

Financialisation and changes in the financial structure of European manufacturing companies

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Objectives

- ❑ Empirical study on the structural distortion of manufacturing companies' balance sheets in 9 countries of the Euro zone (1990-2006)
- ❑ It offers an analysis of the most representative ratios of the impact of European economies' financialization upon European manufacturing companies balance sheets
- ❑ Thesis: the tightening of European macroeconomic policies in the 1990s as well as financialization of European economies contribute to the decrease in the rate of productive investment of manufacturing companies through:
 - slowdown in demand growth
 - emergence of new entrepreneurial strategies focused on maximizing shareholder value
 - extension of M/A
 - increased role of II
 - balance sheet « downsizing » policy
 - the rise of short termism
 - a neomalthusian investment policy

Overview

This study is composed of three parts:

- ❑ Ratios and their evolution
- ❑ Analytical framework of the impact of financialisation on productive activity
- ❑ Major indicators of corporate strategies' financialization in Europe

Empirical study (1/5)

Sample and Data

The data analysed concern three categories of companies: companies of all sizes, large companies and small companies

The ratios analysed are as follows:

Financial fixed assets/Total assets;

Tangible and intangible fixed assets/Total assets;

Income statement ratios are also analysed through:

Net acquisition of tangible and intangible fixed assets/Turnover;

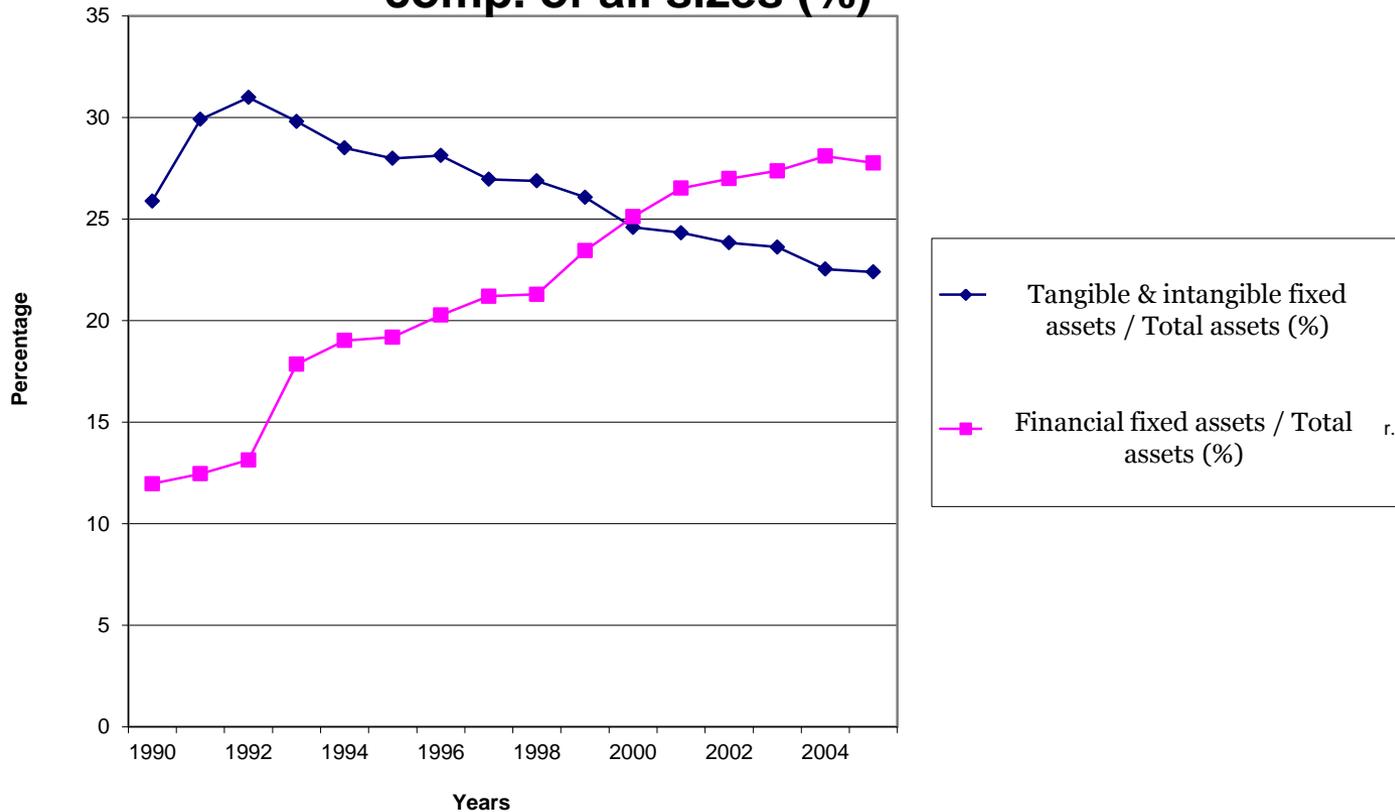
Net acquisition of financial fixed assets/Turnover;

Compensation of employees/Turnover and;

Net profit/Turnover

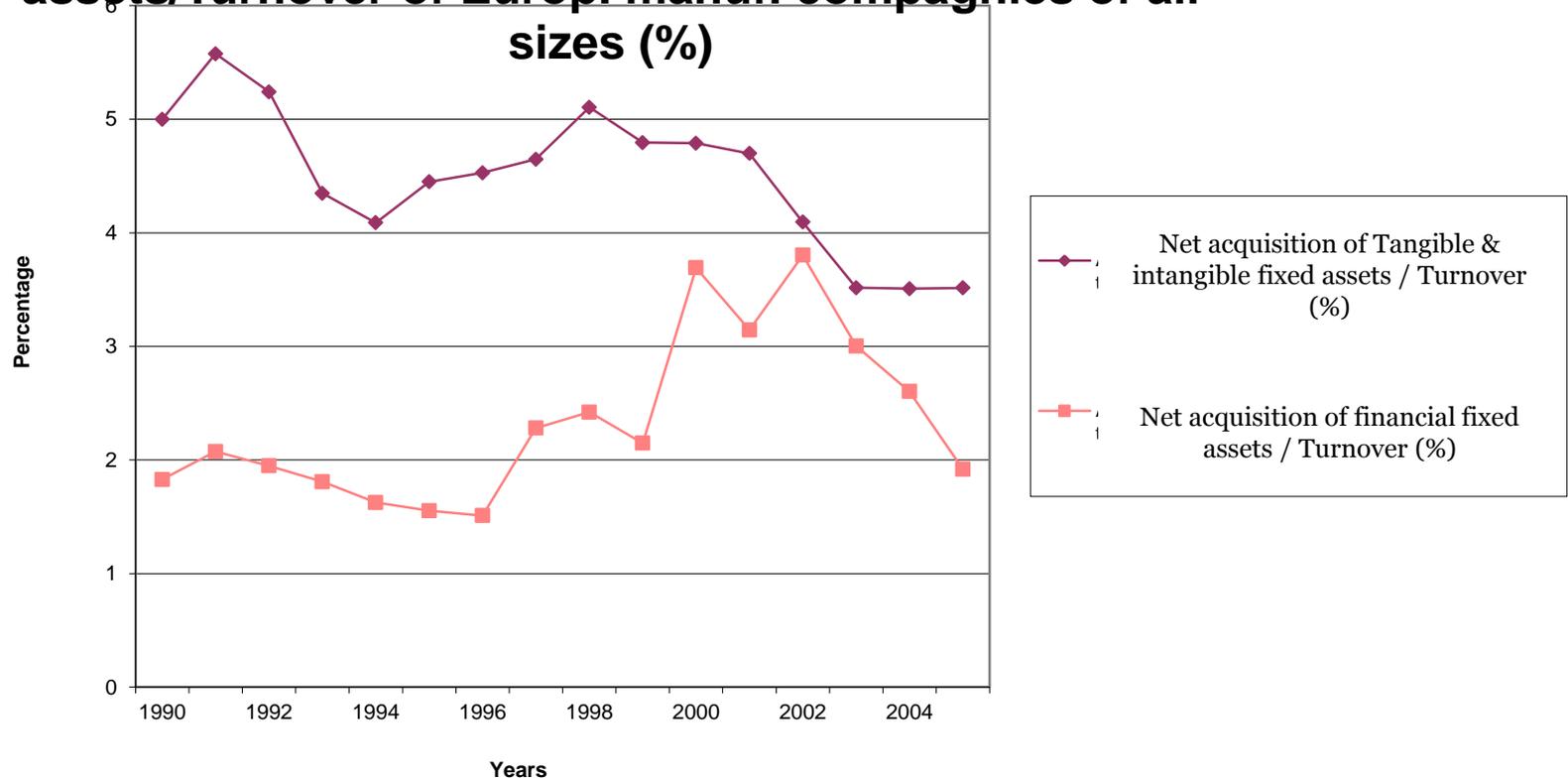
Empirical study (2/5)

**Tangible and intang. fixed assets/Total assets vs
Financ. fixed assets/Total assets europ. manuf.
comp. of all sizes (%)**



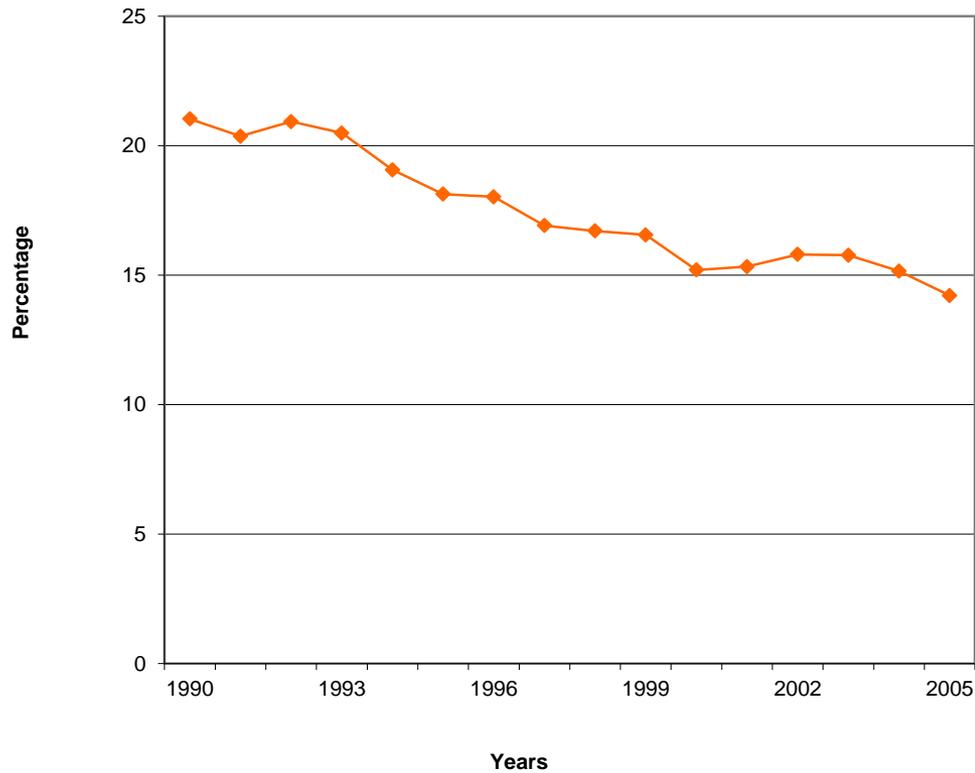
Empirical study (3/5)

Net acquisition of tang. and intangible fixed assets/Turnover vs net acquis. of financ. fixed assets/Turnover of Europ. manuf. compagnies of all sizes (%)



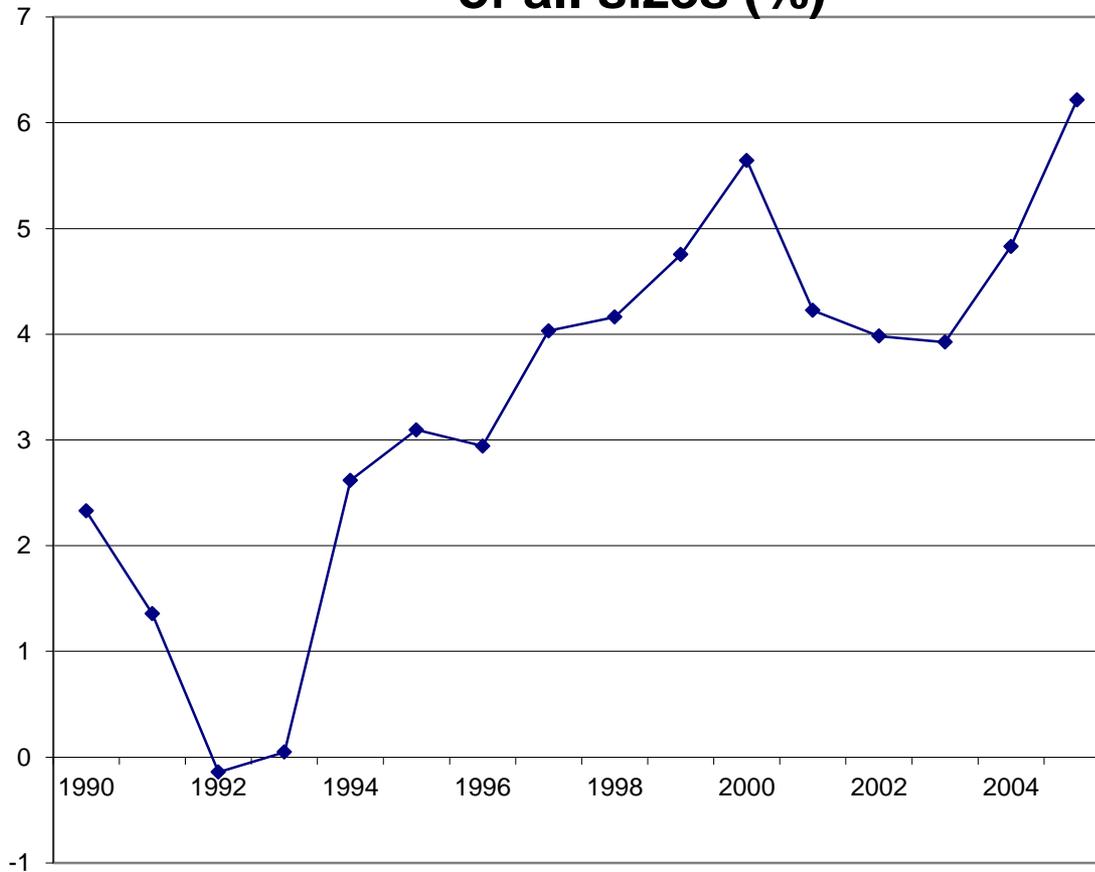
Empirical study (4/5)

Compensation of employees/Turnover of European manuf. comp. of all sizes (%)



Empirical study (5/5)

**Net profit/Turnover of European manuf. companies
of all sizes (%)**



Financialisation of economies and productive investment (1/4)

Overview of the second part

- ❑ Analytical tools for grasping the impact of financialization on corporate strategies and on investment behaviour
- ❑ Concept of financialization of strategies providing the theoretical framework of the study
- ❑ Main vectors of corporate strategies' financialization and its impact on productive investment

Financialisation of economies and productive investment (2/4)

Theses' overview - the portfolio choice theory

Companies have to decide between:

- invest their funds in financial markets
- make productive investments

There choice will depend on expected comparative rates of return and risk aversion

The high rate of return of financial securities favours the crowding out of productive investment by financial investment

The main criticism of this theory concerns the relationship established between financial and real assets

- Perfect substitutability between these two kinds of assets
- Optimal resource allocation because corporate managers "know" the returns of these two types of investment

Financialisation of economies and productive investment (3/4)

Theses' overview - the finance « parasitism »

- ❑ Finance prevents capital from being invested in a productive way by levying a part of the profit made in the form of dividends, financial charges or repurchase of shares
- ❑ Financialization of economies reinforces the power of finance

This thesis

- ❑ Reduces the consequences of financialization at the level of corporate income distribution
- ❑ Overvalues the place of cash-flow in investment decision
- ❑ Obscures the reality of power relations between company shareholders and creditors

Finally, anticipated rate of return on financial assets which influences corporate strategies include potential capital gains that do not result to income distribution

Financialisation of economies and productive investment (4/4)

Theses' overview - financialisation of corporate strategies

This theory anchors the negative consequences of the phenomenon in the sphere of production and production decision

Financialisation of corporate strategies

- ❑ Encourages a substantial increase in distributed corporate income
- ❑ Imposes the pre-eminence of shareholder value creation in the strategic and operational corporate decision making
- > direct negative impact upon productive investment

This thesis provides the theoretical framework of the study

Financialization of strategies and productive investment (1/3)

Theoretical assumptions of the concept of financialization of corporate strategies

Theoretical assumption 1:

There is a plurality of objectives of the capitalist enterprise :

- ❑ maximization of profit or shareholder value but also,
- ❑ growth, expansion of market shares, power over its partners...

Theoretical assumption 2:

The specific objective or the relative weight of the different objectives pursued by the companies depend on the institutional context. This context reflects the balance of power between social classes and different categories of stakeholders involved in the ownership, management and corporate finance

- ❑ The rise of neoliberalism and FG reinforce shareholder's power to impose managerial criteria aiming maximising shareholder's value
- ❑ Increasing role of the institutional investors

Financialization of strategies and productive investment (2/3)

Theoretical assumptions of the concept of financialization of corporate strategies

Theoretical assumption 3:

Corporate operational and strategic choices are not the result of technological or industrial imperatives

The selection procedure is

- ❑ fundamentally driven by the goals of enlarged capital reproduction
- ❑ influenced by the desire to consolidate the existing balance of power between owners and management

The shareholder revolution favours

- ❑ the establishment of refocusing strategies for companies
- ❑ an unprecedented Mergers & Acquisitions movement (M-A)

Financialization of strategies and productive investment (3/3)

Corporate strategies driven by the objective of “shareholder value” have negative consequences on real investment:

- ❑ They encourage balance sheets downsizing policies: abandonment of capital intensive activities and equity capital economy
- ❑ They promote salary reduction pressures > sluggish demand
- ❑ They favour the rise of short-termism
- ❑ They stimulate M/A at the expense of productive investment

Financialization and distortion in structure of European companies balance sheets

The distortion in structure of European manufacturing companies is the result of:

- ❑ the new European macroeconomic context
- ❑ the financialisation of corporate strategies

Financialization and distortion in structure of European companies balance sheets

European macro-economic context, drop in demand and slowdown of capital accumulation

The European macro-economic context is characterised by two major interconnected changes:

- ❑ the expansion of financial globalization
- ❑ the relaunching of European economic integration with the Single European Act (1986) and the European Economic and Monetary Unification (EMU) project

The EMU project leads to a tightening of macro-economic policies in Europe thus contributing to sluggish demand and investment stagnation in Europe

Financialization and distortion in structure of European companies balance sheets

Financialization of strategies and structural distortion of balance sheets in European industrial companies

Distorsion in the financial structure of European manufacturing companies is a consequence of the financialisation of corporate strategies

Major vectors of financialization of European business strategies are:

- the expansion of external growth (M/A) operations
- the development of refocusing and outsourcing policies
- the reinforcement of the role of institutional investors

Governments actively contribute to the establishment of new principles of corporate governance in favour of sustaining shareholder value objective by reforming legal context

Financialization and distortion in structure of European companies balance sheets

Financialization of strategies and structural distortion of balance sheets

Extension of financialisation of European manufacturing companies corporate strategies

- ❑ Transnational M-A is the new face of industrial globalization in the 1990s in Europe
- ❑ Increased role of institutional investors
- ❑ Refocusing strategies in the core business: intrasectoral operations represent more than 80% of the European manufacturing companies' external growth operations
- ❑ European governments favour the extension of the shareholders value model
 - The two Vienot reports (1995, 1999) and the law on « new economic regulations » (2001) in France
 - Law on corporate transparency and abolition of taxes on capital gains on assignment of shares in Germany

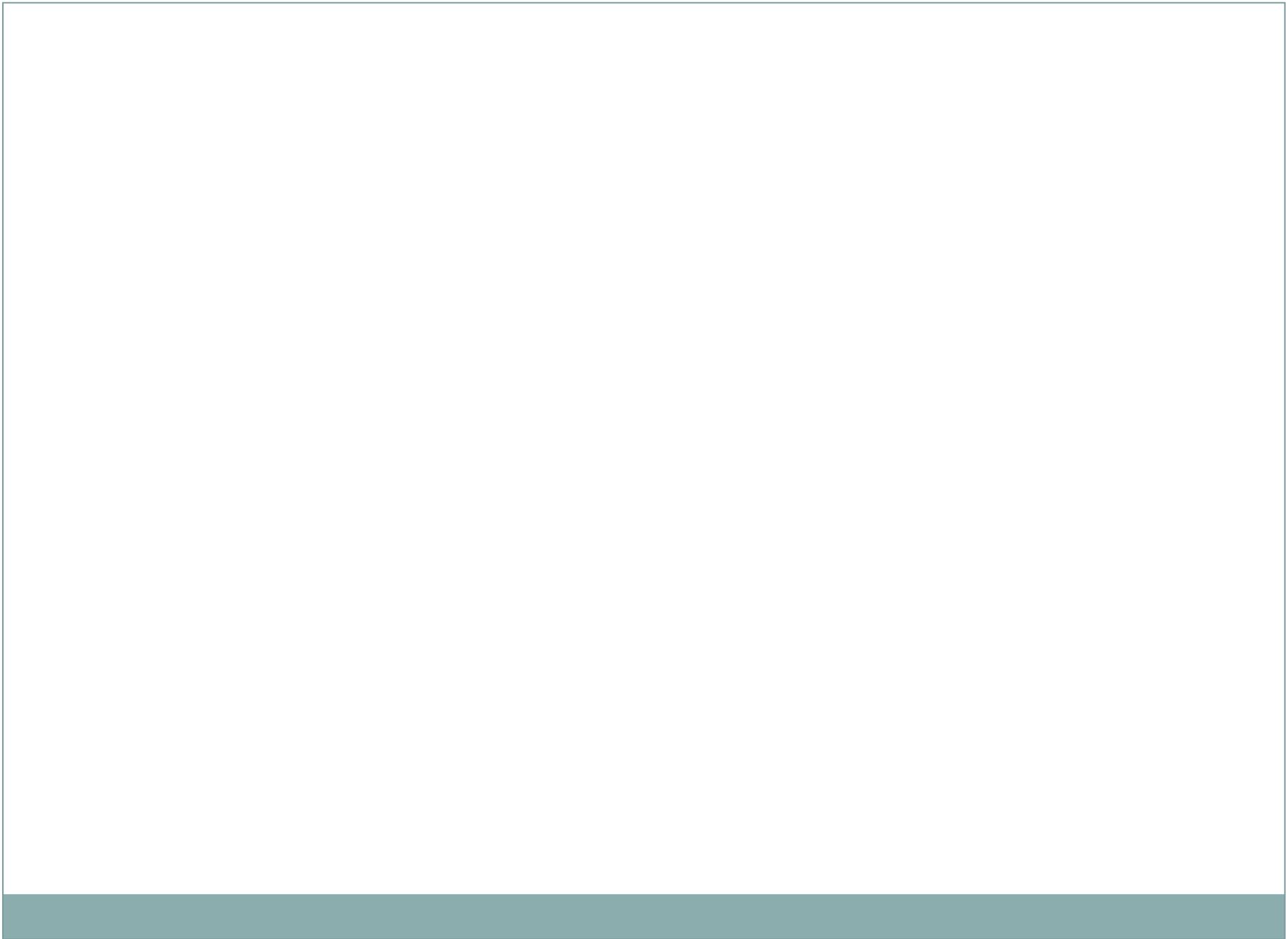
Financialization and distortion in structure of European companies balance sheets

Financialization of corporate strategies and structural distortion of balance sheets

Institutionalization of the Anglo-Saxon way of “good” governance leads to challenging some fundamental characteristics of French and German models of industrial group control

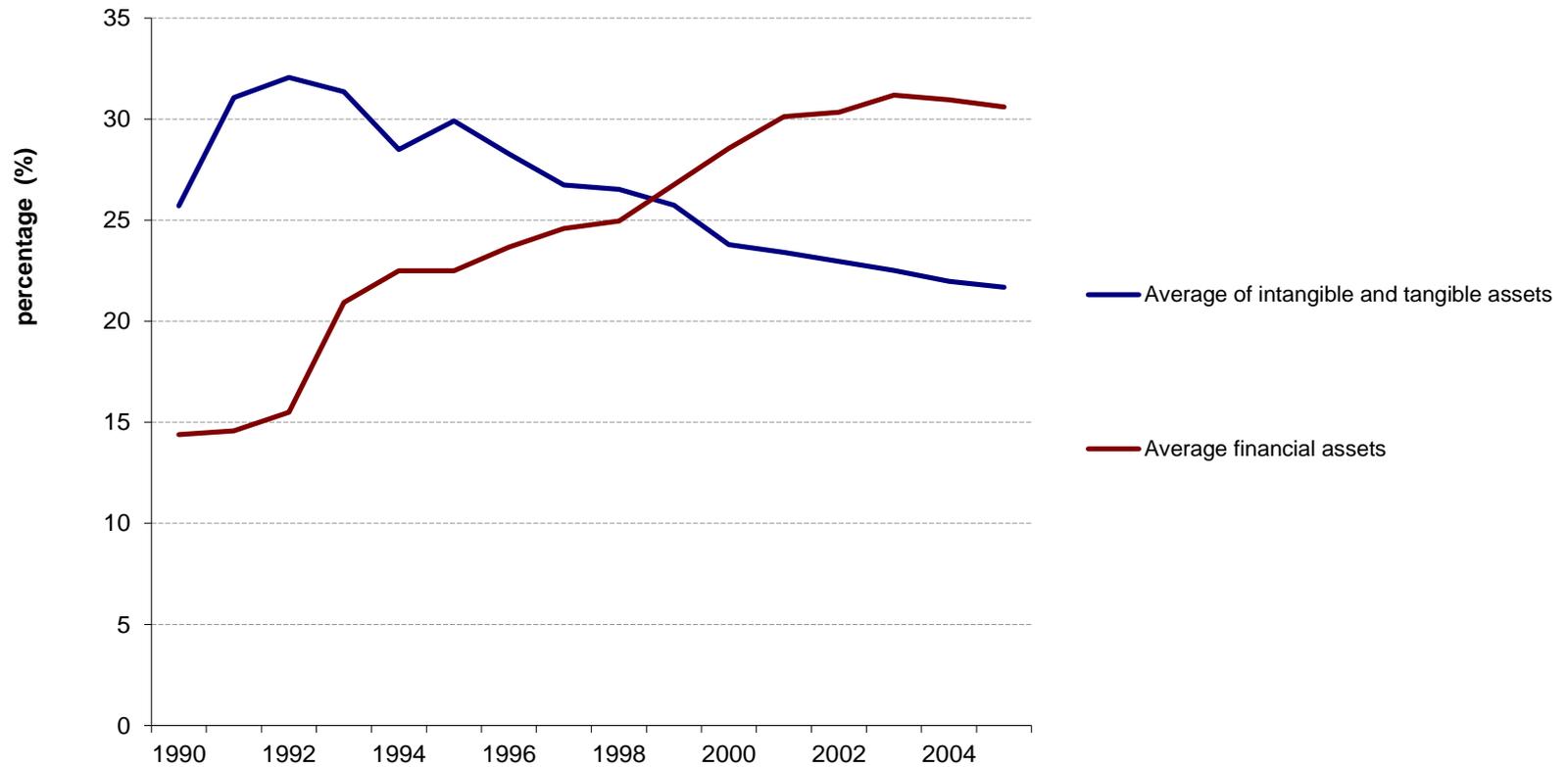
- ❑ hard core shareholding (France) and cross-shareholding (France, Germany)
- ❑ central importance of banking institutions and insurance companies ensuring the coherence of these models

Corporate strategies financialisation, notably M/A expansion and the tightening of European macroeconomic policies favour structural distortion of the European industrial companies balance sheets in favour of financial assets



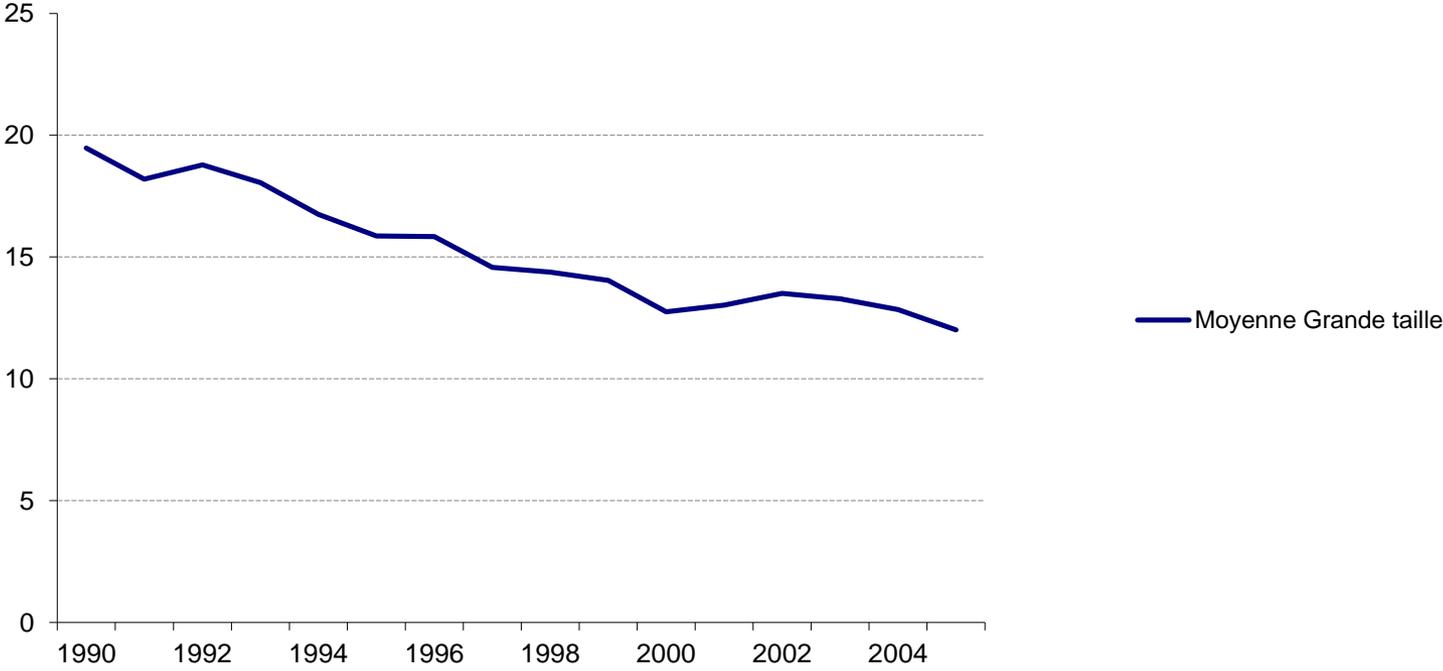
EMPIRICAL STUDY

**Tangible and intang. fixed assets./Total assets vs
Financ. fixed assets/Total assets europ. manif.
comp. of large size (%)**



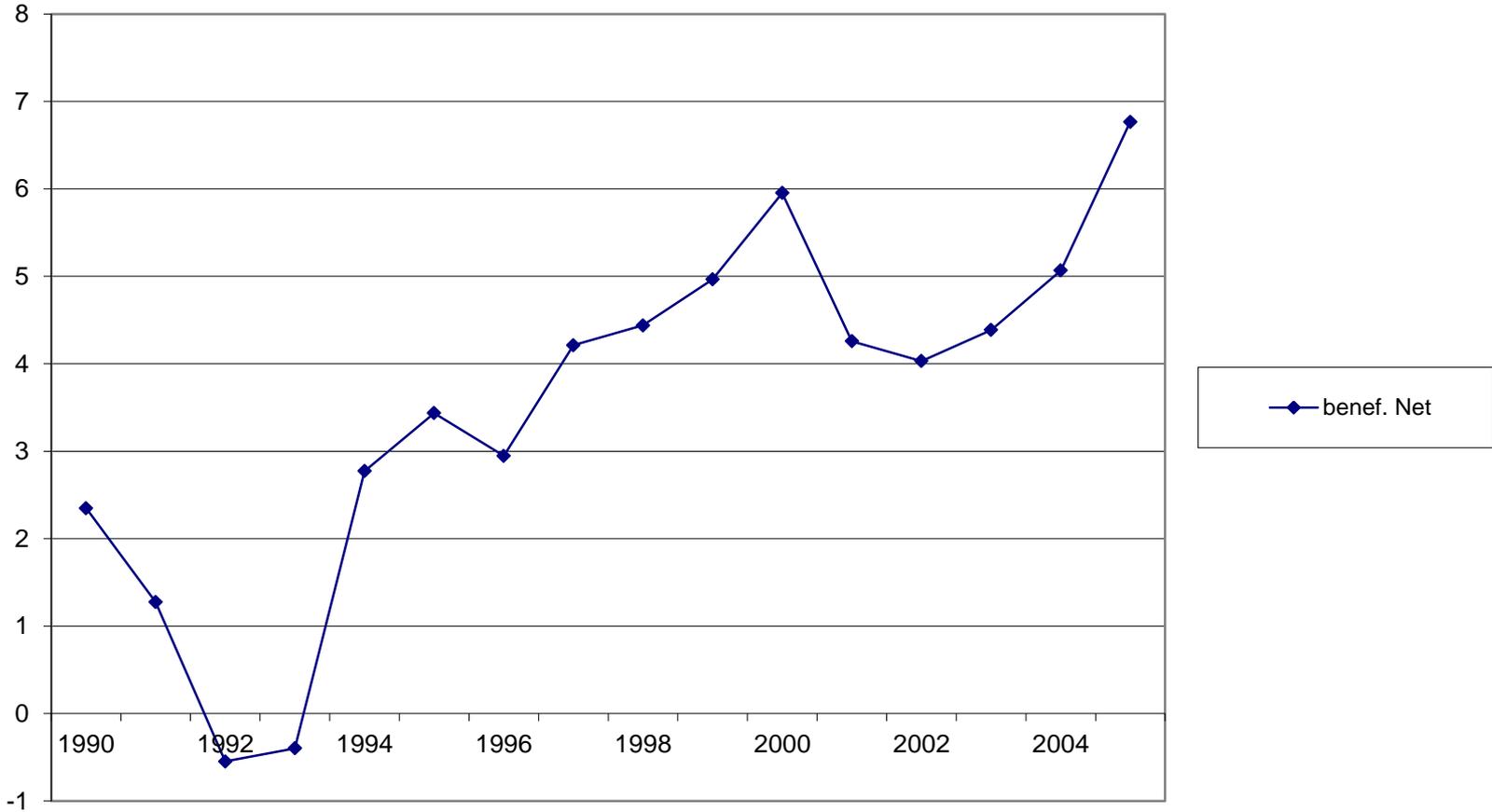
EMPIRICAL STUDY

Compensation of employees/Turnover of European manuf. comp. of large sizes (%)



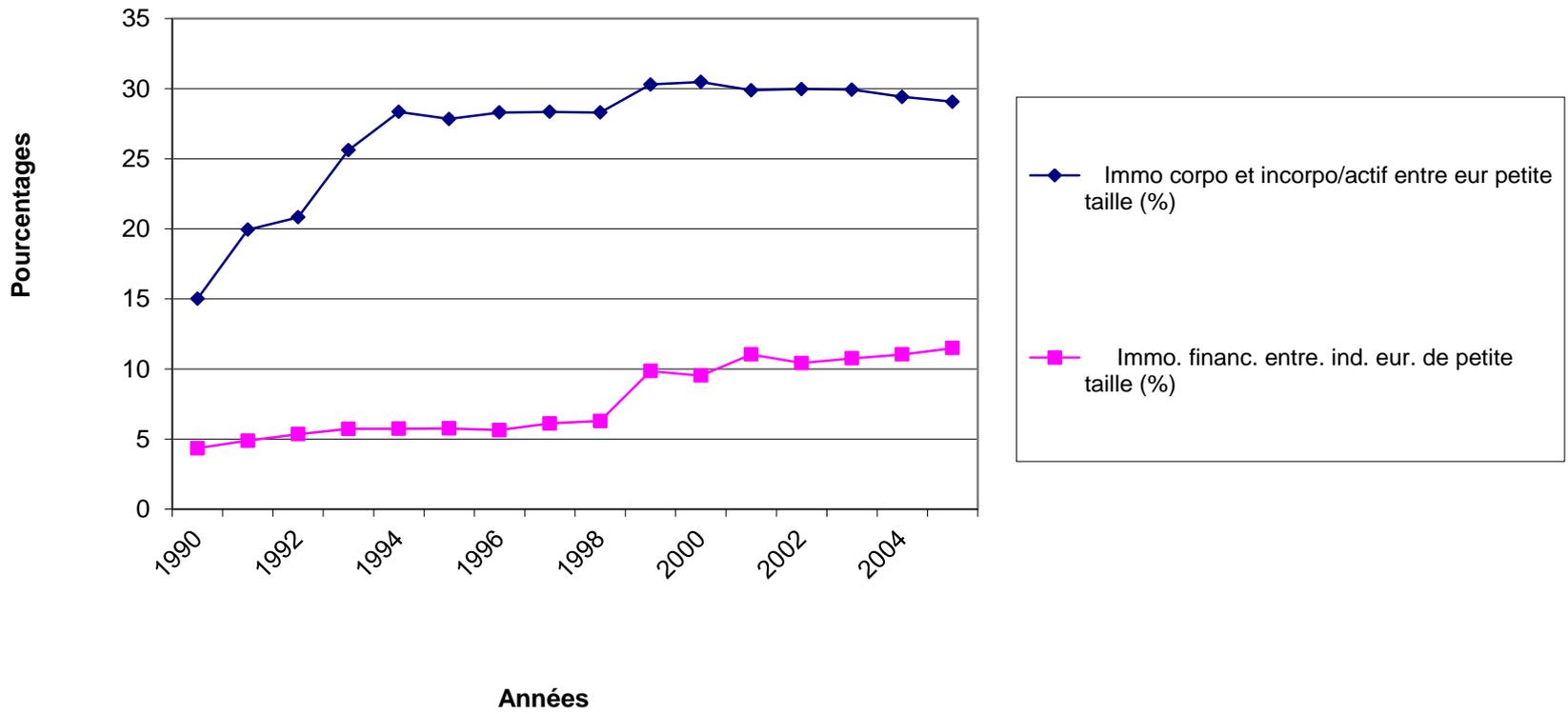
EMPIRICAL STUDY

Net profit/Turnover of European manuf. companies of large sizes (%)



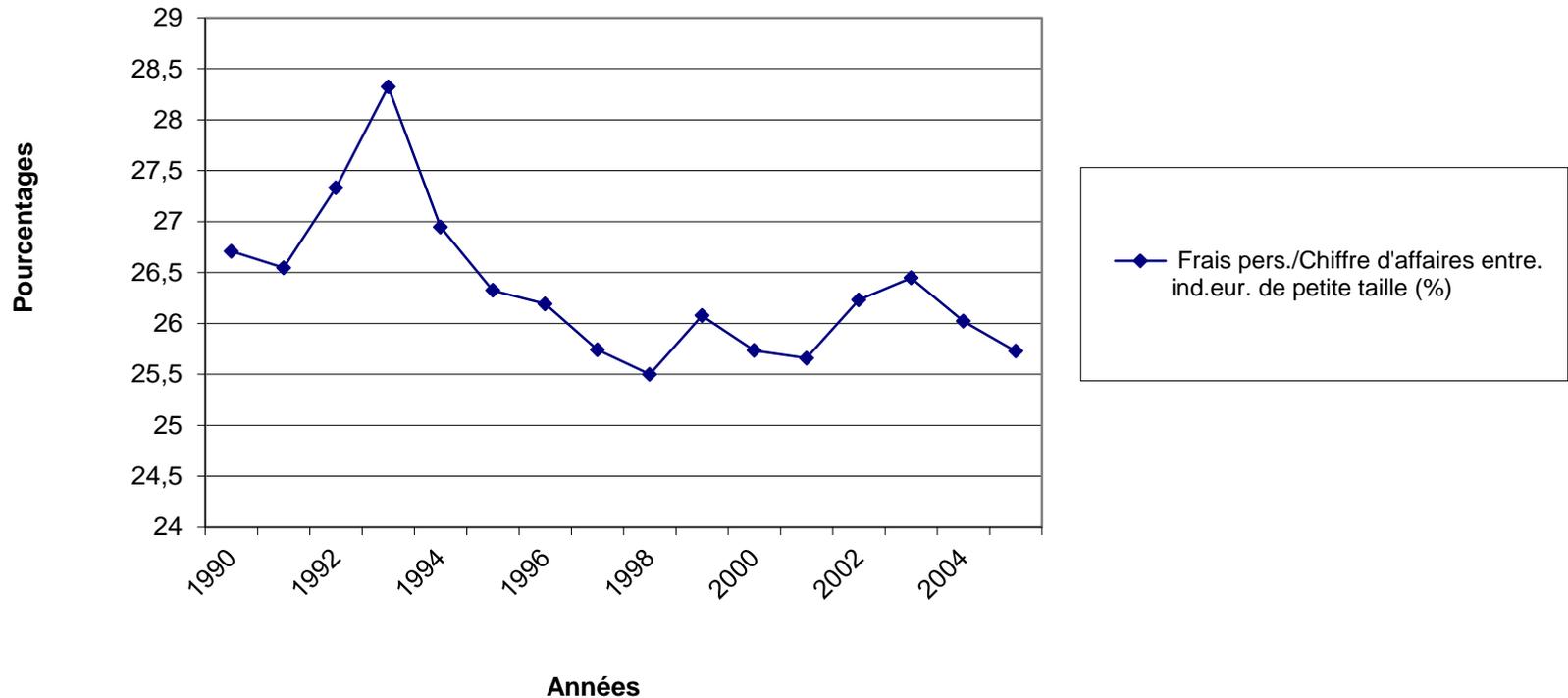
EMPIRICAL STUDY

Tangible and intang. fixed assets./Total assets vs Financ. fixed assets/Total assets europ. manif. comp. of small size (%)



EMPIRICAL STUDY

Compensation of employees/Turnover of European manuf. comp. of small size (%)



EMPIRICAL STUDY

Net profit/Turnover of European manuf. companies of small size (%)

