Financial market boom and changes in the financial structure of European industrial companies

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The relationships between the financial sphere and the real economy have been an important theme in theoretical debates since the crisis in the 30s and have been among major concerns in implementing economic policies.
The expansion of financial markets and financial activities in the context of financial globalisation and the new problems resulting from it during the last twenty years have revived this debate. It concerns notably:

- **the link between financial market boom and financial instability;**
- **the consequences of the financial market boom on the balance of power among stakeholders involved in the ownership, financing and management of companies and;**
- **the impact of financial activity boom on production, and notably on productive investment.**

This paper sets out to analyze the results of an empirical study on the structural distortion of manufacturing companies' balance sheets in the Euro zone: Germany, Austria, Belgium, Spain, Finland, France, Italy, the Netherlands and Portugal. It offers an analysis of the most representative ratios of the impact of European economies' financialization on companies' activities. The study - based on the development of the European Commission Bach database – concerns the period from 1990 to 2006. Financial activities in the nineties have been deeply influenced by the expansion of the "internet" bubble connected with the rise of the "new" economy.

The concept of financialization has several meanings. In this study we distinguish financialization of economies from corporate strategies' financialization. Financialization of economies refers to changes within financial systems favoured by financial globalization. Its consequences are the boom of financial markets, increase in stock prices and substantial reinforcement in the role of institutional investors. The shareholder's value revolution is an outcome of these changes. Corporate strategies' financialization expresses the effects of increasing hold of shareholder value objective on corporate activities.

This study highlights the strengthening – very marked until the early 2000s – of manufacturing companies' financial activities to which the diminution of the share of tangible and intangible assets is the corollary. This change combines with the slowing down of investment rates, general reduction of salary percentage in turnover and increase in corporate profitability.

Other studies pertaining to non financial French companies (NFCs) as well as NFCs of OECD countries in the 1980s relay quick increase of securities within total assets (Bardos M., 1993; Serfati C., 1996). Our study shows that financialization of NFCs of several European countries in the 1980s also affects manufacturing companies in the euro zone and carries on until the early 2000s.

The central assumption of this work is that the financialisation of European economies as well as the tightening of European macroeconomic policies in the 1990s – transition period to the unique currency - contribute to the decrease in the rate of productive investment through two main elements: the slowdown in demand growth and the emergence of new entrepreneurial strategies. These strategies favour the shortening of time horizon for corporate management and a Neo-Malthusian investment policy.

This study has three parts. The first part concerns ratios used and their evolution. The second part shows the analytical framework of the impact of financialisation on productive activity. The third part analyzes the distortion of European manufacturing companies' balance sheets in favour of fixed financial assets.

Hereafter you can find the first party of the study.

I/ Empirical study

1. Sample and data

The data analysed concern three categories of companies: companies of all sizes, large companies (turnover of more than 50 million euros) and small companies (turnover of less than 10 million euros).
The study relates to the period from 1990 to 2006, for which complete data for most countries are available.

The ratios analysed are as follows:
- **Fixed financial assets/Total assets;**
- **Tangible and intangible assets/Total assets;**

Income statement ratios are also analysed through:
- **Net acquisitions of tangible and intangible assets/Turnover;**
- **Net acquisitions of financial fixed assets/Turnover;**
- **Compensation of employees/Turnover and;**
- **Net profit/Turnover.**

Fixed financial assets include both acquisitions, which provide the company with a power of control over other companies and securities that the company intends to keep in the long term. Fixed financial assets often include external growth operations. It is deemed that speculative logic can influence the acquisition behaviour of securities whereas the acquisition of fixed financial assets meet strategic objectives of the search of synergies and/or diversification strategy. In fact, distribution between these two categories of assets is very difficult. First, there is a very significant increase in the quick assets ratio of long-term investments. It is also observed that minority interest may include, on the purchasing date of securities, long- and short-term motivations according to the opportunities and expectations of market evolution. Moreover, the legal limit setting the distribution between long-term investments and securities is very different from one European country to another. For instance, it is 10% in France and 20% in Germany. Finally, statistical data indicates that the share of long-term investments in the balance sheet of small companies is too large (e.g. 40% of assets in Sweden, 24% in Belgium and Finland) for them to be considered fully corresponding to

true long-term investments. For these reasons, the financial concerns and the search for capital gains seem to significantly contribute to the increase in the share of Fixed financial assets.

2. Results

As the data available is not fully harmonised, the comparison between structures of balances sheets from one European country to another may not be very revelatory. That is why our comments mainly concern the evolution of ratios.

The calculation of ratios enables the following observations to be made:

- **The Fixed financial assets /Assets ratio increases quite clearly during the period analysed for almost all the countries of the Euro zone. This evolution mainly results from the growth of acquisitions in subsidiaries, the other fixed financial assets being generally a small (less than 5%) and quite stagnant share for all the groups of companies and all countries.**
  The increase of the ratio is high for large and companies of all sizes of all the European countries. The increase is clearly lower for small companies within most countries.
- **In 2006, Fixed financial assets ranged from 11% (Italy) to 51% (The Netherlands) of the total assets of companies of all sizes. For five of the nine countries (Belgium, Spain, the Netherlands, Germany, Finland), the Fixed financial assets /Assets ratio is higher, or even a lot higher than the Tangible and intangible assets/Assets ratio.**
  Amongst the three leaders of the Euro zone – Germany, France, Italy – the growth of Fixed financial assets within total assets of manufacturing companies is particularly fast in Germany - 16 growth points for companies of all sizes – compared to 4 points for France and 3 points for Italy.

- **The increase of the Fixed financial assets /Assets ratio is recorded by the group of large and companies of all sizes in all countries. An increase – much smaller – is also recorded by the group of small companies in most European countries.**

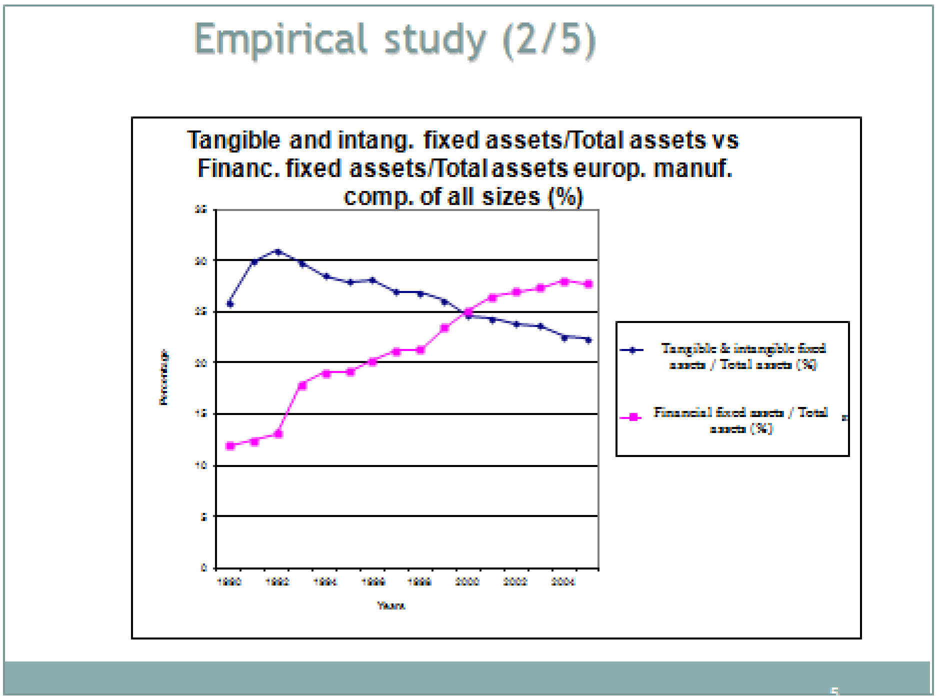
- **The Tangible and intangible assets/Assets ratio generally tends to decrease for companies of all sizes and large companies, whereas small companies indicate a clearly stronger evolution.**

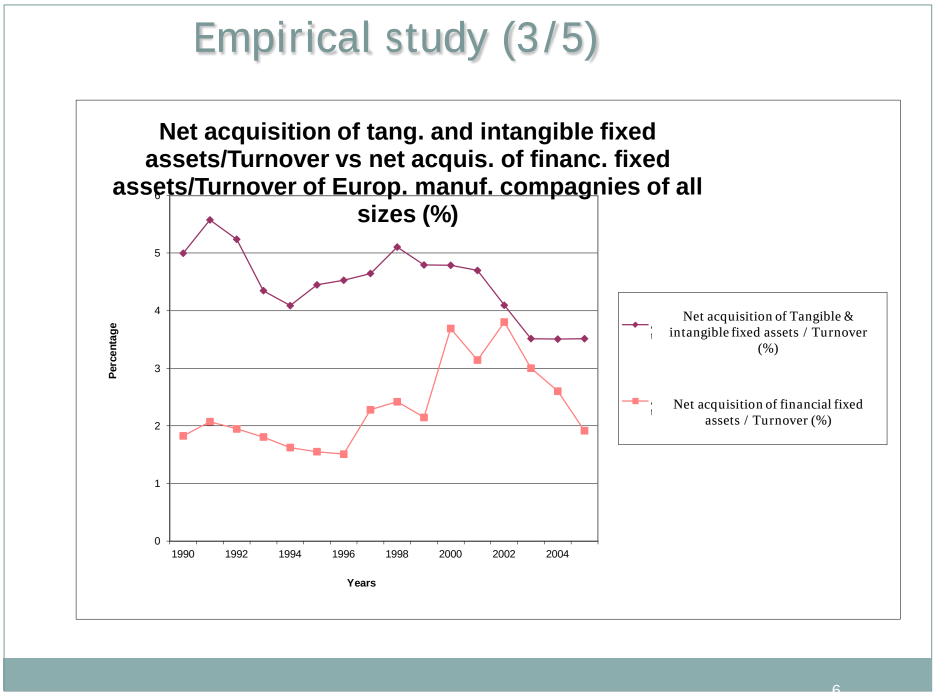
- **The Net acquisitions of tangible and intangible assets/Turnover ratio also tends to decrease in most European countries, as opposed to the net acquisitions of Fixed financial assets /Turnover ratio which tends to increase.**

- **Finally, there is a decrease in the share of labour costs in the turnover of all companies and a very significant increase in the net profit/Turnover ratio.**

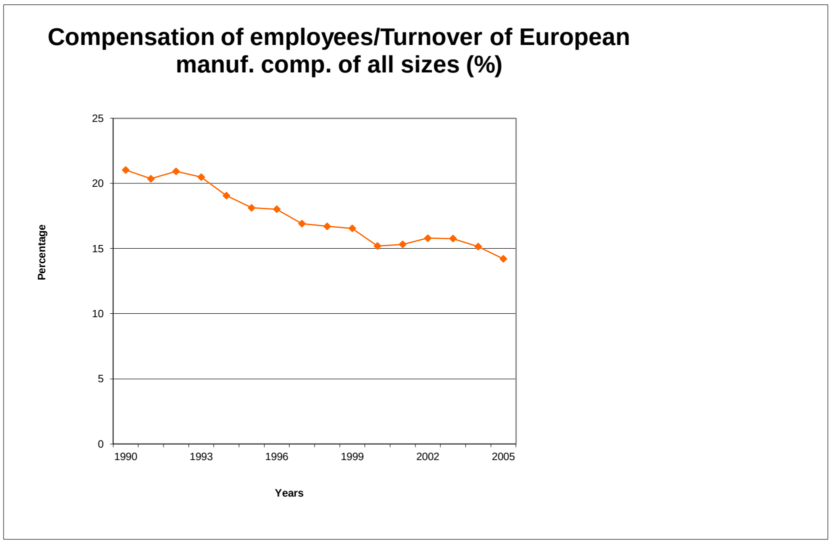
These transformations indicate a strengthening of the financial aspect of the activity of European manufacturing firms which results from the weakening of the productive aspect. It should be specified that the distortion of the structure of balance sheets does not only reflect the increase in the price of securities, as until very recently, according to

the accounting principles of Western European countries, securities were not quoted at the market price but at the cost price.





Empirical study (4/5)



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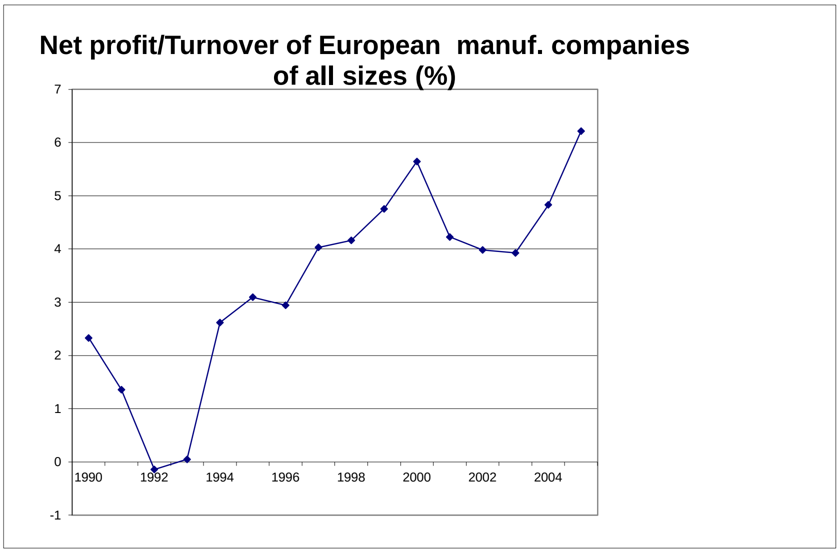

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