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Executive Financial Background, Financing Constraints, and Corporate Financialization

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Abstract: *This paper takes the listed companies of China's Shanghai and Shenzhen A-shares from 2008 to 2019 as the sample and uses methods such as two-stage least squares regression to empirically test the relationship between executive financial background, financing constraints, and corporate financialization. The research conclusions are as follows: (1) The financial background of corporate executives has a significant positive impact on corporate financialization, and the conclusion remains valid after controlling for endogeneity. (2) The mechanism test shows that an increased proportion of executives with a financial background can alleviate the financing constraints of enterprises, thereby enhancing the promoting effect of executive financial background on corporate financialization. This paper studies the influencing factors of corporate financialization from the perspective of executives, enriches the related research on executive financial background and corporate financialization, and provides a new angle for managers and regulatory departments to consider financial risks, as well as a new direction for investors to correctly recognize the value of enterprises.*

Keywords: *Financial Background; Corporate Financialization; Financing Constraints*

1. Introduction

In the context of the economic financialization wave, the import of international financial risks, and the overlay of China's structural problems, the management decisions and investment behaviors of enterprises have gradually changed. A large amount of industrial capital has flowed into financial and other high-return industries, leading to a development trend in China's real economy and financial system from tangible to intangible. Based on the current economic situation, the Central Economic Work Conference held in December 2016 pointed out the need to "focus on preventing asset bubbles" and to "revitalize the real economy", placing the prevention and control of financial risks in a more important position; the report of the 19th National Congress of the Communist Party of China in 2017 once again proposed to "deepen financial system reform and enhance the capacity of financial services to serve the real economy"; the Central Economic Work Conference held in December 2020 also clearly stated the need to "improve the governance of financial institutions and promote the healthy development of the capital market".[1]

This paper takes the data of A-share listed companies in Shanghai and Shenzhen stock markets from 2008 to 2019 as the research sample, focusing on the impact of executives' financial backgrounds on corporate financialization, and analyzes the specific relationship between the proportion of executives with financial backgrounds and the degree of corporate financialization. The financial background of executives is mainly measured from three aspects: working background, professional background, and academic background, while the degree of corporate financialization is measured by the proportion of financial assets held by the company to its total assets. Furthermore, this paper analyzes the mechanism of action of executives with financial backgrounds on corporate financialization, namely testing whether the pathway "executive financial background - corporate financing constraints - corporate financialization" is valid.[2]

2. Literature Review

With the development of financial markets, corporate financialization has gradually become an important trend in the development of China's non-financial enterprises in recent years. Although the concept of corporate financialization is widely used in academia, the definition of corporate financialization is still somewhat vague. We can derive the definition of corporate financialization from the definitions of financialization. Different definitions of financialization have mainly been explained

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from two perspectives: first, from the perspective of asset structure, corporate financialization refers to enterprises investing more in or relying more on financial markets; second, from the perspective of profit acquisition, corporate financialization leads to the main source of enterprise profits coming from investments in financial assets.[3]

Current research on corporate financialization mainly focuses on the following aspects: motives, influencing factors, and impacts.

(1) Motives for corporate financialization: Based on the analysis of the connotation of corporate financialization, it is currently believed that corporate financialization mainly stems from two motives: "precautionary" and "profit-seeking". The "precautionary" motive refers to the "reservoir" motive that can serve the real economy, where financial assets have strong liquidity and low adjustment costs, allowing for the liquidation of held financial assets to alleviate financial issues faced (Almeida et al., 2004). From the "profit-seeking" perspective, with the sustained downturn in the real economy and the continuous decline in the return on investment for enterprises, enterprises choose to invest in financial assets instead of some of their main businesses to achieve short-term excess returns (Cai Mingrong and Ren Shichi, 2014).

(2) Influencing factors of corporate financialization: Different scholars have different entry points for the influencing factors of corporate financialization. Analyzing from both external and internal perspectives of the enterprise, from an external perspective, scholars currently believe that the main factors affecting corporate financialization include the macroeconomic environment (Deng Chao et al., 2017), the concept of maximizing shareholder value (Deng Chao et al., 2017), and financial markets (Xu Xintu, 2020). From an internal perspective, there are factors related to executives (Dai Zewei, 2019; Du Yong, 2019), corporate social responsibility (Gu Leilei et al., 2020), and social capital (Yang Xingquan, 2021).

(3) Impacts of corporate financialization: Scholars currently believe that the impacts of corporate financialization are mainly reflected in capital investment (Luan Tianhong, Yuan Yadong, 2019) and sustainable innovation (Xiao Zhongyi, Lin Lin, 2019). Luan Tianhong et al. argue that corporate financialization significantly reduces its capital investments; Xiao Zhongyi et al. believe that if corporate financialization is motivated by the "reservoir" motive, it promotes sustainable innovation, while if it is due to the "crowding out" effect, it inhibits sustainable innovation.

From the above analysis, it is evident that scholars have not yet conducted a comprehensive study on the financial background characteristics of executives, and executives play a crucial role in the business decisions of enterprises. The different backgrounds of executives lead to different strategies and decisions. Therefore, this paper mainly analyzes corporate financialization from the perspective of executives' financial backgrounds.[4]

3. Research Hypotheses

(1)Senior Executives' Financial Background and Corporate Financialization

Through extensive research by scholars, the current viewpoint suggests that corporate financialization is mainly driven by two motives: "precautionary" and "profit-seeking." From a "precautionary" perspective, financial assets possess strong liquidity, lower adjustment costs, and can maintain appreciation to a certain extent during the holding period, reducing the company's reliance on external financing. From a "profit-seeking" perspective, financial assets can yield considerable returns in a short period, and capital will flow from industries with low investment returns to those with high returns, thus companies will invest funds in the financial industry.[5]

According to the upper echelons theory, due to the complexity of the external environment, managers cannot fully comprehend all aspects of it, and managerial traits influence their strategic choices, thereby affecting corporate behavior (Hambrick & Mason, 1984). Executives with a financial background, as opposed to those without, differ in the following aspects: (1) Cognition, executives with a financial background have more accurate knowledge and judgment regarding issues in the finance field. (2) Resource acquisition, executives with a financial background form their professional social networks, significantly mitigating information asymmetry (Deng Jianping & Zeng Yong, 2011). (3) Foresight, executives with a financial background can draw on their experiences to understand the trends of governments and regulatory bodies, making adjustments to corporate behavior accordingly. Therefore, this paper posits that, regardless of the motive, executives with a financial background will allocate more financial assets to the company. Hence, the following hypothesis is proposed:

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H1: Compared to executives without a financial background, those with a financial background play a facilitating role in corporate financialization.

(2)The Mediating Effect of Financing Constraints

If the hypothesis that executives' financial background promotes corporate financialization holds true, it then becomes necessary to further explore through what channels executives' financial background impacts corporate financialization. As mentioned earlier in the analysis of executives' financial background, those with a financial background have certain advantages in resources and channels over those without a financial background, evidently mitigating the company's financing constraints. This can provide a favorable financial environment for the company's normal development and financial investments, thereby enhancing the level of corporate financialization. Based on the above analysis, the following hypothesis is proposed:

H2: Executives with a financial background can alleviate the company's financing constraints, thereby promoting the elevation of corporate financialization levels.

4. Research Design

(1)Data Source

Influenced by the 2008 financial crisis, the expansion of the financial system in developed countries slowed down, but it did not significantly hinder the process of financialization in China. Furthermore, after this period, China's financial sector has shown rapid expansion and fast development. Therefore, this paper selects all A-share listed companies from 2008 to 2019 as the sample. Based on this, the sample was preliminarily processed according to the following conditions: (1) Exclude financial listed companies; (2) Exclude companies listed as ST or *ST; (3) Exclude listed companies with missing key data. The data used in this paper comes from the GTA database and the authors' manual collation. To mitigate the impact of extreme values, the continuous variables needed for analysis in this paper have been winsorized at the top and bottom 1%.

(2)Variable Selection

1) Financial Background. The executives in this paper mainly refer to the core management personnel who have a significant influence on the operation management and financial asset allocation decisions of the company, including the chairman of the company, CEO, and CFO. Financial background is measured in three aspects: professional financial background, financial academic background, and financial work background. Professional financial background mainly refers to executives with certificates in the field of commerce, such as senior economists. Financial academic background mainly refers to executives with academic backgrounds in commerce-related fields, such as finance, international trade, business administration, etc. Financial work background mainly refers to executive members with work experience in policy banks, commercial banks, and other financial institutions. The financial background variable is mainly based on the above definitions, measuring the proportion of executives with a financial background among all executives.[6]

2) Corporate Financialization. The degree of corporate financialization in this paper refers to the measurement method of Du Yong et al. (2018) and is defined by the ratio of financial assets to total assets. The definition of financial assets in this paper specifically includes: trading financial assets, available-for-sale financial assets, held-to-maturity investments, net loans and advances, derivative financial instruments, investment properties, long-term equity investments. Different from the definition of financial assets in accounting measurement, it: (1) does not include cash and cash equivalents (2) includes investment properties.

3) Financing Constraints. Based on the financing constraint variable SA index designed by Hadlock and Pierce (2010), it is constructed using two variables that change little over time and have strong exogeneity: company size and company age. The specific calculation formula is: $-0.737Size + 0.043Size^2 -0.040*Age$, where Size is the natural logarithm of the company size (in million yuan), and Age is the length of time the company has been established. The absolute value of the calculated SA index represents the financing constraint FC, where a larger FC value indicates a more severe degree of financing constraint experienced by the company.

(3)Model Design

To test the previously proposed hypothesis H1, this study constructs the following model to be tested:

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$$fin_{it} = \alpha_0 + \alpha_1 finback_{it} + \alpha_2 CVs_{it} + \Sigma Ind + \Sigma year + \varepsilon_{it} \quad (1)$$

In model (1), fin represents the degree of financialization of company i in year t, measured by the ratio of financial assets to total assets. finback represents the ratio of executives with financial backgrounds among all executives employed by company i in year t. CVs are the control variables in this study, specifically including: company size (size), represented by the natural logarithm of total assets; financial leverage (lev), represented by the company's debt-to-asset ratio; company profitability (roa), represented by the return on total assets roa; company growth (growth), represented by (current year's main business income - last year's main business income) / last year's main business income; shareholding structure (top10), represented by the number of shares held by the top ten shareholders; ownership concentration (zindex), represented by the ratio of the largest shareholder's holding percentage to the second largest shareholder's holding percentage; board size (board), represented by the logarithm of the number of board members; fixed asset investment (fa), represented by the ratio of fixed asset investment to total assets. In addition, this study also controls for industry fixed effects ind and year fixed effects year.

To test the hypothesis H2 proposed earlier, this study constructs the following model to be tested:

$$fin_{it} = \alpha_0 + \alpha_1 finback_{it} + \alpha_2 CVs_{it} + \Sigma Ind + \Sigma year + \varepsilon_{it} \quad (2)$$

$$fc_{it} = \beta_0 + \beta_1 finback_{it} + \beta_2 CVs_{it} + \Sigma Ind + \Sigma year + \varepsilon_{it} \quad (3)$$

$$fin_{it} = \gamma_0 + \gamma_1 finback_{it} + \gamma_2 fc_{it} + \gamma_3 CVs_{it} + \Sigma Ind + \Sigma year + \varepsilon_{it} \quad (4)$$

In models (2), (3), and (4), fc represents the level of financing constraints of company i in year t, obtained by taking the absolute value of the financing constraint variable (SA index). To test the hypothesis H4 proposed earlier, model (2) is used to examine the impact of executives' financial backgrounds on corporate financialization. If the coefficient α_1 is significant, model (3) is then used to test the impact of executives' financial backgrounds on the level of corporate financing constraints. If the coefficient β_1 is significant, model (4) incorporates both the explanatory variable of executives' financial background and the mediating variable of corporate financing constraints for analysis. If the coefficient γ_2 is significant and the coefficient $\gamma_1$is not significant, it indicates a full mediating effect; if both coefficients γ_2 $\gamma_1$are significant, it indicates a partial mediating effect; if γ_2 not significant, the mediating effect does not hold.

5. Empirical Analysis

(1)Descriptive Statistics:

Table 1: Main Variable Descriptive Statistics

Variable	Observations Mean	Standard	Deviation	Minimum	Median	Maximum
fin1	27000	0.0667	0.100	0	0.0268	0.533
finback	27000	0.281	0.223	0	0.250	1
size	27000	22.07	1.321	19.48	21.89	26.09
lev	27000	0.435	0.216	0.0481	0.428	0.973
roa	27000	0.0412	0.0627	-0.236	0.0379	0.229
growth	27000	0.182	0.583	-0.893	0.104	4.003
TobinQ	26800	2.030	1.293	0.881	1.607	8.514
Top10	27000	0.585	0.154	0.226	0.595	0.902
zindex	27000	10.62	18.53	1.004	3.879	118.5
board	26900	2.143	0.200	1.609	2.197	2.708
fa	27000	0.224	0.169	0.00180	0.188	0.725
ic	25400	0.640	0.149	0	0.672	0.895
risk	27000	18.63	1.822	13.22	18.68	23.24
fc	27000	3.725	0.255	3.022	3.731	4.324

Table 1 presents the descriptive statistics of the sample. It is evident from the table that there is a positive correlation between executives' financial background and the degree of corporate financialization. From Table 2, the Pearson (Spearman) correlation coefficient is 0.05, significant at the 1% level, indicating a significant positive correlation between executives' financial background and the degree of corporate financialization. Moreover, Table 1 shows that there is also a positive correlation between executives' financial background and financing constraints (fc), with a Pearson correlation

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coefficient of 0.01, significant at the 10% level. These conclusions preliminarily support the hypotheses of this paper. To further validate the correctness of the hypotheses, more rigorous proof through subsequent multiple regression is necessary.[7]

Table 2: Analysis of Correlation between Main Variables

	fin1	finback	ic	risk	fc
fin1	1	0.06***	-0.01	-0.02***	0.20***
finback	0.05***	1	-0.01	0.02***	0.01*
ic	-0.01**	-0.01	1	0.22***	-0.14***
risk	-0.12***	0.02**	0.22***	1	0.01*
fc	0.17***	0.02***	-0.12***	-0.05***	1

Note: The lower left corner shows Pearson correlation coefficients, and the upper right corner shows Spearman correlation coefficients; *, **, *** respectively indicate significance at the 10%, 5%, and 1% levels.

According to Table 2, the main variables required for regression in this paper do not have severe multicollinearity.

(2)Executives' Financial Background and Corporate Financialization

Table 3: Regression with Full Sample and Moderating Effects

	(1)	(2)
	fin1	fin1
finback	0.0097***	0.0115***
	(3.4112)	(4.1699)
size		0.0035***
		(6.5279)
lev		-0.0003
		(-0.6836)
roa		0.0003
		(0.2085)
growth		-0.0000
		(-0.5849)
top10		-0.1063***
		(-26.3471)
zindex		0.0002***
		(8.7041)
lnboard		-0.0161***
		(-5.0076)
fa		-0.1565***
		(-33.9870)
_cons	0.0764***	0.1180***
	(8.8703)	(8.1320)
F	38.3801	57.0196
r2_a	0.1114	0.1704
N	2.7e+04	2.7e+04
industry	YES	YES
year	YES	YES

t statistics in parentheses
* p < 0.1, ** p < 0.05, *** p < 0.01

Table 3 presents the impact of executive financial background on corporate financialization, i.e., the test results of Model (1), where the dependent variable is the degree of corporate financialization (fin), and the independent variable is executive financial background (finback). The results in the first column show that the estimated coefficient of finback is approximately 0.0097, significant at the 1% level (t=3.4112), indicating a positive correlation between executive financial background and corporate financialization, thus confirming H1. To mitigate potential interference from other factors, we controlled for variables such as firm size (size), as shown in the second column.[7]

(3) Testing the Mechanism of Action

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Table 4: Presents the examination of the mediating mechanism

	(1)	(2)	(3)
	fin1	fc	fin1
finback	0.0108***	-0.0368***	0.0129***
	(4.2524)	(-6.3093)	(5.0877)
size	0.0089***	-0.0061***	0.0092***
	(15.7187)	(-4.7009)	(16.3307)
lev	-0.0701***	0.0938***	-0.0746***
	(-19.6922)	(11.5093)	(-21.0426)
roa	-0.0392***	0.2456***	-0.0514***
	(-3.7032)	(10.1200)	(-4.8741)
growth	-0.0048***	0.0110***	-0.0053***
	(-4.7769)	(4.7510)	(-5.2242)
top10	-0.1157***	-0.4166***	-0.0965***
	(-29.6362)	(-46.6181)	(-23.9184)
zindex	0.0003***	0.0007***	0.0003***
	(10.7284)	(10.2885)	(9.8334)
lnboard	-0.0148***	0.0518***	-0.0172***
	(-4.9354)	(7.5271)	(-5.7621)
fa	-0.1400***	0.0217**	-0.1411***
	(-32.0713)	(2.1735)	(-32.5338)
fc			-0.0461***
			(-17.3274)
_cons	0.0274*	3.6892***	-0.1427***
	(1.9365)	(113.9600)	(-8.3285)
F	65.6943	139.5912	68.6611
r2_a	0.1917	0.3371	0.2005
N	2.7e+04	2.7e+04	2.7e+04
industry	YES	YES	YES
year	YES	YES	YES

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.0$

In order to verify the above hypothesis that the financial background of senior executives affects corporate financialization by influencing corporate financing constraints, this paper conducts tests through models (2), (3) and (4), and the regression results are shown in Table 4. In column (1), the estimated coefficient of finback is about 0.01, which is significantly positive at the 1% level; In column (2), the estimated coefficient of finback is significantly negative at the level of 1%, that is, executives with financial background can significantly alleviate the financing constraints of enterprises, which is consistent with the previous hypothesis. In column (3), the estimated coefficient of fc is significantly negative at the level of 1%, and the estimated coefficient of finback is significantly positive at the level of 1%, and the estimated coefficient of finback is increased, indicating that financing constraints play a partial intermediary effect in the promotion of corporate financialization by executives with financial background. That is, the financial background of senior executives affects corporate financialization by alleviating corporate financing constraints. The results of this model support hypothesis H2 above, that is, the mechanism of the financial background of senior executives affecting corporate financialization is the path of "financial background of senior executives - financing constraints - corporate financialization".[8-10]

6. Conclusion and Recommendations

(1) Conclusion

This study examined the impact of executive financial background on corporate financialization using data from Chinese A-share listed companies from 2008 to 2019. The findings suggest that executive financial background has a significant positive effect on corporate financialization, even after controlling for endogeneity. Further tests of mechanism of action reveals that executive financial background promotes corporate financialization by reducing corporate financing constraints.

(2) Implications and Recommendations

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1) From the Perspective of Corporate Executives:

Companies should strive to build diverse executive teams with rich backgrounds, leveraging their varied experiences and expertise to make decisions that benefit the company most effectively.

2) From the Perspective of Internal Management:

Continuous improvement of internal management practices and the establishment of stringent management systems are essential to ensure that the company operates as a tightly knit and cohesive unit.

3) Considering the Risk Level of the Company:

It's crucial to reasonably control the company's own risk level. From an asset structure perspective, effectively managing the company's risk can help avoid issues such as a breakdown in the company's financial chain.

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