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INCAS

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Financialization and Institutional Environments
Firm-level Outcomes from a Comparative Perspective

May 2019

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INCAS
Understanding institutional change in Asia: a comparative perspective with Europe
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ABOUT THE INCAS PROJECT

INCAS is a Marie Skłodowska-Curie Actions R.I.S.E funded project under the European Commission's H2020 Programme.

The project INCAS aims at creating a top-level research and advanced training network on institutional change in Asia, in comparative perspective with Europe.
The coordinator, Ecole des Hautes Etudes en Sciences Sociales (France), promotes this network together with Oxford University (UK), Freie Universität Berlin (Germany), and in collaboration with Waseda University (Japan). The aim of the proposed mobility scheme is to give birth to a European consortium and network of faculties and advanced graduate students specialized in the comparative analysis of institutional change in Asia and Europe. The partners have chosen Japan as a reference point because of its comparability with Europe as shown by previous studies, its historical influence on development and further institutional changes in Asia, and the expertise accumulated within our research team.

Analyzing current economic dynamics in Japan and later expanding this analysis to other Asian countries promises to generate insights that might be help to better understand challenges for Europe and to prepare relevant policy proposals. Our purpose is to compare the results obtained in the case of Japan and few other Asian countries (South Korea, Taiwan, China, and possibly Thailand, after having checked the data availability), not only to previous results on Europe but also to original results we will get on European countries (primarily France – which will be our reference country in Europe – and then the UK, Germany, and Italy) in mobilizing new historical data and applying our theoretical framework.

Financialization and Institutional Environments
Firm-level Outcomes from a Comparative Perspective

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Abstract:
This conceptual paper is concerned with the outcomes of the financialization of non-financial firms, and particularly with the role of institutions in shaping these outcomes. It centers on the question of whether the institutional setting of economies can be expected to moderate the effects of financialization on companies' employment practices, investment decisions, R&D activities, and value chain. To approach this question, I first sketch out the concept of financialization and its meaning when considering its firm-level implications. I then draw on the literature on comparative institutional theory to identify two opposite institutional settings, liberal market economies and coordinated market economies. In a third step I combine empirical findings from the literature with theoretical reasoning, to hypothesize about how the outcomes of financialization on the firm-level differ between liberal and coordinated economies, developing two different scenarios about the trajectory of firm-level financialization in coordinated market economies. Finally, I discuss the implications of these scenarios for our understanding of financialization and its connection to institutional environments. Overall, the paper argues that taking an institutionally comparative perspective on financialization alerts us to the possibility that financialization does not represent a uniform process causing the same outcomes to manifest in non-financial corporations around the globe. Instead, as the financialization of firms takes place in diverse institutional settings, associated practices will have to be adapted to local institutions enabling and constraining them.

1. Introduction

The concept of financialization is debated with growing interest within several social science disciplines – including sociology, economics, political sciences, and business studies – and has gained particular relevance in light of the recent global financial crisis. Due to the multidisciplinary nature of the debate, perspectives and definitions of the concept of "financialization" are numerous. The concept shares this characteristic with other concepts describing major contemporary economic and social changes, like neo-liberalism and (financial) globalization.

Depending on the particular analytical perspective and empirical problem in focus, different phenomena and factors are included in or excluded from the concept. In her review article, van der Zwan (2014) sketches out the impressive range of empirical problems that the financialization literature has concerned itself with. It can be broadly categorized into three different approaches. First, particularly economists, political scientists, and economic sociologists have studied financialization as a "regime of accumulation" (examples of this approach being Arrighi, 2000; Krippner, 2005; Aglietta, 2000; Boyer, 2000). They find that in the late 20th century non-financial companies in the US, under pressure due to declining profitability and emerging competition from European and Asian economies, have increasingly turned towards investment in financial products to sustain and boost their profit margins (cf. Boyer 2000). This approach highlights the negative effects of financialization on the accumulation of productive capital of national economies (Orhangazi 2008; Stockhammer 2004), as well as its role in increasing income inequality (Lin & Tomaskovic-Devey 2013). Second, scholars from a variety of fields, including business studies and economic sociology, have highlighted the relationship between financialization and the diffusion of shareholder value-oriented management

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practices. The concept of shareholder value, originally derived from agency theory, is seen by scholars in this field to work as a crucial ideological support justifying the redistribution of corporate profits and assets to shareholders (Froud 2000, 2006), thus being a driving force in financializing non-financial companies. Third, scholars of the "financialization of the everyday" have studied how financial markets increasingly pervade people's daily lives, through trends like the commodification of mortgage debt (Langley 2006), the diffusion of defined contribution pension plans (Cobb 2015), and insurance products against all kinds of individual risk (Martin 2002).

This current paper focuses on financialization on the level of firms. This level of analysis is of particular interest as the study of it helps us understand how broad, macro-level financial market incentives and pressures are translated into concrete changes within corporations. These company-level changes in turn affect macro-level outcomes of financialization, like income inequality, unemployment, and so on. More specifically, in this paper I try to hypothesize about the firm-level outcomes of financialization (in the domains of employment, investment, R&D, and value chain organization) based on the empirical findings that the literature provides, and about the role of different institutional environments in shaping these outcomes. I attempt to answer the question: "How do institutions moderate the relationship between financialization and firm-level outcomes?"

In order to develop an institutionally comparative perspective on financialization and its outcomes for non-financial firms, this paper is structured as follows. In section 2, I discuss the broad concept of financialization, with a particular its focus on its meaning when studying the phenomenon on the level of firms. In section 3 I then introduce relevant literature from comparative institutional analysis necessary to develop a picture of how institutions shape corporate strategies and decision making. Furthermore, in this section I identify two broadly different types of institutional systems that characterize countries: liberal market economies and coordinated market economies. Section 4 then draws together empirical findings on the outcomes of financialization that manifest themselves in affected non-financial corporations, and on this basis I develop hypotheses about the role of institutions in shaping these outcomes. For this purpose, I draw on the characterization of coordinated market economies developed in section 3 to speculate about two possible scenarios that could be observed in this institutional setting. Finally, the paper closes with a brief discussion of the wider implications of each scenario for our understanding of financialization and the role of institutions in shaping it.

2. What is financialization?

This study is concerned with one major area of interest within this very broad financialization debate, namely with the financialization of non-financial corporations. The financialization of corporations – as understood here – is importantly concerned with what Nölke and Perry (2017) define as "profit financialization". Profit financialization describes non-financial companies' increasing focus financial markets and financial assets as a means of generating income. This trend has been enabled by the rapid expansion of financial markets in the latter 20th century, and the development of numerous high-yield financial products available to private investors and corporate investors alike.

Empirically, this trend has been identified with three typical observations (Krippner 2005): First, nonfinancial corporations have increased the share of their financial assets relative to productive assets. Second, non-financial corporation generate an increasing share of their income from financial dealings, compared to their income from their core non-financial operations. Third, non-financial corporations make increasing payments to financial markets. All three of these observations are linked in that companies, which decide to make use of the new profit opportunities, will have to invest substantial funds, which are often debt-financed and thus incur higher interest expenses, into the acquisition of financial assets, which generate substantial financial returns in a relatively short term.

As the decision to engage in financialized business practices involves crucial questions of capital allocation and the

distribution of corporate profits, it can be expected (and is observed) to cause wide-ranging changes to non-financial firms. These changes span the areas of employment practices, investment, research and development (R&D), and supply chain management.

This paper argues that the size and shape of these wide-ranging changes that affect non-financial corporations will crucially depend on the institutional environment these corporations are embedded in. Institutions enable and restrict the actions of companies seeking to benefit from the new profit opportunities of the global financial markets. In the next section I will summarize the literature concerned with types or systems of institutions that characterize different national economies. Based on these theories of comparative institutionalism I will then develop hypotheses about the different ways financialization can be expected to change non-financial corporations around the world.

3. Institutional differences between countries

Most of what we know about the phenomenon of financialization and its outcomes for non-financial firms has been deducted from the study of the US case of financialization – a case which has been well-documented in the literature. So far, there has been little problematization of this geographical fixation within large parts of financialization research. Only a few studies have ventured beyond the American context, trying to diagnose similar processes in other developed economies, such as the UK, France and Germany (Berghoff 2016; Stockhammer 2004), as well as in transitional and emerging economies like Turkey (Akkemik & Özen 2014), or Mexico (Correa et al. 2012; Levy-Orlik 2013) with mixed results, generally suggesting developments parallel to the financialization of the US economy, though not as far progressed. There is certain danger in attempting to reproduce the findings from the US case in other countries, using the same measures and diagnostics used in the classical studies of e.g. Krippner (2005). Implicit in such an approach is the assumption that financialization represents a general, uniform development, occurring in developed economies (and even transitional and emerging economies) across the globe in roughly the same shape and order, bringing about the same changes in non-financial firms. Arguments by some scholars, particularly from the "financialization as regime of accumulation" approach (van der Zwan 2014) – suggesting that financialization represents an inevitable further step in the evolution of global capitalism, seem to support such a perspective. With a similar notion Berghoff (2016: 106), studying the financialization of German corporations, assures us: "The tenets of financialization are universal.".

This universalist account of financialization seems questionable if we consider the few international studies of financialization that go beyond reproducing the findings of the US case. This emerging stream of more historically and institutionally informed financialization research considers the phenomenon outside of the US, and paints a less uniform picture, among other aspects, in regards to the driving forces behind financialization. For example for the case of China, Wang (2015) finds that the Chinese government and state-related asset management groups were the driving factor in financializing the economy, in a sort of top-down political project. Studies on the financialization of the Mexican economy on the other hand highlight that here the process was driven by the increasing internationalization and export orientation of Mexican firms, the government's currency policies, and the economy's growing dependence on the petrol business (Correa et al. 2012; Levy-Orlik 2013). Finally, Ahmadjian and Robbins (2005) emphasize the important role that foreign shareholders played in spreading financial motives in Japanese corporations.

The comparative institutionalist literature alerts us to the fact that great institutional diversity exists among developed economies around the world, not to speak of the diversity of emerging and transitional economies. The shape of the US economy and the mechanisms securing its smooth operation, just as those of any other economy, are not to be seen a-historically and without context. The institutions regulating the characteristic market mechanism of coordination of the US economy, the financing of its business ventures, and the governance of its corporations, are

highly specific to that country, and are the result of a historically and politically contingent development process. Understanding this institutional "setting" in more detail also helps us to better understand the particular trajectory of financialization in the US compared to the trajectories of other countries.

3.1 Comparative institutional theory

The role of institutions in shaping economic outcomes have long been an object of study, but oftentimes studies have been only concerned with the isolated effect of a single institution or institutional domain on isolated activities of companies. In an attempt to identify a coherent pattern among these isolated findings, a number of empirically-informed approaches have attempted to theorize about the broader theoretical connection between major institutional domains (cf. Jackson and Deeg 2008), namely the "varieties of capitalism" approach (Hall & Soskice 2001), the "business systems" approach (Whitley 2000), and the "diversity of capitalism" approach (Amable 2003). While all three approaches differ from each other to some theoretical degree, their common feature is the idea that the institutional systems of countries are to a large degree internally consistent, and that the institutional configurations of certain countries are sufficiently similar to be grouped into distinct types or varieties of capitalist economies. This idea is founded on the concept of "institutional complementarity", which assumes that synergies arise between certain configurations of institutions which mutually reinforce each other. For example, flexible labor markets, characterized by low levels of employment protection and a high degree of worker mobility between companies, will not greatly enhance an economy's competitiveness if they are not paired with equally flexible financial markets, i.e. large and liquid stock and bond markets that enable entrepreneurs to quickly set up new business ventures, change (restructure, downsize, or grow) existing firms, and close down unsuccessful firms. If flexible labor markets interact with flexible financial markets in one economy, so the argument goes, companies in that economy will gain a comparative institutional advantage that enables them more than companies in other institutional settings to quickly develop and implement radical technological innovation, and to quickly adapt to changing market environments. In the opposite case, stable internal labor markets, which are based on long-term employment and the development of firm-specific skills in company employees, will not unfold their full potential if not coupled with equally long-term oriented financial markets, e.g. based on the provision of patient capital from main banks. Yet, if both institutional features appear together, companies in these economies gain a comparative institutional advantage in using highly skilled, committed workers in the development of incremental innovations, and in minimizing the overall risk of domestic companies. If we assume the existence of such comparative institutional advantages, only a limited number of institutional configurations, which utilize these comparative advantages, will be viable under the pressure of global economic competition.

The different approaches to comparative institutional theory (which will be discussed below) come to different conclusions about how many types of such viable institutional configurations exist, but they generally agree on the fundamental divide between liberal Anglo-Saxon economies on the one hand, and (non-market-) coordinated economies in continental Europe and East Asia. The influential "varieties of capitalism" approach, put forward by Hall and Soskice (2001), distinguishes two different ideal types of market economies, distinguished by their institutional configurations: liberal market economies (LME) and coordinated market economies (CME). The distinction between these types is drawn based on the degree of market coordination in an economy. In liberal market economies, firms coordinate with other actors (competitors, customers, suppliers, trade unions, etc.) mainly through arms-length transactions on markets, and through hierarchy within the boundaries of the firm (cf. Williamson 1975). In coordinated market economies on the other hand, companies use a much broader array of forms of "non-market" coordination, including corporatism, state intervention, family ties, and the formation of business associations and of business groups. The "business systems" approach, proposed by Whitley (2000, 2007), develops a somewhat more fine grained distinction. It identifies 6 different business systems that characterize developed economies around

the globe. The Anglo-Saxon economies (US, UK) are categorized as compartmentalized economies, characterized – similarly to Hall & Soskice's LME – by large firms that interact with competitors, workers, and flexible and highly liquid financial markets in arms-length transactions. The business systems approach shines some more light on the diversity of coordinated market economies by distinguishing coordinated industrial districts, state organized systems, collaborative systems, and highly coordinated systems as four further business system types. These different kinds of coordinated market economies employ different forms of coordination, such as inter-firm cooperation, governmental planning (e.g. in South Korea), corporatism (i.e. organized interest groups like unions and employer associations; e.g. in Germany), or alliance building within business groups (e.g. Japanese "keiretsu"). Finally, in a similar fashion, the "diversity of capitalism" approach proposed by Amable (2003) distinguishes 5 different types of capitalisms, based on a factor analysis of institutional features in the domains of product market regulation, the wage-labor nexus, financial systems, social protection, and education systems. He defines these types as market-based capitalism, social-democratic capitalism, Asian capitalism, continental European capitalism, and Mediterranean capitalism. Again, liberal market economies like the US and the UK fall into the market-based type, while coordinated market economies like Germany and Japan are grouped into different coordinated types. Amable identifies a number of countries (e.g. the Netherlands, Denmark, and Austria) that stand at a middle ground along the coordination continuum, combining some market-oriented institutional features with non-market features. An interesting finding in this approach is the fact that countries usually lumped together as "non-market" types actually differ quite substantially in the weight they put on particular mechanisms of non-market coordination.

Overall, while the "business systems" and "diversity of capitalism" approaches refine our understanding of non-market coordination, highlighting the different forms and mechanisms of coordination (corporatism, state, families, business groups, etc.), they confirm – and in the case of Amable (2003) also empirically demonstrate – the rough grouping into liberal and coordinated market economies proposed by the "varieties of capitalism" approach. Still, these approaches alert us to the necessity of seriously considering the particular differences between economies broadly grouped together under the label of "coordinated" when studying particular cases.

3.2 Liberal and coordinated market economies

Taking together the notions from these frameworks of institutional diversity, we can thus – for the purpose of this study – broadly distinguish liberal market economies from more coordinated types of market economies. Some general institutional features of liberal and coordinated market economies in the domains of **employment protection, collective bargaining, training and skill development, corporate finance, and corporate governance** can be identified. These features will be described in the following paragraphs, with the US serving as an illustrative example for the liberal economy type, and Japan and Germany serving as examples of the coordinated variety. These descriptions are mostly based on the works of Hall and Soskice (2001), Whitley (2000, 2007), and Amable (2003).

Liberal market economies

Overall, corporations in liberal market economies are characterized by a dominance of shareholders in top level decision making. This dominance is institutionally supported by highly flexible labor markets and financial markets, and by the absence of institutions that would grant decision making rights to other stakeholders besides shareholders, or that would create any substantial company dependence on stakeholders (e.g. workers) of the corporation.

Generally, the institutionally granted level of **employment protection** in liberal market economies is low. The OECD Employment Protection Regulation Index[2] positions the liberal economies of the US, the UK, Canada, and New Zealand last among the OECD countries. Employment protection includes the legal and contractual regulation of the hiring process (such as the inclusion of disadvantaged groups, company use of temporary employment, or training

2 According to the latest data from 2013

requirements), as well as the firing process (such as legitimate reasons to lay off workers, notification periods, and severance payments). Companies in liberal market economies can relatively easily adjust the size and make-up of their workforce without incurring great direct cost from layoffs, a practice commonly referred to as "hire and fire". The workforce flexibility granted by low levels of employment protection is supported by flexible and active external labor markets, in which workers with certified skills are readily available for hiring. Under such flexible employment conditions, incentives are low for both companies and workers to invest in the development of firm specific skills. High turnover and the availability of workers with certified skill sets in external labor markets also imply a low company dependence on their workers and thus limits workers' power within corporations.

Collective bargaining is highly decentralized in liberal market economies. Declining unionization rates, the absence of corporatist institutions that would grant worker influence despite low levels of unionization, and right-to-work legislation all contribute to the weakness of collective worker interest representation in the US. Collective bargaining usually takes place on the level of single firms. Collective organization of workers across firm or industry boundaries is thus very limited. Due to these factors workers, particularly blue collar workers, hold very little power in corporations and have little influence on the employment practices of firms.

Training and skill development of workers in liberal market economies is mostly limited to company-external education on the initiative of workers. Tertiary education and vocational skill development in liberal economies is usually financed by workers themselves. Tertiary education and training aim at the development of general, standardized skills, which are certified. Companies, according to their labor demand, then search out workers with certification for the required skills on the external labor market. This configuration of the education and skill development system in liberal market economies contributes to the flexibility of employment, as companies can easily find the workers they need, and workers can relatively easily find new employment in case their current employment relationships end. The flip side of this coin is that neither companies nor employees are faced with sufficient incentives to develop firm-specific skills that could aid labor productivity and product or process innovation within companies. Due to the lack of firm-specific skills and the low commitment to particular employment relationships, companies in liberal market economies are not as dependent on their workers as companies in coordinated market economies. This factor also reduces the power of workers in the company and their influence on employment conditions and strategic decision making.

The **financial system** of liberal market economies is generally described as being market-based. This means that companies mostly depend on stock and bond markets for the provision of capital. Companies directly engage with anonymous investors, selling stock or bonds in arms-length market transactions, instead of relying on main banks as financial intermediaries. As the relationship between companies and financiers is highly transient, and as the suppliers of capital have little access to inside knowledge about the condition of the companies they invest in, publically available accounting information and the valuation thereof in the form of stock prices and credit ratings are crucial for the provision of capital. Market-based corporate finance is characterized by a certain degree of short-termism of investors (cf. Jackson & Petraki, 2011; Aspara et al., 2014). The arms-length character of financing relationships, and the easy exit from investments through large and highly liquid secondary stock and bond markets induce a high turnover in stock and debt holding. Companies are thus pressured to maintain a high market valuation and credit rating to ensure the continued supply of capital. Their ability to credibly promise short-term profits, and to increase shareholder value by paying out dividends or buying back shares, strongly affects their market valuation. Companies are thus incentivized to focus their investments on strategies that offer quick and high returns, and are highly dependent on meeting shareholders' expectations.

Corporate governance in liberal market economies is typically centered on the representation of shareholder interests. The board system of the US and the UK does not separate between passive monitoring functions and active

management functions of directors, it doesn't provide for the inclusion of other stakeholder representatives besides shareholders, nor does it differentiate the authority of inside directors and outside directors. These factors contribute to shareholders' direct influence on top level decision making in corporations. With the diffusion of the shareholder value concept, the ideal of "board independence" has taken hold and has become an established norm of corporate governance in the Anglo-Saxon economies. Inside members of corporate boards (i.e. corporate executives) in these economies have increasingly been replaced with outside directors who are "independent" of the internal workings and personal networks within companies, and are expected to more thoroughly promote shareholder interests against the (supposed) opportunistic tendencies of company insiders. Thus, board-level decision making in these companies is firmly in the hands of shareholders. While in post-war "managerial capitalism" managers used to still hold considerable discretion in decision making, the recent rise of institutional investors has led to a concentration of shareholder power in the hands of professional investment funds that are able to coordinate their voting behavior and policy preferences much more effectively than widely dispersed private stockowners. Invoking the prescriptions of economic agency theory, these institutional investors have played a major role in the widespread adoption of stock-option variable pay for corporate executives. These incentives worked to bridge the divide between manager interests and shareholder interests, aligning corporate executives with shareholders' goal of shareholder value maximization. Thus, the institutionally enshrined dominance of shareholders in the corporate governance of liberal market economies, combined with the rise of institutional investors and the alignment of executive incentives have contributed to the general short-termism in top-level decision making.

Coordinated market economies

Overall, the top level decision making of corporations in coordinated market economies is shared among a range of different stakeholders, including shareholders, workers and managers. This arrangement is institutionally supported by long-term, stable, and legally protected employment creating a company dependence on workers, by the provision of patient capital, and by laws and rules requiring the direct involvement of a range of stakeholders (besides shareholders) in board level decisions, or the indirect consideration of their interests. Furthermore, formal and informal rules and norms set a limit to radical restructuring of corporations, e.g. through large scale layoffs, the redirection of investment or of profits, or the closure or spin-off of company divisions.

Compared to liberal market economies, **employment protection** in coordinated market economies is generally rather high, and companies are relatively inflexible in adjusting their workforce. Companies wishing to reduce their workforce face substantial legal obstacles to simply firing employees. In coordinated economies, companies are often legally bound to respect long notification periods, and to offer severance packages to employees (particularly those who have worked at the same company for a long time). In many cases labor representatives, like works councils in Germany, have to be consulted before decisions about workforce downsizing become final. Companies may be required by law (e.g. Japan) or by collective bargaining agreements (e.g. Germany) to justify downsizing decision against a limited list of legitimate reasons for layoffs (most commonly economic necessity). Finally, the threat of litigation over improper layoffs creates great financial risk for companies. Hiring on the other hand is less flexible as well, much for the same reason. As in coordinated market economies employees are so difficult for companies to dismiss, thorough testing and vetting of candidates is necessary before making the considerable commitment of hiring new workers. Thus, worker turnover is rather low when compared to liberal market economies, and employment relationships usually last significantly longer. As the external labor market in coordinated market economies is relatively small, and as company strategies often depend on skilled labor, companies turn towards internal labor markets (which in the case of Japan can span whole business groups) to develop employee skills internally and allocate them to wherever demand arises within the company (group). With the generally quite long employment periods (lifelong employment being the norm in Japanese companies for many decades), workers are committed to their companies, and, together with their employers, invest in the development of firm specific skills. Employment protection thus con-

tributes to companies' dependence on cooperation with workers, and in this way bolsters the role of worker interests in corporate decision making.

Collective bargaining in coordinated market economies is generally more centralized, compared to liberal market economies. Collective bargaining agreements are often negotiated on the regional or sectoral level. In Germany for example, large industry trade unions and employer associations negotiate industry-wide agreements. While Japan is particular in its decentralized bargaining system, trade unions are still quite influential in determining working conditions and wage levels, with enterprise unions working closely and cooperatively with the management of large corporations. The existence of such formal and informal rules granting worker representatives a say in strategic decisions safeguards their power in corporations even though unionization rates have generally been on the decline in coordinated market economies as well. With unions being organized around industries or business groups, and being supported by corporatist institutions, workers can more easily coordinate their interests, and can influence corporate decision making more effectively.

The **training and skill development** of workers in coordinated market economies is usually jointly supported by employers and employees. Worker training and education aims at the development of industry- and firm-specific skills. In the case of Germany, vocational training is often carried out in the form of apprenticeships, which involve on-the-job training in companies as well as formal education in vocational schools. Apprenticeship programs are jointly developed by employers and trade unions, and also require worker contribution in the form of deferred payment during the initial skill development period. In the case of Japan, the skill development of the core workforce is usually carried out by companies themselves, which employ various forms of on-the-job training and job rotation to equip their employees with a wide range of company-specific skills. These forms of skill development also support the effective operation of internal labor markets that grant a certain level of "soft" workforce flexibility despite strict employment protection regulation. As the strategies of companies in coordinated market economies are usually based on improving operational efficiency and generating incremental innovation over longer periods of time, skilled employees are of crucial importance for the continued success of firms. Firms thus have to ensure workers' commitment and loyalty to the firm, by addressing their interests and concerns, in order to avoid the loss of skills that have been developed over long periods of time. This further adds to the importance of employees' voice in top level decision making of corporations.

Companies in coordinated market economies rely much more on relational banking for the provision of financial capital, compared to liberal market economies. The system of **corporate finance** in coordinated economies is thus frequently characterized as being bank-based (Zysman 1983). In the German case, so called "Hausbanken" (main banks) have a long history of providing capital to large corporations, with which they have long lasting commercial relationships spanning all kinds of financial services. The Japanese system is similarly characterized by main banks serving particular business group companies. These banks, being interested in developing and maintaining long lasting business relationships with their client companies, wanting to ensure a stable demand for their services, have been described as a source of "patient capital". Under such a system of corporate finance, creditors are much more patient in regard to temporary economic slumps and difficulties that their debtors might go through, than the uncommitted financiers in stock and bond markets. The bank-based financial systems of Germany and Japan are currently undergoing change (Deeg 2010; Deeg & Hardie 2016), with main banks turning away from their traditional roles, but stock markets still play a much smaller role in the financing of corporations than is the case for liberal market economies. Companies in coordinated market economies are thus able to acquire relatively patient capital to finance long-term research and development projects and to invest in productive assets, while being shielded against the intense short-term earnings pressures from institutional and foreign investors.

The **corporate governance** systems of coordinated market economies are overall more pluralistic than those of lib-

eral market economies. Besides shareholders, other stakeholder interests are included in top level corporate decision making as well. In Germany, co-determination laws require up to half of the board seats in corporations to be allocated to worker representatives. In Japan, corporate boards have traditionally been dominated by company insiders, i.e. corporate executives, who, due to their usually long employment histories in their companies also act as representatives of worker interests on the board. Furthermore, the still relatively high levels of cross-shareholding among domestic corporations place representatives or business partners, suppliers, customers, or even competitors on the boards of corporations. While the concept of "board independence" is slowly diffusing to coordinated market economies as well, the inclusion of non-shareholder directors on corporate boards is still widely seen as a legitimate and beneficial practice. Managerial and supervisory governance roles are often separated in coordinated market economies. In Japan, the roles are at least partly split up in the form of the board of directors on the one hand, and the board of auditors on the other. In Germany a board of (inside) directors, the *Vorstand*, is in charge of strategic and operational decision making, while shareholders can only directly place their representatives on the supervisory board, the *Aufsichtsrat*. This arrangement makes a direct influence of shareholders on board level decision making rather difficult. Overall the corporate governance of companies in coordinated market economies is shared between company outsiders and insiders, with company insiders posing a counterbalance to shareholder pressures for greater shareholder value. Recently, German and Japanese companies are increasingly adopting variable stock-option pay for executives, thus narrowing the divide between insider and shareholder interests, but nevertheless boards in the economies are much more concerned with negotiating strategies that mutually benefit a wide range of stakeholders.

4. The outcomes of the financialization of non-financial corporations

The descriptions of the previous section should have made the point clear that institutions crucially shape the internal workings of national economies. We can therefore expect that these institutional settings also play an important role in shaping the process of financialization and its firm-level outcomes. In the following sections the outcomes of financialization in the domains of corporate employment practices, investment, research and development, and value chain organization will be discussed.

4.1 Firm-level outcomes in liberal market economies

As pointed out above, the institutional setting of liberal market economies grants exceptional power to the shareholders of corporations. It is thus no surprise that in the US, financialization, i.e. the utilization of new profit opportunities offered by financial investments, has been largely utilized as a means of increasing shareholder value, often to the detriment of other corporate stakeholders, particularly workers.

The particular institutional setting of the US economy, and the resulting dominance of shareholders within the corporation, enabled shareholders – in particular institutional shareholders – to guide corporations' financialization, i.e. their intensified engagement with the new profit opportunities offered by the financial markets. The strength of shareholders in the governance of US corporations stems from the rise of institutional investors in the 1970s and 1980s, triggered in part by the regulatory change surrounding the ERISA regulation of 1974/78, which allowed large trusts and pension funds to invest much larger quantities of capital in risky stock and bond markets, or to entrust their capital to investment funds, such as hedge funds and private equity funds, which invested in the stock markets as well. Stock markets' size and liquidity grew vastly as a result, and an active market for corporate control developed, which put corporations under intense pressure to deliver high financial profits in response to ever shorter reporting cycles, or else face hostile takeovers (Ho 2009). At the same time, institutional investors replaced widely dispersed small-time shareowners as the dominant shareholders of US corporations. These institutional investors, themselves being uniformly driven by competition for ever higher investment returns, found it much easier to coordinate their

voting behavior (e.g. under the guidance of activist investors). They were thus able, aided by the prevalent fear of takeovers and competitive pressure from Japanese firms, to directly pressure corporate managers to implement shareholder value-increasing policies, which often circled around corporate restructuring, downsizing, and the redirection of corporate funds to shareholders (Lazonick 2010). These policies have been summarized under the heading of "downsize and distribute", constituting the extraction of value from employment downsizing, wage cuts, from the divestment of productive assets and underperforming business units, and the distribution of this value to shareholders through the means of share buybacks and dividends (Lazonick & O'Sullivan 2000). This process led to corporations' financialization: First, corporations were pressured to reduce investment in productive assets, and instead use their capital to invest heavily in financial products. Thus, the size of financial assets of non-financial corporations, relative to their productive assets, grew substantially. Second, the heavy involvement of non-financial corporations in financial dealings led to a steep increase in earnings from financial assets. Third, the intense earnings pressures forced corporations to take up large amounts of debt to finance share buybacks and dividend payouts, or to reinvest in financial assets. These high levels of debt, combined with direct and indirect payments to shareholders, greatly increased corporations' payments to financial markets.

In the following paragraphs I will outline empirical findings about the changes that the financialization of non-financial corporations has caused. These changes have to be understood against the background of the institutional setting of the US economy, and shareholders' role in advancing the process of financialization. The following discussion of outcomes and their relationship to institutions is also captured in *figure 1*.

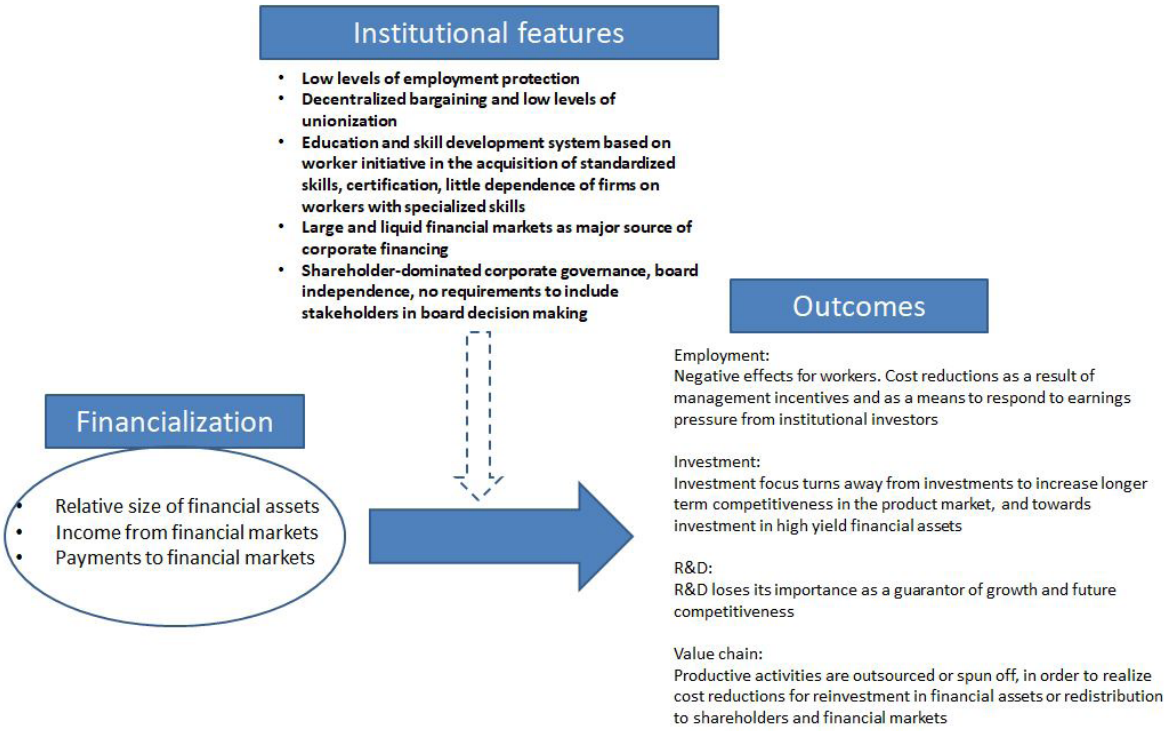

Figure 1: *Relationship between firm-level financialization, outcomes, and macro level institutional features in the case of liberal market economies*

Changes to the **employment practices** of financialized firms in the US were largely aimed at cost reductions for the purpose of redistributing savings to shareholders, and were associated with wide-ranging negative consequences for the employees of these corporations. One commonly observed outcome of financialization is the increased occurrence of mass layoffs. Lin (2016) shows that financialization is associated with a greater frequency of layoffs and with reduced employment growth during growth periods. He suggests three mechanisms behind this observation: First, productive assets are replaced by financial assets, leading to less demand for workers in productive business.

Second, as corporations become increasingly indebted and have to cover increasing interest expenses, less funds are available for financing employment growth and wage increases – a connection supported by Hillier et al. (2007) as well. Third, the increased distribution of corporate funds to shareholders in accordance with financialized companies' shareholder value orientation limits the funds available for financing employment as well. Lin (2016) further finds that the negative effects on employment are particularly affecting blue-collar workers in the productive sector. Jung (2015) points in a similar direction, showing that blockholding by institutional investors increases the occurrence of downsizing. Furthermore, the introduction of shareholder value practices like stock-option pay, independent directors, and chief financial officers on the boards are also associated with increased downsizing. The association between financialization and increased downsizing in US corporations is further supported by Budros (1997, 2000) and Fligstein and Shin (2004).

Another consequence of financialization for the employment practices of corporations is the reduction of employee compensation and benefits. Tomaskovic-Devey et al. (2015) show that reduced employee compensation in non-financial firms is as result of financialization, as non-financial firms' focus on financial means of profit generation reduces workers' contribution to the value added. Cobb (2015) furthermore shows that financialization, here measured as the higher ratio of financial assets relative to productive assets, leads firms to drop defined benefits pensions for employees, under which these firms would cover the retirement risk of workers.

Pressures to downsize corporations' workforce and reduce employee compensation meet an institutional environment that is particularly conducive to such employment practices. Low levels of employment protection allow these measures of cost reduction. Low levels of firm-specific skill development prevent company dependence on their workforce, few strategically important skills are lost in the process of downsizing, and companies face little reason to maintain employee commitment and loyalty through appropriate wage levels. Weak collective bargaining institutions, the exclusion of worker representatives from the governance of corporations prevents any meaningful resistance against these changes on part of the workers. The institutional environment of liberal market economies can be expected to moderate the relationship of financialization to downsizing and wage reductions, intensifying its effects. We can thus formulate the following proposition:

A1: In liberal market economies, financialization of non-financial firms leads to higher levels of workforce downsizing, compared to coordinated market economies.

A2: In liberal market economies, financialization of non-financial firms depresses the level of wages and employee benefits more strongly, compared to coordinated market economies.

The **investment** decisions of financialized corporations in the US have also been implicated to be subject to change. Orhangazi (2008) found that non-financial corporations that underwent financialization reduced their real investments in productive assets. He explains this effect through two mechanisms: On the one hand, investment opportunities offered by high yield financial products crowd out investment in the core productive assets of firms. On the other, increased payouts of corporate funds to shareholders (in the form of share buybacks and dividends) reduce the amount of funds available for real investment. Stockhammer (2004) similarly finds that the financialization of corporations leads to reduced accumulation of productive assets. In explaining this effect, he refers to the shift of power within the corporation, from company insiders (namely managers) to shareholders, and the associated shift from growth objectives towards the aim of maximizing shareholder value.

In judging the investment effects of financialization, reference has to also be made to the nature of capital providers: As described before, investors in liberal market economies like the US are relatively transient, and mainly base their investment decisions on companies' accounting information. This feature applies particularly to institutional investors. Due to the increased power of institutional investors in US corporations, combined with the active market

for corporate control, corporate executives are under intense pressure to choose investments that quickly generate shareholder value. In accordance with this notion, the short-termism literature also argues that the presence of transient institutional investors reduces corporations' long-term oriented investments in productive assets and R&D (cf. Aspara et al. 2014).

Again, within the institutional environment of liberal market economies like the US, the crowding out effect of financialization on real investments is exacerbated by flexible financial markets and "impatient" capital providers. Institutionally empowered institutional investors successfully replaced company insiders' growth objectives with the motive of shareholder value maximization. And institutionally marginalized stakeholders like workers, who could oppose the reduction of productive investment, are relatively powerless in influencing investment decisions. The large scale divestment of real assets for the benefit of increased financial trading by non-financial firms is facilitated by low levels of employment protection (that would make the divestment of divisions costly) and dependence on skilled labor. We can thus formulate the following proposition:

A3: In liberal market economies, financialization of non-financial firms leads to a greater decrease in real investment, compared to coordinated market economies.

In line with findings and arguments about financialization's effect on investment, company involvement in **R&D** can be expected to decrease as well. The "crowding out" argument outlined above should apply to research funding as well, as it can be seen as another form of long-term oriented investment in the core productive business of companies. Considering empirical insight on the issue of R&D, Gleadle and Haslam (2010) show in their case study of a research-intensive firm how under influence of financialization, the company is increasingly forced to justify its R&D activities through narratives promising shareholder value gains in the foreseeable future. In a similar fashion, Holst (2016) observes that financialization leads to an "investification" of R&D activities, where all R&D projects have to be justified in regards to how they create shareholder value. As the success and expected payoffs of long-term research programs, which aim at the substantial improvement of products and processes, are difficult to predict and justify vis-à-vis short-term oriented investors, these programs are very likely to be affected by cost cutting under the auspices of shareholder value maximization.

Montalban and Sakinç (2013) do not find evidence that the financialization of pharmaceutical companies in the US led to a significant decrease in their R&D expenditures and intensity, but they do show that increasing levels of financialization cause these companies to re-orient their R&D strategies towards "blockbuster drugs", i.e. a small number of research project that are associated greater risk in the event of failure, but higher payoffs in the short and mid term.

Considering the institutional environment of corporations in liberal market economies, short-termist tendencies in R&D planning can again be expected to be exacerbated by impatient capital and short-term oriented, institutionally empowered investors. Company insiders like managers and workers, who would usually position the long term growth of their companies above shareholder value considerations, are relatively powerless in liberal market economies (in the case of workers), or coaxed through stock market based incentives to align themselves with shareholder value maximization. I thus suggest the following proposition:

A4: In liberal market economies, financialization of non-financial firms leads to a greater decrease in R&D spending and intensity, and a stronger shortening of planning horizons, compared to coordinated market economies.

Relatively little has been said about the effect of financialization on corporations' **value chain** organization. Milberg (2008) argues that financialized firms increasingly concentrate their business, leading to more frequent spin-offs of poorly performing divisions. Financialized firms are more likely to globalize their value chains through the extensive

use of outsourcing and contracting productive activities. This association between the financialization of US corporations and outsourcing has been empirically confirmed by Soener (2015).

Within the institutional context of liberal market economies, outsourcing as a means of reducing costs and freeing up capital for distribution to shareholders or re-allocation to financial assets is facilitated by existing institutions. The low level of employment protection and a lack of company dependence on employees' specialized skills enable corporations to quickly divest and outsource productive operations. I thus hypothesize:

A5: In liberal market economies, financialization of non-financial firms leads to a greater increase in the use of outsourcing parts of the corporate value chain, compared to coordinated market economies.

As this section intended to show, the outcomes of financialization for US non-financial corporations were highly dependent on the institutional environment found in the US economy and other liberal market economies. The aim of US corporations' intensified engagement with financial markets can be largely described as "downsize and distribute", i.e. downsizing productive activities and workforce, and distributing funds to shareholders. Core measures to realize this aim, namely workforce downsizing, the reduction of real investment and R&D spending, and the reinvestment of these funds into the acquisition of financial assets were enabled by flexible financial markets, low levels of employment protection, and the institutionally granted power of shareholders. Opposition to these changes by other stakeholders of the firm was inhibited by the lack of institutions granting them a voice in top level decision making.

4.2 Firm-level outcomes in coordinated market economies – two scenarios

While we have some empirical insight into the outcomes of financialization in US corporations, and can draw analogies about similarly organized liberal market economies, we have little insight about what outcomes can be expected in financialized firms in coordinated economies. Acknowledging the crucial role of institutions in shaping these outcomes, the quite different institutional makeup of coordinated economies ought to be considered when hypothesizing about the relationship. For the case of coordinated market economies different scenarios can be thought of.

As discussed in section 3, coordinated institutional systems are fundamentally different from liberal systems. To recapitulate, corporations in coordinated economies are quite constrained in their policy choices, particularly in the area of employment. They are highly dependent on skilled workers, who are tied to their employer companies through long lasting employment contracts and the joint development of firm-specific skills. This long term commitment with workers, together with patient capital providers such as main banks, serves to orientate companies towards long term strategies following growth aims. The results of this strategic orientation include considerable investments in specialized skills and productive assets, and commitment to long term research projects. The governance of corporations is split among shareholders, managers, workers, and other stakeholders of the corporation, and the purpose of the firm is considered to be balancing these various stakeholder groups' interests, rather than simply maximizing shareholder value.

Scenario 1

In the first possible scenario, these institutions defining the coordinated market economy system are strong and stable enough to shape the outcomes affecting financialized firms. In this case, the financialization process and its outcomes will not be exclusively driven by shareholder interests, as has been the case in the US and in similarly shaped institutional systems. We would thus expect financialized companies to adopt policies that utilize the profit opportunities offered by financial markets, while refraining from measures that would have a significant negative effect for influential stakeholders like workers and allied companies, or would tip the power balance within corporations towards shareholders. The scenario is sketched out in *figure 2*. Along the outcome categories discussed before,

a number of propositions for this scenario can be formulated.

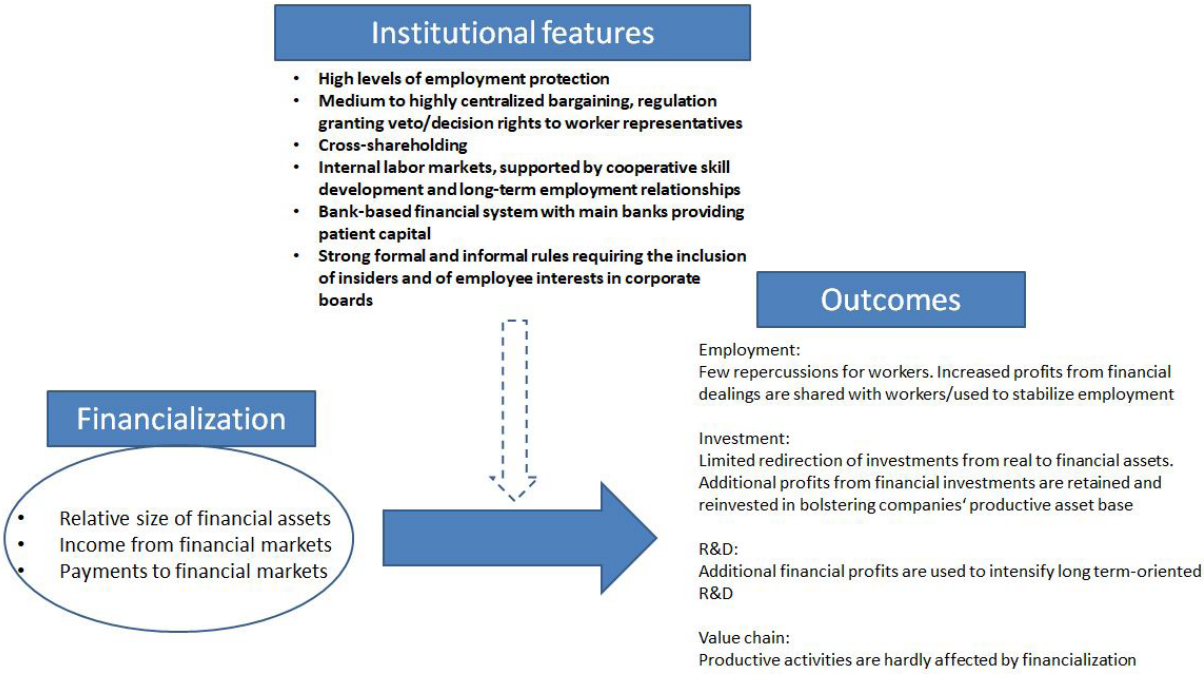

Figure 2: *Scenario 1 – Relationship between firm-level financialization, outcomes, and macro level institutional features in the case of coordinated market economies*

Due to high levels of employment protection, the high dependence of firms on skilled and committed employees, and the influential role of employees and unions in the governance of corporations, corporations will likely refrain from the sizable downsizing observed in the US case. Similarly, wage and benefit cuts, which could threaten employees' commitment to their companies and lead to the loss of skills, would neither pose a viable option for financialized corporations to free up funds. If anything, financialized corporations could be expected to use part of the additional profits from their financial investments to raise employment and wage levels, to reinforce employees' commitment to the firm and ensure longer term competitiveness. We would thus expect the following:

B1: In coordinated market economies, financialization of non-financial firms has no effect on the levels of workforce downsizing, or might even lead to employment growth, compared to liberal market economies.

B2: In coordinated market economies, financialization of non-financial firms has no, or even a slightly positive effect on the level of wages and employee benefits, compared to liberal market economies.

In coordinated market economies, where influential inside stakeholders of the firm (managers, workers) favor long-term growth strategies over shareholder value maximization, funds for financing the increased involvement in financial markets will not be drawn from the divestment of productive assets ensuring the competitiveness of firms. Instead, retained earnings (which are difficult to access by relatively powerless shareholders) and loans from main banks could be used to invest in financial assets. In turn, increased earnings would then be at least partly reinvested in boosting the real asset base of firms' competitiveness. Thus:

B3: In coordinated market economies, financialization of non-financial firms has no, or even a slightly positive effect on real investment, compared to liberal market economies.

Similarly to above argument, corporations in this scenario are not likely to withdraw funds from their R&D budgets, as

growth-oriented inside stakeholders would oppose such measures. In addition, corporations in coordinated economies are relatively shielded against short-termist pressures, as shareholders are weak and capital is supplied through relational banking. Increased earnings from financial investments could again serve to even increase R&D spending, securing the long-term competitiveness of companies. Thus:

B4: In coordinated market economies, financialization of non-financial firms has no, or even a positive effect on R&D spending and intensity, and does not affect planning horizons, compared to liberal market economies.

Within the coordinated institutional environment, the outsourcing of parts of corporate value chains is quite difficult to implement, due to the barriers to workforce downsizing discussed above. It is difficult to make any clear predictions about this aspect, but in any case institutionally empowered workers are likely to veto the use of this measure, as they could perceive outsourcing as a threat to the security of their own employment. Likewise managers might oppose outsourcing, fearing negative effects on their companies' longer term competitiveness due to skill loss. Thus:

B5: In coordinated market economies, financialization of non-financial firms will not lead to an increase in the use of outsourcing of parts of the corporate value chain, compared to liberal market economies.

Overall, this first scenario can be described as a form of "negotiated financialization" where negative repercussions for any influential stakeholder group are avoided by refraining from far-reaching restricting of corporations. The main outcome of financialization would be the limited use of retained earnings and commercial loans for investing in financial assets, and the reinvestment of additional financial earnings in productive assets and R&D projects.

Scenario 2

In the second scenario, the power of shareholders – particularly institutional shareholders – would be strong enough to transform financialized corporations despite the incompatibility of these changes with the wider institutional configuration of those coordinated economies. Well-organized and active institutional shareholders would in this scenario be able to institute a shareholder value orientation against the diverse interests of other stakeholders. A sign of such a development could be seen in the influence that foreign institutional investors exert on downsizing decisions of Japanese corporations (Ahmadjian & Robbins 2005; Ahmadjian & Robinson 2001). Key to such a shift would be the disassembly of corporate practices that anchor companies in the institutional environment. This could include the discontinuation of financing through main banks, and the acquisition of new capital from stock and bond markets, especially form large and liquid foreign markets. Indeed, listing foreign countries at US and UK stock exchanges has become an increasingly common practice. Increasing the debt leverage of firms can also serve to intensify earnings pressures and reduce managerial autonomy. Another means of supporting such a shift could be shareholder pressure for the nomination of "independent" directors replacing company insiders on the board. This trend too can increasingly be observed in Japanese companies. Finally, the use of stock market-based incentives in executive compensation can work to reduce manager opposition to shareholder value maximization and instead align them with this strategic aim. The characteristics of the scenario are summarized in *figure 3*.

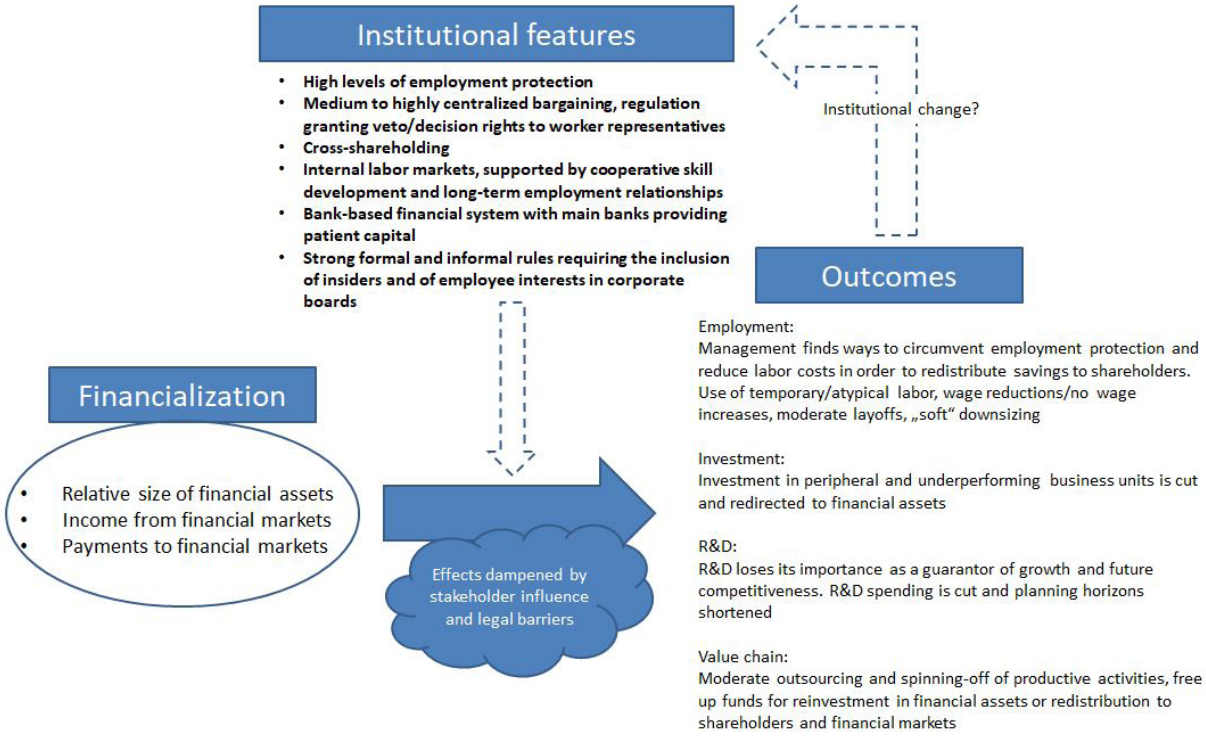

Figure 3: *Scenario 2 – Relationship between firm-level financialization, outcomes, and macro level institutional features in the case of coordinated market economies*

In regard to employment practices, companies could attempt to circumvent the tight employment protection regulation in coordinated market economies by using more creative means of reducing personnel cost than direct layoffs and wage reductions: work intensification in combination with workforce reduction through natural fluctuation, as well as the use of temporary work, contract work, and other form of atypical employment could be viable means. As can be observed in Germany, companies can also attempt to withdraw from industry-wide collective bargaining, and instead negotiate lower-wage company-level bargaining agreements with smaller, less connected unions. Thus:

C1: In coordinated market economies, financialization of non-financial firms leads to higher levels of workforce downsizing, though less so than in liberal market economies.

C2: In coordinated market economies, financialization of non-financial firms depresses the level of wages and employee benefits, though less so than in liberal market economies.

In order to finance a stronger involvement in financial dealings and increased levels of dividends and share buybacks, shareholders will pressure corporations to reduce investments in real assets and in R&D activities. While this demand will be met by inside stakeholder resistance, the result could be negotiated cuts in the investment budget, limited to peripheral or underperforming business units within the firm. Furthermore, shareholder pressure for greater accountability could lead to a seeping-in of a shareholder value rhetoric into decisions on what the kinds of R&D projects to be chosen.

C3: In coordinated market economies, financialization of non-financial firms leads to a decrease in real investment, but less so than in liberal market economies.

C4: In coordinated market economies, financialization of non-financial firms leads to a decrease in R&D spending and intensity, and a shortening of planning horizons, but less so than in liberal market economies.

Finally, aided by the soft methods of employment reduction described above, and supported by managers aligned

with a shareholder value orientation, a limited degree of outsourcing could be implemented to free up funds for greater financial investments and payouts to financial markets.

C5: In coordinated market economies, financialization of non-financial firms leads to an increase in the use of outsourcing parts of the corporate value chain, but less so than in liberal market economies.

This second scenario can be seen as a form of "adaptive financialization", where the shareholder-driven process is similar to the one observed in liberal market economies, yet adapted to the institutions limiting the choice of means for the implementation of a "downsize and distribute" regime. Though this form of financialization would not directly clash with the institutional environment in coordinated economies, its ideological inconsistency with the institutional environment could imply far-reaching consequences of firms' financialization for the institutional system as a whole. This aspect will be discussed in the following discussion.

5. Discussion and Conclusion

This paper aimed at hypothesizing about the outcomes of financialization for non-financial corporations. After briefly summarizing the literature on financialization, it attempted to contextualize the issue of financialization outcomes by highlighting fundamental differences in the institutional setting of liberal and coordinated market economies. It then drew together our knowledge about the outcomes of financialization for non-financial firms, explicitly considering the role of institutions in shaping these outcomes. Turning to the case of corporations in coordinated economies, two different possible scenarios were developed about what outcomes of financialization could be expected in this institutional setting[3].

Considering this comparative institutional perspective, the expectation that the outcomes of the financialization of non-financial corporations will be the same regardless of the country under study seems unlikely. The existence of institutions in coordinated economies, which are incompatible with the "downsize and distribute"-oriented restructuring of corporations, leads us to two equally interesting projections: either the supposedly uniform process of financialization will be adapted to particular institutional environments, in which case studies looking beyond liberal economies should be able to discover different "varieties of financialization"; or the uniform pressures behind financialization are strong enough to elicit uniform changes in corporations even in institutional environments that are hostile to such changes. In this latter case, the spread of corporate practices that circumvent institutional barriers to shareholder-oriented restructuring and redistribution could contribute to a fundamental change of the overall institutional system, possibly leading to convergence with the liberal Anglo-Saxon system.

To shed light on these intriguing questions, this paper has put forward a number of propositions about possible outcomes of financialization in coordinated market economies. These propositions are supposed to encourage more empirical inquiry into cases of financialization in non-liberal market economies. Insights from such studies are necessary to advance our understanding of the phenomenon, and the role of institutions therein.

3 Despite the fact that corporations in coordinated market economies operate under the same institutional system, the particular power distribution between shareholders and stakeholders in specific companies can differ widely, depending on their competitive strategies, ownership structure, and other factors. It might thus be most realistic to assume that, depending on the specific features of companies under study, both scenarios described above apply to a number of financialized corporations in coordinated market economies.

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