

Financialisation and productivity: there are worrying t...

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This was [posted today](#) by the Productivity Insights Network which was established in January 2018 and is funded by the [Economic and Social Research Council](#). I have no idea why I cannot copy and paste it from their site:



Financialization and Productivity Project Lead: Professor Adam Leaver

This project directly addresses the PIN priority area of 'UK business investment (including financialisation) behaviour'. It complements existing analyses of the role of shareholder value pressures in encouraging corporate short-termism and low investment (Stockhammer 2006; Tori & Onaran 2018), specifically that i) shareholder distributions compete with investment (Lin and Tomaskovic-Devey, 2013), ii) excessive discounting disincentivises investment (Haldane 2015), and iii) higher returns from finance lead to a switching of investment from productive to financial sources (Orhangazi, 2008). To assess this, our project takes an interdisciplinary approach which bridges accounting and political economy to examine the accounting and law innovations used within the UK water industry before and after the financial crisis; so chosen because of its weak productivity performance post-crisis (Frontier Economics 2017; Riley et al 2018). These accounting insights may add a missing piece to the productivity puzzle: that when financial engineering proliferates, productivity declines.

I worked with Adam Leaver on this project. The [executive summary](#) of our report is here, and the [full report here](#).

The key findings were:

Our results found that companies showing the weakest trends in terms of labour productivity coincided with the highest proportionate investment in assets of uncertain value where balance sheet valuation might be subject to the greatest degree of management discretion e.g. goodwill, intangible assets, derivatives and deferred tax assets. This was matched also by higher levels of liabilities of uncertain value e.g. deferred tax and pension liabilities. As a whole, the proportion of assets and liabilities of uncertain value rose across the sample over the period reviewed, but rose most notably as a proportion of group net asset values in companies with the weakest trends in productivity, where the value of those assets dominated the worth of these companies at the end of the period under review.

We found that the majority of our company panel took advantage of the different reporting requirements for group and parent entities. The result is that parent companies operating as single entities tend to report higher levels of retained profit than they do when reporting as group parent entities. This matters because it is the retained earnings of parent companies as single entities that, controversially, determines their ability to pay dividends, even when the group accounts question their ability to do so. Those with weaker productivity trends had a larger gap between parent and group accounts.

We also reviewed the quality of the financial reporting of these entities. This was based upon their apparent reliability of their tax disclosures, and adjustments made to them over time. Results here were not completely conclusive, but there is some indication that the quality of reporting is declining, which might either indicate a greater use of tax avoidance, giving rise to a broad trend of increased revisions to past tax disclosures, or a genuine decline in the quality of tax estimates included in these accounts, which did however appear consistent and systemic in many cases over the period. This is important because a penny saved on tax is a penny available for distribution.

This research sought to identify whether indicators of financialization derived from the annual reports of six companies in two sectors (pharmaceuticals and water) co-incide with weak productivity performance. We do find a strong 'co-incidence', particularly in the two largest pharmaceutical firms: AZN and GSK. We use the term 'co-incidence' deliberately because establishing causation conclusively is difficult in the absence of interviews that would better reveal management motives. This caveat is important because it is not clear whether the use of financial engineering to create shareholder value 'crowds out' investment-led, productivity-oriented alternatives, or whether managers turn to financial engineering when those alternatives are exhausted; or indeed whether in this very small sample the coincidence is random. Nevertheless, this

report does paint a worrying picture of performance in some of the UK's largest and most prestigious firms which warrants further research.

I am pleased to say we have funding for that further research, which is now in progress.