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Management Incentives and Corporate Financialization: A Literature Review

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Abstract: In recent years, the real economy has slowed down, while the financial industry and the real estate industry have entered a stage of rapid development. More and more non-financial enterprises are involved in finance, increase financial asset allocation, and expand investment in the financial industry due to sustainable development needs and super-profits. The development of financial activities has affected the main business development of the entity enterprises to a large extent, and even brought financial hidden dangers and risks. As an effective means of enterprise internal governance, management incentive is gradually practiced in the process of entity enterprise financialization. By combing relevant literature, this paper finds that: there are existing literatures on the relationship between management incentive and financialization of entity enterprises, but different management incentive ways have different impacts on enterprise financialization. At present, the corporate financialization governance is one of the most important and worthy of discussion in the theoretical and practical circles. Whether management incentives affect the corporate financialization and whether they can effectively manage the possible risks and challenges of the corporate financialization is worth discussing.

Keywords: Management incentives, corporate financialization, financialization governance.

1. Introduction

In recent years, due to the economic downturn and excess capacity of the entity, the entity enterprises have gradually appeared the phenomenon of "financialization". With the expansion of the financial market and the increase of financial products, real enterprises improve the liquidity of corporate assets and obtain super profits through financial activities. The "transformation from real to virtual" of real enterprises affects the world economy and politics at the macro level (Du & Wang, 2024; Gao & Wang, 2024). At the micro level, enterprise innovation may be inhibited (Wang et al., 2017), reducing the efficiency of business investment (Tori & Onaran, 2017; Zhang et al., 2018), damaging corporate performance (Yang et al., 2021). Existing literatures focus on the causes, measures and economic consequences of corporate financialization, but there are few studies on the pre-factors of corporate financialization. However, the pre-factors of corporate financialization have a profound impact on it, especially the internal incentive mechanism of the enterprise.

As an internal incentive mechanism, management incentive plays an indispensable role in the financialization governance of entity enterprises, which is mainly reflected in two aspects: Firstly, management incentive enables the management to maximize the interests of the enterprise and converge with the interests of shareholders, prompting the management to make decisions from the position of shareholders, so as to prevent the risks of enterprise financialization. Secondly, effective management incentives can realize the optimal incentive contract between management and shareholders, and urge the management to pay attention to the long-term value of the enterprise, exert the benefits of corporate governance, and then restrain the excessive financialization of the enterprise. The effectiveness of corporate governance is the key to the financialization process of different enterprises, so it is necessary to study the internal governance factors of enterprises. Based on the review of the relevant literature on management incentives and corporate financialization, this paper puts forward some views on the shortcomings and prospects of the existing literature.

2. Research on Management Incentive

Based on the assumption of rational economic man and human capital, management incentive provides governance measures for modern enterprises to solve multiple "principal-agent" problems. By combing the relevant literature, this paper reviews the influencing factors and economic consequences of management incentives.

2.1. Research on the Influencing Factors of Management Incentive

The ultimate goal of enterprise management incentive is to obtain super profit to maximize enterprise value. This paper sorts out the influencing factors of management incentive from two aspects: corporate governance and corporate characteristics.

At the level of corporate governance, the main manifestations are equity structure, property right nature, board of directors. Firstly, a reasonable ownership structure can stimulate the management to better serve the interests of shareholders and promote the synergy of the interests of management and shareholders. Zhang believes that, the mixed reform and the transfer of control rights of state-owned enterprises open a channel for building an effective management incentive mechanism, which is conducive to improving the governance structure of enterprises [1]. When chain shareholders exist, Zhang's study also proves that they inhibit the incentive level of enterprise management compensation, which broadens the solution ideas of enterprise decision makers in rationalizing enterprise ownership structure [2]. Secondly, the nature of property rights has an important impact on corporate governance, and management incentives extend the corporate governance measures of shareholders. The study of Erik focuses on whether the increase in the degree of corporate co-ownership affects management incentives [3]. In addition, as the core institution of corporate governance, one of the main functions of the board is to supervise and motivate the management. Based on the agency framework, Zhu proposed that the salary of the chairman in listed enterprises can improve the sensitivity of management compensation to performance and has a supervisory effect [4]. The salary of the chairman in the listed enterprise will enhance the sensitivity of the management compensation and the size of the enterprise, which has the collusion effect. The salary of the chairman in listed enterprises significantly reduces the value of the company, and the collusion effect is stronger than the supervision effect. Based on the above theory, Su and Cheng believe that an incentive mechanism for management innovation conforming to the characteristics of enterprises should be built [5]. Aman and Dimo put forward a view on the value of dynamic capabilities for board supervision and management incentives [6]. Romec's natural experiment shows that internalizing stakeholder orientation in the board of directors will negatively affect management incentives [7].

At the level of enterprise characteristics, the main manifestations are management characteristics, enterprise life cycle, enterprise growth, enterprise scale. Firstly, the characteristics of management will affect their decision-making styles and investment preferences, as well as individuals' attitudes towards different incentive types. Li confirmed that personal experience such as educational level and overseas experience of management moderates the relationship between management motivation and innovation performance [8]. Weak management may lead to the sinking of the power of the management level. Xu et al. believe that this will lead to a significant increase in scale compensation (rather than performance compensation) of the management level, and at the same time significantly decrease the sensitivity of compensation and performance of the enterprise [9]. Secondly, in different enterprise life cycle, it is necessary to adopt appropriate incentive strategies for the management. The analysis of Chowdhury and Shams shows that the effect of management incentive implementation in the growth and maturity period is higher than that in the introduction and decline period [10]. In addition, in enterprises with high growth and large scale, the supervision effect between shareholders and managers is weak, which increases the complexity of enterprise management and the cost of coordination, so shareholders have the motivation to implement management incentives [11]. For example, Huai believes that M&A will increase the scale of enterprises, and the incentive effect on management shares or mixed compensation is greater than cash compensation [12]. According to the research of Chen and Zhang, enterprise digital transformation can increase management incentives through resource empowerment, thus effectively alleviating enterprise agency conflicts [13].

2.2. Research on the Economic Consequences of Management Incentives

The economic consequences of the implementation of management incentives to enterprises are discussed by scholars, and different scholars even draw different conclusions on some economic consequences. This paper mainly reviews the economic consequences of investment innovation and firm performance, and summarizes the views of scholars.

Investment and innovation is the focus of enterprises to maintain core competitiveness and sustainable development. Under the guidance of the management incentive mechanism, the management can carry out investment and innovation activities based on the core interests of the enterprise. Jin analyzed the multiple effects of management incentives on enterprise investment scale, and concluded that salary incentives and equity incentives can effectively improve the investment scale of the company [14]. Li and Liu expounded the positive impact of equity incentive on innovation performance through empirical evidence [15]. Under the influence of equity incentive, R&D investment will have a more significant effect on innovation performance. Guo and Xiao connect management incentives with performance forecasts and find that the monetary compensation received by management determines their attitude towards performance forecasts disclosed to external investors [16]. Zhou et al. had different results on the discussion between management incentive and R&D investment of enterprises, believing that management compensation incentive can promote R&D investment of enterprises, while equity incentive has no significant impact on R&D investment [17]. Aiming at green innovation in the Chinese context, Li and Maqsood use the data of Chinese state-owned enterprises to conclude that government restrictions on management compensation incentives will inhibit corporate green innovation, and equity incentives can positively regulate such negative effects [18]. Under A similar scenario, Zhao et al. conducted an empirical study using the data of China's heavily polluting enterprises, and the results showed that management compensation incentive promoted green innovation, while equity incentive inhibited green innovation [19]. This contradicts the conclusions of Li and Maqsood, possibly due to the different experimental data selected.

There are different conclusions about the influence of management incentive on firm performance in academic circles. Ji believes that management equity incentives can bring about the reduction of dual agency costs, thus improving corporate performance [20]. Tian and Duan proposed that management compensation incentives can also promote enterprise performance by reducing the separation rate of the two rights [21]. Focusing on the research of a certain enterprise, some scholars also found that management equity incentives can improve market performance, and compensation incentives can improve financial performance [22]. Wang et al. compared the impact of different incentive types on enterprise performance, and the results showed that compared with equity incentive, compensation incentive has a stronger incentive degree [23]. However, Sharma et al. emphasize that awarding compensation incentives to management can improve the marketing performance of enterprises, but the actual actions taken by management to this end cannot be identified [24]. Therefore, in some cases, the impact of management incentives on firm performance is not significant. Cho confirmed that in enterprises belonging to large enterprise groups, foreign directors have no significant impact on the relationship between management compensation and corporate performance [25]. The reason may be that the headquarters of large conglomerates have substantial control over the evaluation and compensation of corporate management, which weakens the supervisory role of foreign directors.

3. Research on Corporate Financialization

The research on corporate financialization is rooted in economic financialization and is a branch of economic financialization research. The research of corporate financialization mainly focuses on its cause, measurement and economic consequences, which is the cornerstone of national economic stability and sustainable development of enterprises.

3.1. Research on the Causes of Financialization of Entity Enterprises

From the perspective of "investment substitution" motivation, enterprises can obtain financial investment more directly through financial means such as bonds and stocks, and enjoy relatively low financing costs. The real economy is declining, and enterprises prefer financial investment to physical investment in pursuit of profit maximization. Crotty found that neoliberal policies changed the competitive environment of non-financial enterprises by slowing down the growth of global aggregate demand, removing national trade barriers and direct investment [26]. These changes have led to the evolution of financial markets, leading to a shortening of corporate planning horizons and a rush to invest in the financial sector. Sweezy believes that monopolistic or oligopolistic firms prefer corporate financialization [27]. Since the entity investment will expand the production capacity of enterprises and reduce the industry income, these enterprises tend to use surplus funds for financial investment in order to maintain the monopoly position of the industry and do not generate the entity investment demand. Pan believes that corporate financialization has a "crowding out" effect on innovation and is a "substitution" relationship of resource allocation [28]. Yuan proved from the perspective of resource allocation structure that, compared with enterprises with high financing constraints, enterprises with low financing constraints are more inclined to squeeze out their future capital investment by speculative arbitrage of long-term financial assets [29]. Based on the perspective of financial cycle, Du et al. found that the dominant motive of corporate financialization is "investment substitution", and the "substitution" effect of short-term financial assets is more obvious [30].

From the perspective of "reservoir" motivation, enterprises allocate financial assets with strong liquidity when they have sufficient funds to reserve liquid funds needed in the future. The precautionary reserve alleviates the liquidity pressure of enterprises when they are strapped for funds and provides a source of funds for enterprises. Thierry et al. showed that the melting of industrial capital can provide more options for enterprise financing and resource allocation, and optimize the internal resource layout of enterprises [31]. Zhang believes that the moderate financialization of enterprises is mainly based on the motivation of preventive savings, which will help smooth the fluctuation of fixed asset investment of enterprises in the future period [32]. Li et al. put forward the "reservoir" motivation of corporate financialization against the background of corporate ESG [33]. The empirical study of Huang et al. also shows that the financialization motivation of the non-financial enterprise sector is dominated by "reservoir" on the whole, and the appropriateness of enterprise financialization is low [34].

3.2. Research on the Measurement of Corporate Financialization

Early studies on financialization mainly focus on the proportion of financial assets in the whole economy from the perspective of macroeconomic. This approach is simple and straightforward, but fails to fully account for the complex structure within financial assets. With the deepening of the understanding of financialization, some scholars began to study financialization from the enterprise level, and reflected the degree of financialization by the holding of financial assets and the degree of participation in financial activities of enterprises. Economist Goldsmith put forward the Financial Interrelations Ratio, which is the ratio of the value of all financial assets to the value of all real assets, to indicate the degree of economic monetization. On this basis, Levine and Zervos construct an indicator of the ratio of commercial credit to total credit from the perspective of credit to measure corporate financialization. At the micro level, Crotty measured the ratio of investment real estate, corporate financial assets and tangible assets of real enterprises. Orhangazi innovates by adding the ratio of financial assets to total assets in the asset composition index. Liu et al. selected transactional financial assets, buy-back financial assets, available-for-sale financial assets, hold-to-maturity investment, loan issuance and advances as estimation indicators to further refine the measurement of corporate financialization [35]. Song and Lu adopted the Penman-Nissim analytical framework to estimate the allocation ratio of corporate financial assets combined with corporate financial assets and financial income [36]. Some scholars also reflect the degree of financialization of enterprises by calculating the proportion of the income or expenditure of financial market investment in the total income of enterprises. This method focuses on the change of the income of enterprises. Krippner constructs an independent financialization indicator on cash flow, that is, the ratio of securities income to cash flow [37]. Zhang and Zhuge refer to the quantitative analysis framework of Krippner and Milberg and increase the comparison index between financial profits and non-financial profits in the sources of profits, and increase the proportion of fixed assets and fixed asset investment in GDP respectively in the use of profits [38]. At present, the academic community has not reached a consensus on the measurement of corporate financialization.

3.3. Research on the Economic Consequences of Corporate Financialization

With regard to the financialization of enterprises, scholars are concerned about the economic consequences it brings to enterprises. Entity enterprises have now "invested" in financialization, resulting in the deepening of the process of "de-real to virtual", which brings "opportunities" or "challenges" to enterprises.

Most scholars are opposed to corporate financialization, believing that it brings mostly negative benefits. According to Yang, the financialization of non-financial enterprises may lead to price competition and financial system risks due to the increase of supply in the financial market [39]. Luo et al. aiming at the status of financialization of state-owned enterprises, pointed out that financialization behavior of enterprises will not only exacerbate the operational risks of state-owned enterprises and reduce the performance sensitivity of executives' compensation, but also seriously "squeeze" the R&D and innovation activities of enterprises [40]. Meng analyzed that enterprises conduct financial investment for the purpose of pursuing short investment cycle and high return efficiency, which inhibits the high-quality sustainable development of enterprises [41]. Wang found that financialization makes enterprises afraid of high-risk but profitable investment projects, thus weakening their risk bearing capacity [42]. Xu and Guo analyzed different types of financial assets and concluded that investment financial assets crowd out innovative activities related to long-term performance [43]. Monetary financial assets have a positive impact on corporate profitability, but inhibit the improvement of return on invested capital and long-term performance. Similar to the research results of scholars such as Luo et al., Zheng et al. also demonstrated the phenomenon of financialization "crowding out" investment in corporate entities and its negative effect on business performance [44].

A small number of scholars believe that moderate financialization is conducive to the flexibility and efficiency of enterprise development, but the "threshold" for preventing and supervising the development of financialization is very high. Mu and Tong found that financial investment income can provide liquidity for enterprises and play a strategic role in supporting the development of enterprises' main business [45]. Huang et al. hold that the financialization of non-financial enterprises can promote technological innovation and improve development ability [46]. Moderate financialization can also help enterprises improve their financial performance, solvency and operational capacity, and reduce corporate risks. Wang believes that financialization can replace part of the cash flow of enterprises, increase capital value and positively affect the total factor productivity of enterprises [47]. According to the analysis of Yu et al., improving the degree of corporate financialization can significantly reduce the issuing credit spread of debt-issuing enterprises, and it can also reduce the credit spread of corporate bond issuance by improving the business performance of enterprises [48].

4. Research on Management Incentive and Corporate Financialization

An enterprise is an incomplete contract (Zhang, 1996), and the existence of principal-agent relationship separates its ownership and control. A good principal-agent relationship can reduce transaction costs, improve decision-making efficiency and enhance risk control. However, the information asymmetry and joint liability between the agent and the principal may lead to moral hazard and adverse selection. It has become an important means of corporate governance to guide management's "rational person" behavior with incentive mechanism (Miao et al., 2014). Holmstrom and Milgrom found that the compensation contract could solve the problem of post-event information asymmetry in the principal-agent relationship. However, the problem of prior information asymmetry cannot be completely solved (Gibbons, 1987). The research of Chen and Jia shows that equity incentive can significantly restrain the agency cost of enterprises and regulate the conflict of interest between shareholders and operators [49]. Influenced by the sense of self-interest, enterprise managers will also obtain implicit incentives through high-frequency on-the-job consumption (Yermack, 2006). Xiang and Zhang believe that the on-the-job consumption behavior of enterprise managers can make up for the loss of their inequity aversion utility [50]. Therefore, some scholars believe that incentive behavior may cause management to ignore the long-term development of enterprises and aggravate financialization. Some scholars also believe that incentive behavior makes the interests of management converge with the interests of shareholders, leading the management to attach importance to the development of the enterprise entity, which is conducive to the enterprise "from virtual to real". The empirical results of An et al. and Wang et al. show that compensation incentive amplifies the financial profit-seeking motivation of management and promotes the allocation of corporate financial assets [51][52]. Equity incentive restrains the profit-seeking behavior of finance and restrains the financialization of enterprises. Li et al. found that management equity incentives can promote long-term industrial investment and innovation investment by inhibiting financial asset allocation, and inhibit enterprises from "turning from real to virtual" [53]. He and Shi believe that equity incentives can be used as a governance mechanism of "real and virtual balance" to prevent excessive corporate financialization [54].

5. Conclusion

Combing through relevant literature, there are abundant researches on management incentives and corporate financialization. The research of management incentive mainly focuses on the influencing factors and economic consequences. Among them, scholars focus on the factors that influence management incentives in the aspects of enterprise nature and corporate governance. The economic consequences of management incentives can be divided into two categories: investment innovation and firm performance. Secondly, the main scope of the research on the financialization of entities includes the causes, measures and economic consequences. The researchers analyze the causes of corporate financialization from the two motivations of "reservoir" and "investment substitution". Domestic and foreign scholars have different opinions on the measurement of corporate financialization. Financialization brings "opportunities" or "challenges" to enterprises, which is the focus of scholars' research. At present, there are few literatures on the connection between management incentives and corporate financialization, and most of the existing researches only focus on the impact of management equity incentives on corporate financialization. In addition, few literatures have explored the transmission mechanism and regulatory effect between management incentives and corporate financialization.

High-quality development is the main theme of national economic development, and real enterprises, as the main driving force of national economic development, are the key subjects to achieve economic goals. The financialization of non-financial enterprises in China is developing rapidly. On the one hand, financial investment and products can bring vitality to enterprises. On the other hand, it may have a negative effect on the high-quality development of enterprises by inhibiting the two paths of entity enterprise innovation and physical capital investment. There are many pre-governance factors for corporate financialization, and executive incentive is one of them. This paper reviews the existing literature on management incentives and corporate financialization, finds that there are shortcomings in the existing literature, and puts forward the following prospects: First, the management's view on financial investment and other financial activities is an important factor affecting the financialization of enterprises. If real enterprises consider the internal incentive mechanism as a starting point, it will be helpful for future research on corporate financialization governance. Secondly, scholars can discuss the possible transmission paths and regulatory factors between management incentives and corporate financialization, in order to enrich relevant research. Finally, the academic community has not yet unified the measurement of management incentives and entity financialization, and future studies can explore more accurate measurement indicators to make the research results more robust.

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