ARTICLE IN PRESS
FINANA-00963; No of Pages 11
International Review of Financial Analysis xxx (2016) xxx–xxx
Contents lists available at ScienceDirect
International Review of Financial Analysis

Financialization: Towards a new research agenda

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A R T I C L E I N F O

Article history:
Received 26 July 2015
Received in revised form 10 February 2016
Accepted 7 March 2016
Available online xxxx

JEL classification:
G00

Keywords:
International finance
Financialization

A B S T R A C T

Although the concept of 'financialization' has become increasingly popular across a wide range of social sciences, it is largely excluded from the discourse of financial economists. The objective of this paper is to provide the basis for its incorporation in academic finance. This first involves removing the existing meta-theoretical obstacles to the acceptation of the concept in the discipline. We then connect financialization with the concomitant development of cyberspace, the global deregulation of financial markets, and the rise of shareholder governance. We identify a corresponding set of changes in the financial and the real sectors, which we support with a series of stylized facts, and situate within current literature. Finally, we put forth a list of relevant research questions for the study of financialization in the context of academic finance.

1. Introduction

Ten years after the beginning of the global financial crisis, it has become apparent that the expansion of the financial sector, the phenomenal sophistication of financial products and the unprecedented velocity of financial transactions have together profoundly altered the relationship between finance, the economy, and society. Such unprecedented complexity makes a convincing case for connecting academic finance with the other social sciences — a task already undertaken by a set of pioneering authors (Boussard, 2016; Chiapello, 2007; Hertz, 1998; MacKenzie, 2006; Muniesa, 2014). Concurrently, the ongoing economic, social and ecological crisis has led several finance scholars to argue that a significant *diversification* of methods, concepts and practical tools developed in academic finance is needed (Alijani & Karyotis, 2016; Bay & Schinkus, 2012; Faugère, 2014; Gleadle, Haslam, & Yin, 2014; Lagoarde-Segot, 2010, 2014, 2015; Lagoarde-Segot & Paranque, in press; Paranque & Pérez, 2015).[1]

As argued in Lagoarde-Segot (2015), one way of tackling these challenges would be to introduce new research *metaphors*[2] into academic finance. The epistemological function of metaphors is to generate new distinctive insights that permit to overcome the inability of existing theories to explain a given context.[3] Financial research consists, to a large extent, in examining the extent to which features of the chosen metaphors are found in the financial realm. Most finance controversies consist in discussing attempts to theorize, operationalize, and test the implications of the metaphorical insights upon which research is based.[4] The introduction of new metaphors hence constitutes a prerequisite for the diversification of academic finance. In this paper, we suggest that 'financialization'[5] – defined as "*the increasing dominance of financial actors, markets, practices, measurements and narratives at various scales, resulting in a structural transformation of economies, firms* (*including financial institutions*), *states and households*" (Aalbers, 2015) – constitutes a relevant metaphor for 21st century financial research.

The paper is structured as follows. Following a discussion of why the term has not yet been incorporated into academic finance, we put forth that the reluctance of finance academics to appropriate the concept stems from a tacit *ontological* stance, which, we show, would benefit from being rendered less rigid. We then introduce 'financialization' into the finance discipline by presenting a new conceptual framework which we support with a set of stylized facts. This leads us, in the final section of this paper, to identify a set of promising research questions for the study of financialization, in the context of academic finance. The remainder of the paper is divided as follows. Section 2 discusses the meta-theoretical obstacles to the study of financialization in academic finance. Section 3 introduces our conceptual framework.

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[1] This research movement has led to the publication of a 'Postcrisis Finance Research Manifesto', which is included in Appendix 1 of the present paper.

[2] We define metaphors in finance as specific vocabulary that serves the process of scientific inquiry by producing a crossing of mental images used by researchers for studying an object. See, for instance, Morgan (1980) and Ardalan (2008).

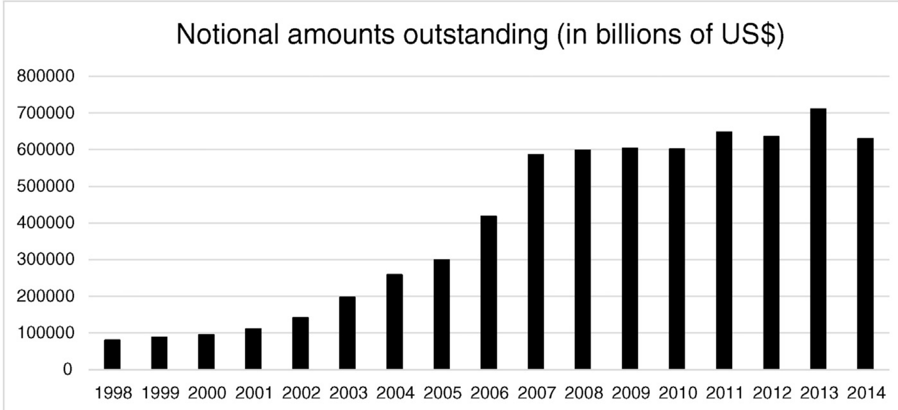
[3] In recent years, metaphors such as 'contagion' and 'sentiment' seem to have become mainstream. For a fascinating account of the use and impact of metaphors by finance practitioners, see Tomoni (2012).

[4] Examples of such controversies include: are financial markets 'efficient'? What is the impact of 'agency conflicts' on the 'risk premium'? Is the 'home bias' diminishing under 'financial integration'?

[5] Aalbers (2015) gives the following definition of the concept: "A definition of financialization (…) would be: the increasing dominance of financial actors, markets, practices, measurements and narratives at various scales, resulting in a structural transformation of economies, firms (including financial institutions), states and households".

http://dx.doi.org/10.1016/j.irfa.2016.03.007
1057-5219/

Please cite this article as: Lagoarde-Segot, T., Financialization: Towards a new research agenda, *International Review of Financial Analysis* (2016), http://dx.doi.org/10.1016/j.irfa.2016.03.007



Source: Bank for International Settlement dataset (2014).

Fig. 1. Notional amounts outstanding of over the counter derivatives.

Section 4 discusses a set of corresponding stylized facts, and Section 5 introduces a new research agenda.

2. Financialization and the ontology of academic finance

The concept of 'financialization' is, to this date, largely overlooked by financial economists. One potential explanation lies in the fuzzy nature of the concept. The success of financialization in social sciences stems from its ability to provide an interdisciplinary convergence point for studying the new complexity of the global economy and society (Aalbers, 2015). However, this is achieved at the cost of some imprecision: 'financialization' embraces several nested levels (such as economic systems, geography, technology, macroeconomic policies, microeconomic behavior, and social narratives). As a result, it can hardly fit a hypothetico-deductive model, nor can it be captured by any empirical proxy. Such imprecision may explain the reluctance of finance scholars to appropriate the concept.

Indeed, academic finance relies on a '*representative idiom*': finance research is conceived as '*an activity that seeks to represent nature, to produce knowledge that* (…) *corresponds to how the world really is*' (Pickering, 1995). In other words, academic finance research posits a dichotomy between the observer and the observed, and assumes an identity between empirical observations and financial reality. This 'objectivist' stance has allowed financial economists to adopt a positivist research agenda, characterized by the search for internal logic and the validation of theories through empirical testing. The relationship uniting financial theories and the financial realm is hence regarded as a relation of neutral correspondence, i.e. a purely external relation which leaves the inner characteristics of the object of study unaffected. In this epistemological framework, the impossibility of identifying financialization with a separate, observable segment of reality tends to nullify the relevance of the concept entirely[6]: financialization is, at best, regarded as a normative notion falling beyond the scope of academic finance.

However, it may be argued that academic finance does not fully correspond to the *representative idiom* discussed above, but also bears several similarities with the *performative idiom*: knowledge in finance is not purely representative, but also has the ability of bringing into existence or modifying various types of realities (Callon, 1998). A wide range of social studies have indeed demonstrated that the way financial theory describes, defines, depicts and models the financial realm has affected the properties of the latter (Boussard, 2016; MacKenzie, 2006; Muniesa, 2014). The financial world may turn out to be objective; however, in order to exist as such, it had to be provoked by financial theory in the first place.

Neither the *performative idiom* nor the *representative idiom* can be demonstrated to be superior: such ontological stances are mere ad-hoc meta-theoretical hypotheses interiorized by researchers throughout the course of their training (Ardalan, 2008).

Given the above dilemma, the least controversial position would be to consider that academic finance does not only describe the outside world, but also constitutes a *Logos* affecting the subjectivity of economic agents. In other words, one may assume a reciprocal causality between financial models and financial practices. It follows that 'normative' concepts, such as 'financialization', cannot be considered beyond the scope of our discipline anymore, but appear to constitute the very fabric of the latter.[7] We thus put forth that adopting a less rigid paradigmatic stance would not weaken the scientific-ness of academic finance, but would, in fact, enrich it considerably, by looking at finance through various lenses (Lagoarde-Segot, 2015; Schinckus, 2015). It is against this broader background that importing the financialization concept into academic finance appears justified and necessary.

3. Conceptual framework

Our conceptual framework is described in Fig. 1. We depict financialization as the joint product of the development of information technologies, the deregulation of economies, and the rise of the 'shareholder value paradigm', at various levels. These three trends manifest themselves via the following interrelated changes, which are occurring simultaneously in the financial and in the real sectors:

- In the financial sector, key changes include financial liberalization reforms, financial transaction velocity, speculative trading, securitization/shadow banking; complex information networks, and geopolitical finance;
- In the real sector, key changes include increased income inequalities, increased leverage, concentration of financial and real assets ownership, and shareholder dominance.

4. Financial sector changes

4.1. Financial integration

Beginning in the 1980's, most OECD and emerging countries began implementing financial liberalization reforms. These reforms were

[6] One particularly compelling argument is that attempts to model financialization would be plagued by endogeneity.

[7] Examples of normative concepts would include terms such as 'alfa', 'risk-premium', 'price discovery', 'agency conflicts', etc.…

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