dummy variables, the duality of board and state of ultimate control shareholders of listed firms, have been established ensuring the reliability of empirical model and regression results to the extant.

3.3. Regression model with related variable description

Related hypotheses (H1a and H1b) that are corporate finalization measured by the degree of corporate finance (FinRatio) will be tested following a function of institutional investors' shareholding (INST) and other selected control variables like corporation leverage degree, the growth and size of enterprises. This empirical regression model has shown as follows:

$$FinRatio_{i,t} = \alpha_i + \beta_1INST_{i,t} + \beta_2Size_{i,t} + \beta_3BM_{i,t} + \beta_4ROA_{i,t} + \beta_5LEV_{i,t} + \beta_6Growth_{i,t} + \beta_7Cashflows_{i,t} + \beta_8Board_{i,t} + \beta_9Indep_{i,t} + \beta_7Duality_{i,t_Dummy} + \beta_8SOE_{i,t_Dummy} + \epsilon_{i,t}$$

($\epsilon_{i,t}$ = the model error item) ----- (1)

Where β_i represents regression coefficients for this empirical regression model and $\epsilon_{i,t}$ is the error item of equation (1). Theoretically, positive β_i suggests that the institutional investors' shareholding may tend to increase the financial ratio which measures the corporate financialization for this research and vice versa.

4. EMPIRICAL RESULTS

4.1. Summary statistics

Table 1 carries out descriptive statistical processing on 25,555 samples, of which 25,467 are enterprises involved in financial asset investment. The mean of financial asset investment (FinRatio1) is 0.06 and the maximum value is 0.28. The mean of institutional investors' overall shareholding ratio (INST) is 0.36 and the maximum value is as high as 0.76. Enterprises in our statistics reveal an average size of 15.04, an average book-to-market ratio (BM) of 0.6, an average return on asset (ROA) of 0.05, an average growth rate of operating income of 0.16.

Table 1. Descriptive statistics for variables

Variable	N	mean	s.d.	min	p50	max
<i>FinRatio</i>	25467	0.06	0.08	0	0.02	0.28
<i>INST</i>	25284	0.36	0.23	0.01	0.35	0.76
<i>Size</i>	25481	15.04	1.01	13.32	15.01	17.02
<i>BM</i>	24837	0.6	0.22	0.21	0.6	0.98
<i>ROA</i>	25555	0.05	0.05	-0.05	0.04	0.15
<i>Growth</i>	23850	0.16	0.23	-0.12	0.1	0.82
<i>Duality</i>	25195	0.26	0.44	0	0	1
<i>SOE</i>	24598	0.05	0.09	0	0	0.32

4.2. Correlation coefficients

According to the un-tabulated results of our research, the FinRatio is significantly and negatively correlated

with the INST, which is consistent with H1a. Although the correlation coefficients among some variables are significant, the correlation coefficients are not more than

0.5. Moreover, the multicollinearity values tested by the VIF variance expansion factor are not more than 5, indicating that there is no obvious multicollinearity among the variables in the regression model.

4.3. Baseline results

Table 2 shows the results of regression models used to test hypotheses. H1a is supported by the negative and significant coefficients of *FinRatio* in regressions using *INST*. Specifically, the coefficient of the variable *FinRatio* is -0.017 , statistically significant at the 1% level, indicating that the institutional investors' shareholding reduces the degree of corporate financialization. Moreover, the shareholding of institutional investors also effectively plays a role in supervising and governing the short-sighted behaviour of the corporates.

Table 2. Basic regression result based on the regression model

Dependent variable =	<i>FinRatio</i>	<i>FinRatio</i>
	(1)	(2)
<i>INST</i>	-0.012***	-0.017***
	(-5.66)	(-6.19)
<i>Size</i>		0.000
		(0.11)
<i>BM</i>		-0.018***
		(-6.88)
<i>ROA</i>		0.156***
		(12.42)
<i>Growth</i>		-0.018***
		(-7.71)
<i>Duality</i>		0.004***
		(2.96)
<i>SOE</i>		-0.028***
		(-4.12)
Constant	0.032***	0.041***
	(7.36)	(3.71)
Observations	25,196	21,752
R-squared	0.147	0.148
Industry FE	Yes	Yes
Year FE	Yes	Yes

The coefficients of the control variables are generally consistent with the studies. Enterprises with a higher book-to-market ratio, lower ROA, and higher growth rate are associated with a lower degree of corporate financialization.

4.4. Robustness checks

4.4.1. Firm and year fixed effects

To mitigate potential problems that may arise from omitting time-invariant and year-invariant firm-specific characteristics, we re-estimate the regression of the model and report the results in Table 3.

Table 3. Firm fixed effect and year fixed effect

Dependent variable =	<i>FinRatio</i>	<i>FinRatio</i>
	(1)	(2)
<i>INST</i>	-0.005**	-0.015***
	(-2.28)	(-5.20)
<i>Size</i>		0.001
		(1.37)
<i>BM</i>		-0.024***
		(-6.79)
<i>ROA</i>		-0.044***
		(-3.72)
<i>Growth</i>		0.006***
		(3.29)
<i>Duality</i>		0.001
		(0.64)
<i>SOE</i>		-0.056***
		(-6.37)
Constant	0.035***	0.032**
	(22.14)	(1.97)
Observations	25,196	21,752
R-squared	0.186	0.189
Firm FE	Yes	Yes
Year FE	Yes	Yes

As shown in table 3, the estimated coefficients of the variable *INST* in the two columns are significantly negative, which implies that our results are not driven by time-invariant and year-invariant firm-specific characteristics.

Verifying *FinRatio1*, bringing all variables into the model for regression, and only controlling the variable of institution shareholding, we can see that the overall shareholding ratio (*INST*) of institutional investors in sample enterprises is significantly negatively correlated with 5% of the financialization level, with a β coefficient of -0.005 , that is, for every additional unit held by institutional investors, the financialization level of enterprises decreases by 0.005 units, which indicates that institutional investment has a significant inhibitory effect on corporate financialization.

Verifying FinRatio2, with the control of all variables, we can see that the regression result is still significant, so the conclusion in the previous paragraph is still valid.

4.5. Including more control variables

As can be seen from the chart, when the variables ‘board degree’, ‘cashflows’, and ‘board independence’ are fixed one by one, the regression results are still significant. When the three variables are fixed at the same time, the significance level of the β coefficient remains unchanged. These all corroborate hypothesis 1a.

Table 4. Robustness test 2 – adding more control variables

Dependent variable =	FinRatio	FinRatio	FinRatio	FinRatio
	(1)	(2)	(3)	(4)
INST	-0.012***	-0.017***	-0.017***	-0.012***
	(-4.59)	(-6.19)	(-5.97)	(-4.36)
Size	0.000	0.000	-0.000	-0.000
	(0.20)	(0.13)	(-0.15)	(-0.27)
BM	-0.008***	-0.018***	-0.018***	-0.008***
	(-3.16)	(-6.86)	(-6.80)	(-3.21)
ROA	0.129***	0.155***	0.157***	0.134***
	(10.48)	(12.33)	(12.52)	(10.81)
Growth	-0.028***	-0.018***	-0.018***	-0.028***
	(-12.24)	(-7.68)	(-7.71)	(-12.43)
Duality	0.003**	0.004***	0.003***	0.003**
	(2.43)	(2.96)	(2.63)	(2.22)
SOE	-0.041***	-0.028***	-0.028***	-0.040***
	(-6.15)	(-4.12)	(-4.19)	(-5.94)
Board	-0.099***			-0.100***
	(-29.43)			(-29.45)
Cashflows		0.000		-0.001***
		(0.19)		(-2.99)
Indep			0.033***	0.028***
			(3.60)	(3.09)
Constant	0.070***	0.041***	0.031***	0.065***
	(6.43)	(3.68)	(2.73)	(5.73)
Observations	21,752	21,752	21,672	21,672
R-squared	0.181	0.148	0.148	0.181
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

4.6. Additional analysis

In this section, we divide the companies under observation into two categories based on whether they are audited by the Big Four accounting firms and control the variables included in the empirical regression model. The regression results show that companies audited by the Big Four accounting firms have a smaller β coefficient (-0.041) than those are not audited by the Big

Four accounting firms (-0.015), which means the former have a lower degree of financialization, and its degree of corporate governance is better than the latter.

Table 5. Additional analysis: the role of Big 4 auditors

Dependent variable =	FinRatio	FinRatio
	(1) Big4	(2) Non-Big4
INST	-0.041***	-0.015***

	(-4.00)	(-5.34)
Size	0.012***	-0.001
	(4.67)	(-1.11)
BM	-0.019*	-0.019***
	(-1.86)	(-6.84)
ROA	-0.010	0.164***
	(-0.21)	(12.69)
Growth	0.009	-0.019***
	(0.91)	(-7.92)
Duality	0.019***	0.003**
	(3.55)	(2.36)
SOE	0.023	-0.030***
	(0.69)	(-4.27)
Constant	-0.188***	0.053***
	(-3.41)	(4.58)
Observations	1,141	20,611
R-squared	0.175	0.152
Firm FE	Yes	Yes
Year FE	Yes	Yes

5. CONCLUSIONS AND SUGGESTIONS

5.1. Conclusions

Financial investment activities are an important part of enterprises' investment activities. However, China's non-financial enterprises are keen on the allocation of financial assets, which leads to the unbalanced development of the financial industry and real industry structure. As an effective external supervision mechanism, institutional investors can exert certain governance effects. Based on domestic and foreign scholars' research, this paper analyses in detail the motivation of institutional investors' involvement in corporate governance and its influence on corporate financial investment. Selecting the relevant data of A-share listed companies from 2007 to 2020, this paper empirically studies the impact of institutional investors on corporate financial assets investment, and draws the following conclusions:

Taking the whole institutional investors' shareholding as the empirical research object, this paper examines the influence of the whole institutional investors on the financialization level of enterprises. It is concluded that the higher the overall shareholding ratio of institutional investors, the stronger the degree of restraining the financialization of enterprises, which also proves that institutional investors have a strong financial governance effect and provides certain reference significance for policy formulation and introduction of institutional investors.

5.2. Limitations

First, there are still many factors that affect the financialization of enterprises, which are not included in the model. This paper mainly discusses the motivation of enterprise financial asset allocation from the perspective of institutional investors' shareholding and corporate governance, but there are still many factors at the enterprise level and macro level, such as investment opportunities, GDP and so on, which need further research. Second, because there are many ways to measure the financialization level of enterprises, this paper only adopts two of them, namely, the total financial assets and the proportion of transactional financial assets to measure the financialization level.

5.3. Suggestions

At present, the development structure of China's financial industry and real industry is unbalanced. Due to the profit-seeking nature of capital, non-financial enterprises give up sticking to their business operations and invest a large amount of capital in the financial field. The phenomenon of "divorced from reality to virtual reality" has become the norm in the capital market, which leads to problems such as existing overcapacity and sustained downturn in the real economy. However, the shareholding of institutional investors can effectively inhibit the excessive financialization of micro-enterprises.

Based on this, the following three further suggestions have been achieved for this paper. i). The relevant government departments should improve the market access mechanism of institutional investors, formulate preferential policies from reality, give necessary and reasonable subsidies, actively regulate and absorb mature institutional investors, especially actively accept the investment behaviour of independent institutional shareholders, and guide such groups to further develop to the participants of corporate governance. ii). It is necessary to improve the external financial environment, continue to promote the process of marketization, give full play to the good corporate governance effect for institutional investors and even provide fertile soil to ensure the steady improvement of enterprise financial investment level. Accordingly, creating a scientific and orderly financial environment and insisting that the real economy is the pillar of the national economy would not be neglected. iii). Enterprises should rationally allocate financial assets and operating assets and grasp the holding ratio of financial assets. Enterprises should strengthen the overall coordination of the relationship between business and financial investment business, rationally allocate the use of funds to increase their value and win the favour of institutional investors. Enterprises can properly allocate short-term financial assets, provide financial support for enterprises, and prevent the shortage

of funds. At the same time, enterprises should carefully allocate long-term financial assets, pay close attention to a series of negative effects such as the decrease of industrial investment and the rise of financial risks that may be brought about in the process of financialization, and avoid excessive financialization.

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