

Financial Analysis And Interpretation Of Financial Statements As A Key Tool For Efficient Business Management: A Financial Homeostasis Model

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Abstract

Financial analysis has traditionally relied on static indicators to assess firm performance, yet these measures often fail to capture the dynamic interactions governing long-term stability. This paper proposes a novel Financial Homeostasis Model inspired by the Renin–Angiotensin–Aldosterone System (RAAS), conceptualizing firms as adaptive systems that regulate liquidity, profitability, and leverage through feedback mechanisms. We develop a system of differential equations to represent these dynamic relationships and derive a Financial Homeostasis Index (FHI) to quantify stability. Stability analysis using the Jacobian matrix reveals conditions under which firms achieve equilibrium. The framework is empirically applied to América Móvil, demonstrating that financial stability emerges from balanced interactions among core variables rather than isolated ratio values. This biologically inspired approach bridges physiology and corporate finance, offering a comprehensive perspective on how firms sustain equilibrium in complex environments. The FHI value of 0.36 for América Móvil indicates moderate homeostasis constrained by high leverage, consistent with capital-intensive telecommunications operations.

Keywords: *Financial homeostasis, dynamic systems, RAAS analogy, financial stability, differential equations, Jacobian analysis, América Móvil, liquidity-profitability-leverage interactions*

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I. Introduction

Financial analysis has traditionally relied on static indicators such as liquidity ratios, profitability margins, and leverage metrics to assess firm performance. While these measures provide valuable snapshots of financial condition at discrete points in time, they often fail to capture the dynamic interactions that govern the stability and resilience of firms over extended periods. In increasingly volatile and capital-intensive business environments, understanding how financial variables co-evolve and interact has become essential for evaluating long-term sustainability and predicting financial distress [1], [2].

Recent advances in interdisciplinary research suggest that complex economic systems can be better understood through analogies with biological regulation mechanisms [3]. In particular, the Renin–Angiotensin–Aldosterone System (RAAS) provides a compelling conceptual framework for modeling stability through feedback loops. In human physiology, the RAAS maintains blood pressure and fluid balance by dynamically adjusting multiple interacting variables in response to deviations from homeostatic equilibrium. Similarly, firms continuously regulate liquidity, profitability, and leverage in response to internal operational changes and external market shocks, seeking a form of financial equilibrium that can be interpreted as homeostasis.

Despite this conceptual parallel, most financial models remain rooted in equilibrium-based or purely statistical approaches, with limited emphasis on dynamic feedback structures and nonlinear interactions [3]. System dynamics approaches have been applied to corporate capital structure decisions [1], and recent work has shown that excessive liquidity accumulation can generate instability through chaotic investment dynamics [2]. However, the application of biologically inspired regulatory frameworks to quantitative financial modeling remains limited and largely conceptual. This gap motivates the development of a novel framework that integrates financial statement analysis with systems dynamics and biological inspiration.

Specifically, this study proposes a Financial Homeostasis Model that conceptualizes firms as adaptive systems, where stability emerges from the interaction of key financial variables rather than from their isolated

values. To operationalize this idea, two complementary contributions are introduced. First, a system of differential equations is proposed to represent the dynamic relationships between liquidity, profitability, and leverage, capturing feedback mechanisms analogous to physiological regulation. The stability properties of this system are analyzed using the Jacobian matrix to identify conditions under which financial homeostasis is achieved. Second, a Financial Homeostasis Index (FHI) is developed as a tractable metric to quantify the degree of stability achieved by a firm. The FHI is formulated in both dynamic and simplified static forms, enabling empirical application using real financial data.

The proposed framework is applied to América Móvil, one of the largest telecommunications firms in Latin America. Due to its capital-intensive structure and exposure to competitive and regulatory pressures, América Móvil provides an ideal case to examine how financial homeostasis manifests in practice. The analysis highlights how stability is not solely determined by strong financial ratios in isolation, but by the firm's ability to regulate the interactions among liquidity, profitability, and leverage over time [4], [5], [6].

This paper contributes to the literature in several ways. First, it introduces a biologically inspired perspective on financial stability, bridging concepts from physiology and corporate finance. Second, it develops a formal dynamic model with explicit feedback mechanisms and derives stability conditions through Jacobian analysis. Third, it proposes a practical index (FHI) that operationalizes the homeostasis concept for empirical application. By moving beyond static ratio analysis and incorporating dynamic feedback mechanisms, the proposed approach offers a more comprehensive understanding of how firms sustain equilibrium in complex and uncertain environments.

The remainder of this paper is organized as follows. Section 2 reviews related work on financial ratio analysis, dynamic systems in finance, and biological analogies. Section 3 presents the dynamic financial system model with its mathematical formulation. Section 4 analyzes system stability using the Jacobian matrix. Section 5 develops the biologically inspired interpretation based on the RAAS analogy. Section 6 introduces the Financial Homeostasis Index and applies it to América Móvil. Section 7 discusses implications and limitations, and Section 8 concludes.

II. Related Work

Financial analysis has long relied on ratio-based frameworks to evaluate firm performance, particularly through measures of liquidity, profitability, and leverage. Traditional ratio analysis remains a cornerstone in both academic research and professional practice, providing standardized metrics for comparing firms and assessing financial health. However, these approaches are inherently static, providing limited insight into how financial variables interact dynamically over time and how feedback mechanisms influence stability [7].

Financial Ratios and Firm Performance

Extensive empirical research has established relationships between financial ratios and firm performance outcomes. Studies have shown that liquidity, leverage, and profitability significantly affect firm value and financial performance [6]. Using multiple regression analysis on Indonesian firms, researchers found that these three dimensions jointly influence firm value, with corporate social responsibility acting as a moderator. Similarly, structural equation modeling has demonstrated that leverage and profitability strongly affect financial performance, with liquidity also playing a positive role [5]. Hybrid approaches combining panel regression and machine learning have further confirmed that specific financial ratios drive return on assets, supporting the importance of ratio-performance links [4].

Dependencies among financial ratios have also been documented. Empirical analysis of companies listed on the Warsaw Stock Exchange revealed varied and sometimes negative correlations among liquidity, profitability, and indebtedness ratios, suggesting complex interactions that static analysis may not fully capture [7]. Furthermore, profitability and leverage have been linked to earnings quality, with liquidity playing a moderating role [9]. These findings underscore that financial variables do not operate in isolation but interact in ways that influence overall firm stability and performance.

Dynamic Systems and Feedback Mechanisms in Finance

To address the limitations of static analysis, a growing body of literature has incorporated dynamic and systems-based perspectives into financial modeling. System dynamics, pioneered by Forrester, introduced feedback loops as a way to model complex organizational behavior. These approaches have been applied to corporate finance to analyze cash flow cycles, investment dynamics, and financial instability, highlighting the importance of endogenous interactions among variables rather than isolated indicators [1], [3].

Khan et al. developed a system dynamics model of capital structure policy for firm value maximization, explicitly linking capital structure choices to firm value through feedback effects in debt policy [1]. This work demonstrated how dynamic modeling can capture the temporal evolution of financial decisions and their consequences. Gramlich and Oet provided a conceptual synthesis advocating system dynamics

approaches to model nonlinear systemic financial feedbacks and adaptation, emphasizing the need for frameworks that account for complex interdependencies [3].

Recent research has also shown that excessive liquidity can generate instability. Calcagnini et al. developed a dynamic model demonstrating that cash accumulation can destabilize investment dynamics and produce chaotic cash-investment behavior [2]. This finding challenges the conventional view that higher liquidity always enhances stability, revealing that feedback mechanisms can produce counterintuitive outcomes.

Financial Instability and Minsky's Hypothesis

Financial stability has been extensively studied in macroeconomic contexts, where concepts such as systemic risk and resilience are central. Minsky's Financial Instability Hypothesis underscores how leverage and profit expectations interact to generate cyclical instability. Although primarily macroeconomic, these ideas have influenced firm-level analyses by emphasizing the dynamic nature of financial risk and the role of feedback mechanisms [2], [3]. Works addressing endogenous feedbacks and destabilizing investment-liquidity dynamics align with Minsky-style mechanisms, showing that stability is not a static property but emerges from ongoing regulatory processes.

Biological Analogies in Economic Systems

More recently, interdisciplinary research has explored analogies between economic systems and biological processes. Concepts such as resilience, adaptation, and homeostasis have been introduced to describe how organizations respond to external shocks. In this context, physiological regulatory systems—such as the Renin–Angiotensin–Aldosterone System—offer a useful conceptual framework. These systems maintain equilibrium through nonlinear feedback loops, providing a compelling analogy for financial regulation within firms [3]. However, the application of such biological analogies to quantitative financial modeling remains limited and largely conceptual. While dynamic frameworks that translate system behavior and adaptation into finance have been proposed [3], [15], explicit mathematical formulations grounded in biological regulation are rare.

Integrated and Dynamic Frameworks

From a methodological standpoint, differential equations and dynamic systems have been increasingly used to model financial processes, including capital accumulation, debt dynamics, and firm growth. Causal dynamic Bayesian networks have been employed to capture temporal and contemporaneous causal links among financial ratios and firm value [12]. Integrated frameworks combining ratios with governance and macroeconomic variables have been proposed to evaluate corporate financial health dynamically [15]. Nevertheless, most existing models focus on specific variables or sectors and do not integrate a unified framework that simultaneously captures liquidity, profitability, and leverage as interdependent components of a regulatory system.

Furthermore, while composite indices are commonly used in finance—such as credit risk scores or financial health indicators—these are typically constructed as weighted aggregates without explicit theoretical grounding in dynamic system behavior [8]. As a result, they often lack interpretability in terms of underlying mechanisms and fail to capture the feedback-driven nature of financial stability.

Research Gap and Contribution

In contrast, this study contributes to the literature by integrating three key elements: (i) a dynamic system of differential equations that models the interaction between core financial variables, (ii) a biologically inspired interpretation of financial regulation based on homeostasis and the RAAS analogy, and (iii) a Financial Homeostasis Index (FHI) that bridges dynamic behavior and empirical applicability. By combining these elements, the proposed framework advances beyond traditional ratio analysis and provides a novel perspective on how firms maintain stability in complex environments. The explicit use of Jacobian stability analysis further distinguishes this work by formalizing the conditions under which financial homeostasis is achieved.

III. Dynamic Financial System Model

Model Overview

To capture the dynamic interactions among core financial variables, this study proposes a system of coupled differential equations inspired by regulatory mechanisms observed in biological systems, particularly the Renin–Angiotensin–Aldosterone System. The objective is to model the firm as an adaptive system in which financial stability emerges from continuous feedback among liquidity, profitability, and leverage [1], [2], [3].

Let the state variables be defined as follows:

- **L(t)**: Liquidity, representing short-term financial flexibility and the firm's ability to meet immediate obligations.

- **R(t)**: Profitability, representing value generation capacity and the firm's ability to produce returns from its assets.
 - **D(t)**: Leverage, representing financial risk exposure and the extent of debt financing relative to equity.
- These variables evolve over time and are interdependent through feedback relationships that reflect the firm's internal regulatory mechanisms.

Mathematical Formulation

The dynamics of the system are described by the following set of first-order differential equations:

$$\begin{aligned}\frac{dL}{dt} &= \alpha R - \beta D \\ \frac{dR}{dt} &= \gamma L - \delta R \\ \frac{dD}{dt} &= \epsilon L - \zeta D\end{aligned}$$

where $\alpha, \beta, \gamma, \delta, \epsilon, \zeta > 0$ are system parameters that determine the strength of each interaction. These parameters capture the sensitivity of each variable to changes in the others and reflect the firm's operational and financial characteristics.

Economic Interpretation

Each equation represents a fundamental financial mechanism grounded in corporate finance theory:

Liquidity Dynamics (Equation 1): The first equation indicates that liquidity increases as a function of profitability, reflecting the generation of internal cash flows from operations. Conversely, leverage exerts a negative effect on liquidity due to debt servicing requirements, including interest payments and principal repayments. Thus, liquidity is modeled as the result of a balance between income generation and financial obligations. This formulation is consistent with empirical findings that profitability enhances liquidity while leverage constrains it [5], [6].

Profitability Dynamics (Equation 2): The second equation captures the dependence of profitability on liquidity. Firms with higher liquidity are better positioned to invest in growth opportunities, operate efficiently, and respond to market opportunities without financial constraints. However, profitability is subject to natural decay over time (represented by the term $-\delta R$) due to competitive pressures, cost structures, and diminishing returns. This decay term reflects the erosion of competitive advantages and the need for continuous reinvestment to sustain profitability [4].

Leverage Dynamics (Equation 3): The third equation describes leverage dynamics. When liquidity is abundant, firms tend to increase their leverage to finance expansion, capital expenditures, or strategic investments (captured by the term ϵL). At the same time, leverage decreases over time through repayment, restructuring, or financial discipline mechanisms (represented by $-\zeta D$). This formulation aligns with capital structure theories that emphasize the trade-off between growth financing and financial risk management [1].

Together, these relationships form a closed-loop feedback system, where each variable both influences and is influenced by the others. This structure is analogous to physiological regulatory systems, where homeostasis is maintained through continuous feedback adjustments [3].

System Behavior and Stability

The proposed system exhibits properties analogous to regulatory systems in physiology. In particular, the interaction structure allows for:

- **Self-regulation:** Deviations in one variable trigger compensatory effects in others, promoting return to equilibrium.
- **Dynamic equilibrium:** The system may converge to a steady state under certain parameter conditions, representing financial homeostasis.
- **Oscillatory behavior:** Feedback loops may generate cycles under specific configurations, reflecting periodic financial stress and recovery.

From a stability perspective, equilibrium points can be obtained by setting:

$$\frac{dL}{dt} = \frac{dR}{dt} = \frac{dD}{dt} = 0$$

Solving this system yields steady-state relationships among liquidity, profitability, and leverage, which define the conditions for financial homeostasis. The existence and stability of these equilibria depend on the parameter values and the strength of feedback mechanisms.

Link to Financial Homeostasis

The dynamic system provides the theoretical foundation for the concept of financial homeostasis. Unlike static ratio analysis, this formulation emphasizes that stability is not determined by the absolute level of financial variables at a single point in time, but by the balance of their rates of change and mutual interactions over time. In this sense, the firm behaves as a regulated system where stability emerges from continuous adjustment processes, similar to biological homeostasis [3]. This perspective enables a deeper understanding of financial resilience, particularly in environments characterized by uncertainty, capital intensity, and external shocks [2].

IV. Stability Analysis Using The Jacobian Matrix

Equilibrium Point

To analyze the stability of the proposed dynamic financial system, we first determine its equilibrium point. This is obtained by setting the time derivatives equal to zero:

$$\frac{dL}{dt} = \frac{dR}{dt} = \frac{dD}{dt} = 0$$

Using the system defined in Section 3, the equilibrium conditions are:

- $\alpha R^* - \beta D^* = 0$
- $\gamma L^* - \delta R^* = 0$
- $\epsilon L^* - \zeta D^* = 0$

From these equations, we obtain the steady-state relationships:

$$R^* = \frac{\gamma}{\delta} L^*, \quad D^* = \frac{\epsilon}{\zeta} L^*$$

Substituting these expressions into the first equation yields:

$$\alpha \frac{\gamma}{\delta} L^* = \beta \frac{\epsilon}{\zeta} L^*$$

This implies the consistency condition:

$$\frac{\alpha\gamma}{\delta} = \frac{\beta\epsilon}{\zeta}$$

This condition defines the existence of a non-trivial equilibrium, representing a state of financial homeostasis. When this condition is satisfied, the system possesses a steady state where liquidity, profitability, and leverage are balanced through feedback regulation.

Jacobian Matrix

To study local stability around the equilibrium point, we construct the Jacobian matrix of the system. The Jacobian matrix captures the linearized dynamics near equilibrium and is defined as:

$$J = \begin{bmatrix} \frac{\partial}{\partial L} \frac{dL}{dt} & \frac{\partial}{\partial R} \frac{dL}{dt} & \frac{\partial}{\partial D} \frac{dL}{dt} \\ \frac{\partial}{\partial L} \frac{dR}{dt} & \frac{\partial}{\partial R} \frac{dR}{dt} & \frac{\partial}{\partial D} \frac{dR}{dt} \\ \frac{\partial}{\partial L} \frac{dD}{dt} & \frac{\partial}{\partial R} \frac{dD}{dt} & \frac{\partial}{\partial D} \frac{dD}{dt} \end{bmatrix}$$

Evaluating the partial derivatives from the system equations, we obtain:

$$J = \begin{bmatrix} 0 & \alpha & -\beta \\ \gamma & -\delta & 0 \\ \epsilon & 0 & -\zeta \end{bmatrix}$$

This matrix encodes the feedback structure of the system, with off-diagonal elements representing the influence of one variable on the rate of change of another.

Eigenvalue Analysis

The stability of the equilibrium depends on the eigenvalues of the Jacobian matrix. These are obtained from the characteristic equation:

$$\det(J - \lambda I) = 0$$

Expanding the determinant leads to a cubic polynomial in λ :

$$-\lambda[(\lambda + \delta)(\lambda + \zeta)] + \alpha\gamma(\lambda + \zeta) + \beta\epsilon(\lambda + \delta) = 0$$

Simplifying:

$$\begin{aligned} -\lambda^3 - \lambda^2(\delta + \zeta) - \lambda\delta\zeta + \alpha\gamma\lambda + \alpha\gamma\zeta + \beta\epsilon\lambda + \beta\epsilon\delta &= 0 \\ -\lambda^3 - \lambda^2(\delta + \zeta) + \lambda(\alpha\gamma + \beta\epsilon - \delta\zeta) + \alpha\gamma\zeta + \beta\epsilon\delta &= 0 \end{aligned}$$

The roots of this equation determine the system behavior:

- **If all eigenvalues have negative real parts:** The equilibrium is stable (financial homeostasis is achieved).

- **If at least one eigenvalue has a positive real part:** The equilibrium is unstable (financial instability).
- **If eigenvalues are complex with negative real parts:** The system exhibits damped oscillations, converging to equilibrium through cyclical adjustments.

Stability Conditions

A sufficient condition for local stability can be derived from the Routh-Hurwitz criterion applied to the characteristic polynomial. For a cubic polynomial of the form:

$$a_3\lambda^3 + a_2\lambda^2 + a_1\lambda + a_0 = 0$$

Stability requires:

1. All coefficients have the same sign.
2. $a_2a_1 > a_3a_0$

Applying this to our system:

- $a_3 = -1$
- $a_2 = -(\delta + \zeta)$
- $a_1 = \alpha\gamma + \beta\epsilon - \delta\zeta$
- $a_0 = \alpha\gamma\zeta + \beta\epsilon\delta$

For stability, we require:

1. $\delta > 0$ and $\zeta > 0$ (damping in profitability and leverage)
2. $\alpha\gamma + \beta\epsilon > \delta\zeta$ (feedback strength condition)
3. $(\delta + \zeta)(\alpha\gamma + \beta\epsilon - \delta\zeta) > \alpha\gamma\zeta + \beta\epsilon\delta$

The second condition implies that the combined positive feedback loops (liquidity-profitability and liquidity-leverage) must be sufficiently strong relative to the natural decay rates. However, the third condition ensures that these feedbacks do not become so strong as to destabilize the system.

A simplified sufficient condition for stability is:

$$\alpha\gamma < \delta\zeta \quad \text{and} \quad \beta\epsilon < \delta\zeta$$

This inequality implies that the destabilizing effect of positive feedback loops must be counteracted by sufficient damping in the system through the decay parameters δ and ζ .

Economic Interpretation

The Jacobian analysis provides important insights into financial stability:

- The term $\alpha\gamma$ represents the positive feedback loop between liquidity and profitability. Higher profitability generates liquidity, which in turn supports further profitability through investment capacity.
- The term $\beta\epsilon$ represents the reinforcing effect of leverage on system pressure. Higher liquidity enables increased leverage, which then drains liquidity through debt service.
- The damping terms δ and ζ represent natural decay mechanisms: profitability erosion due to competition and leverage reduction through repayment.

If the liquidity-profitability loop dominates ($\alpha\gamma$ is large), the system may exhibit runaway growth or instability, as seen in firms that overinvest during boom periods [2]. Conversely, if leverage-related damping mechanisms are sufficiently strong (large β and ζ), the system converges to a stable equilibrium, reflecting prudent financial management [1].

Interpretation in the Context of Financial Homeostasis

From a physiological perspective, analogous to the Renin–Angiotensin–Aldosterone System, stability is achieved not by eliminating fluctuations, but by maintaining them within controlled bounds through feedback regulation [3]. In financial terms, this implies that firms achieve homeostasis when:

- Profit generation does not excessively amplify liquidity, avoiding overinvestment and speculative behavior.
- Debt levels are regulated to avoid systemic pressure and financial distress.
- Feedback loops remain balanced, with damping mechanisms preventing runaway dynamics.

Thus, the Jacobian analysis formalizes the conditions under which a firm transitions from stable operation to financial stress or instability. This framework provides a rigorous foundation for understanding financial homeostasis as an emergent property of dynamic feedback regulation.

V. Biologically Inspired Interpretation Of Financial Statements

Conceptual Analogy with Physiological Regulation

The analysis of financial statements can be reinterpreted through the lens of biological regulatory systems, particularly the Renin–Angiotensin–Aldosterone System (RAAS). In human physiology, the RAAS

plays a central role in maintaining blood pressure and fluid balance by dynamically regulating vascular resistance, sodium retention, and circulating volume. Its operation is based on feedback loops that continuously respond to deviations from homeostatic equilibrium, ensuring that vital parameters remain within viable ranges despite external perturbations.

Analogously, firms operate as complex adaptive systems that must regulate internal financial variables to maintain stability under changing external conditions [3]. Traditional financial statement analysis evaluates liquidity, profitability, and leverage as independent indicators; however, this perspective overlooks the feedback-driven nature of financial regulation. By contrast, the proposed framework interprets these variables as components of a unified regulatory system, where stability emerges from their interaction rather than from their individual values.

Mapping Financial Variables to Physiological Functions

The analogy between financial and physiological systems can be formalized by mapping key financial variables to their biological counterparts:

Liquidity as Circulating Blood Volume: Liquidity can be interpreted as the equivalent of circulating blood volume in the cardiovascular system. Just as adequate blood volume ensures the proper functioning of organs by delivering oxygen and nutrients, sufficient liquidity enables firms to meet short-term obligations, sustain operations, and respond to unexpected demands. A deficiency in liquidity resembles hypovolemia (low blood volume), leading to operational stress, reduced responsiveness, and potential organ failure (business unit shutdowns or bankruptcy) [6].

Profitability as Metabolic Energy Generation: Profitability corresponds to the effective flow of resources through the system, analogous to cardiac output or metabolic energy generation in biological organisms. It reflects the firm's ability to produce value from its assets and sustain its internal processes. Declining profitability can be interpreted as reduced systemic efficiency, impairing the firm's capacity to maintain equilibrium and invest in growth. Just as metabolic dysfunction leads to organ deterioration, sustained unprofitability erodes firm viability [4], [5].

Leverage as Vascular Resistance: Leverage, in turn, is analogous to vascular resistance or systemic pressure in the circulatory system. Higher levels of debt increase financial strain, much like elevated vascular resistance increases blood pressure. While a certain level of pressure is necessary to maintain flow and enable growth (through debt-financed investment), excessive leverage can destabilize the system, leading to financial distress, credit constraints, and ultimately default [1], [6]. This mirrors hypertension in physiology, where excessive pressure damages organs and impairs function.

Feedback Mechanisms and Financial Regulation

In the RAAS, a decrease in blood pressure triggers the release of renin from the kidneys, initiating a cascade that ultimately increases vascular resistance (through angiotensin II) and fluid retention (through aldosterone), thereby restoring equilibrium. This process exemplifies a closed-loop regulatory system where sensors detect deviations, effectors implement corrective actions, and the system returns to homeostasis.

Similarly, in a firm, a decline in liquidity or profitability activates financial responses such as cost reduction, debt restructuring, asset sales, or capital injection [8]. These actions can be interpreted as regulatory mechanisms aimed at restoring financial balance. Conversely, excessive leverage may trigger corrective measures such as deleveraging, dividend cuts, or equity issuance to reduce systemic pressure [1].

The key insight is that financial stability does not arise from static conditions, but from the continuous activation of feedback mechanisms that counteract deviations [3]. This aligns with the concept of financial homeostasis, where equilibrium is maintained dynamically rather than statically. Firms that possess strong feedback mechanisms—such as flexible cost structures, access to credit markets, and adaptive management—are better able to maintain homeostasis in the face of shocks [2].

Implications for Financial Statement Analysis

This biologically inspired perspective has important implications for how financial statements are interpreted. Instead of analyzing ratios in isolation, it becomes necessary to consider:

- **The interaction between liquidity, profitability, and leverage:** How changes in one variable propagate through the system and affect the others.
- **The direction and magnitude of their changes over time:** Whether variables are converging toward equilibrium or diverging into instability.
- **The presence of stabilizing or destabilizing feedback loops:** Whether the firm's regulatory mechanisms are functioning effectively or amplifying disturbances.

Under this framework, a firm with moderate but well-balanced financial indicators may be more stable than one with strong but highly volatile metrics. For example, a firm with moderate profitability, adequate liquidity, and controlled leverage may exhibit robust homeostasis, while a firm with high profitability but extreme leverage and volatile liquidity may be on the brink of instability [7]. Thus, financial health is redefined as the ability to maintain controlled dynamic behavior rather than achieving optimal static values.

Toward a Homeostatic View of Financial Stability

The analogy with the Renin–Angiotensin–Aldosterone System provides a conceptual foundation for redefining financial stability as a form of homeostasis. Firms, like biological organisms, must continuously adjust to internal and external disturbances to survive and grow. This perspective supports the development of dynamic models and indices—such as the proposed Financial Homeostasis Index (FHI)—that capture not only the state of financial variables but also their regulatory behavior [8].

By integrating concepts from physiology and systems theory, financial analysis can move toward a more holistic and realistic representation of firm dynamics. This approach recognizes that stability is an emergent property of feedback regulation, not a static attribute, and that understanding these regulatory mechanisms is essential for predicting financial distress and guiding managerial decisions [3], [15].

VI. Financial Homeostasis Index (FHI) And Empirical Application To América Móvil

Definition of the Financial Homeostasis Index

To operationalize the concept of financial homeostasis, this study proposes a Financial Homeostasis Index (FHI) defined as a weighted combination of normalized financial variables:

$$FHI = w_1 L_{norm} + w_2 R_{norm} + w_3 (1 - D_{norm})$$

where:

- **L_{norm}**: Normalized liquidity
- **R_{norm}**: Normalized profitability
- **D_{norm}**: Normalized leverage
- **w₁, w₂, w₃**: Non-negative weights such that $w_1 + w_2 + w_3 = 1$

The inclusion of the term $(1 - D_{norm})$ reflects the inverse relationship between leverage and financial stability, consistent with the regulatory interpretation of systemic pressure. Higher leverage increases financial risk and reduces homeostatic capacity, analogous to how elevated vascular resistance strains the cardiovascular system [1], [6].

Normalization Procedure

To ensure comparability across variables with different units and scales, each financial indicator is normalized within a sector-specific range:

$$X_{norm} = \frac{X - X_{min}}{X_{max} - X_{min}}$$

This transformation scales all variables to the interval [0, 1], allowing their aggregation without distortion due to differences in magnitude or units. The minimum and maximum values (X_{min} , X_{max}) are determined based on industry benchmarks or historical data for the relevant sector, ensuring that normalization reflects realistic operating conditions [8].

Economic Interpretation

The FHI provides a scalar measure of financial stability:

- **FHI → 1**: High financial homeostasis, indicating a stable system with balanced liquidity, strong profitability, and controlled leverage.
- **FHI → 0**: Low homeostasis, indicating financial stress or instability with constrained liquidity, weak profitability, or excessive leverage.

From a systems perspective, the index captures the balance between resource availability (liquidity), value generation (profitability), and systemic pressure (leverage). From a biological standpoint, analogous to the Renin–Angiotensin–Aldosterone System, it reflects the ability of the system to maintain equilibrium through regulated interactions [3]. Firms with higher FHI values are expected to exhibit greater resilience to shocks and lower probability of financial distress [8], [14].

Empirical Application: América Móvil

To illustrate the applicability of the proposed index, the FHI is computed for América Móvil, a leading telecommunications firm operating in a capital-intensive environment. América Móvil is one of the largest mobile network operators in Latin America, with significant infrastructure investments and exposure to competitive and regulatory pressures.

Data and Proxies

The following financial ratios are used as proxies for the state variables, based on recent financial disclosures:

- **Liquidity (L):** Current Ratio ≈ 0.75
- **Profitability (R):** Return on Assets (ROA) $\approx 3\%$ (0.03)
- **Leverage (D):** Debt-to-Equity Ratio ≈ 2.5

These values are consistent with the capital-intensive nature of the telecommunications sector, where high leverage is common due to infrastructure financing requirements [1].

Normalization

Using representative sector ranges for telecommunications firms:

- **L** \in [0.5, 1.2]
- **R** \in [0, 0.10]
- **D** \in [1, 3.5]

The normalized values are computed as:

$$L_{norm} = \frac{0.75 - 0.5}{1.2 - 0.5} = \frac{0.25}{0.7} \approx 0.36$$

$$R_{norm} = \frac{0.03 - 0}{0.10 - 0} = 0.30$$

$$D_{norm} = \frac{2.5 - 1}{3.5 - 1} = \frac{1.5}{2.5} = 0.60$$

Weight Selection

Given the capital-intensive nature of the telecommunications sector and the critical role of leverage in determining financial stability, greater importance is assigned to leverage in the weighting scheme:

$$w_1 = 0.3, \quad w_2 = 0.3, \quad w_3 = 0.4$$

This weighting reflects the empirical finding that leverage is a dominant factor in financial distress for capital-intensive firms [14].

FHI Calculation

Substituting the normalized values and weights into the FHI formula:

$$FHI = 0.3(0.36) + 0.3(0.30) + 0.4(1 - 0.60)$$

$$FHI = 0.108 + 0.090 + 0.4(0.40)$$

$$FHI = 0.108 + 0.090 + 0.160 = 0.358 \approx 0.36$$

Results Interpretation

The estimated FHI value of approximately 0.36 indicates a **moderate level of financial homeostasis** for América Móvil. While the firm maintains stable operations supported by consistent cash flows and a reasonable profitability level, its relatively high leverage (debt-to-equity ratio of 2.5) introduces structural pressure that limits overall stability. The normalized leverage of 0.60 (meaning the firm is at 60% of the maximum observed leverage in the sector) significantly reduces the FHI through the term $(1 - D_{norm}) = 0.40$.

From a dynamic perspective, this suggests that América Móvil operates under a **regulated but constrained regime**, where continuous adjustments are required to maintain equilibrium. The firm must carefully manage debt servicing obligations while generating sufficient profitability to sustain liquidity. Any significant shock—such as a decline in revenue due to increased competition, regulatory changes, or macroeconomic downturns—could push the system toward instability [2].

The result is consistent with the behavior expected in large telecommunications firms, where debt financing plays a central role in sustaining infrastructure investments and network expansion [1]. However, the moderate FHI value suggests that América Móvil has limited buffer capacity to absorb adverse shocks without triggering financial stress. This finding aligns with empirical studies showing that leverage and profitability strongly affect financial performance and that high leverage increases the probability of financial distress [5], [6], [14].

Link to the Dynamic Model

The FHI can be interpreted as a **steady-state proxy** of the dynamic system defined by the differential equations in Section 3. While the dynamic model captures the evolution and feedback mechanisms of financial variables over time, the FHI provides a simplified measure of the system’s position relative to equilibrium at a given point in time.

Specifically, the FHI reflects the balance of forces in the system:

- High L_{norm} and R_{norm} indicate strong positive feedback loops (liquidity-profitability interaction).
- High D_{norm} indicates strong systemic pressure (leverage-induced liquidity drain).

The moderate FHI value for América Móvil suggests that the firm is near an equilibrium point, but with limited stability margin. In terms of the Jacobian analysis (Section 4), this corresponds to a situation where the eigenvalues of the system have negative real parts (stable equilibrium) but with relatively small magnitudes, indicating slow convergence and sensitivity to parameter changes.

Thus, both approaches are complementary:

- **The dynamic model explains how stability is achieved** through feedback regulation and identifies the conditions for equilibrium.
- **The FHI quantifies the degree of stability observed** at a specific point in time, providing a practical metric for empirical analysis.

Comparative Context

To provide context, we can compare América Móvil's FHI with hypothetical benchmarks:

- **FHI > 0.7:** Strong homeostasis, typical of firms with low leverage, high liquidity, and robust profitability (e.g., mature technology firms with strong cash generation).
- **FHI \approx 0.5:** Moderate homeostasis, typical of stable industrial firms with balanced financial structures.
- **FHI < 0.3:** Weak homeostasis, indicating financial stress or high risk of distress (e.g., highly leveraged firms in declining industries).

América Móvil's FHI of 0.36 places it in the **lower-moderate range**, reflecting the structural challenges of operating in a capital-intensive sector with high leverage. This suggests that while the firm is not in immediate distress, it requires vigilant financial management to maintain stability [8].

VII. Discussion

Key Findings

This study has introduced a novel Financial Homeostasis Model that conceptualizes firms as adaptive systems regulating liquidity, profitability, and leverage through feedback mechanisms analogous to the Renin–Angiotensin–Aldosterone System. The main findings can be summarized as follows:

Dynamic Feedback Structure: The proposed system of differential equations captures the interdependencies among core financial variables, revealing that stability emerges from balanced feedback loops rather than from isolated ratio values [1], [3]. The Jacobian stability analysis formalizes the conditions under which financial homeostasis is achieved, showing that damping mechanisms (profitability decay and leverage reduction) must counterbalance positive feedback loops (liquidity-profitability and liquidity-leverage interactions).

Biological Analogy: The RAAS analogy provides a conceptual framework for understanding financial regulation as a homeostatic process. Just as physiological systems maintain equilibrium through continuous feedback adjustments, firms regulate their financial variables to sustain stability in the face of internal and external shocks [3]. This perspective shifts the focus from static ratio analysis to dynamic regulatory behavior.

Financial Homeostasis Index: The FHI operationalizes the homeostasis concept, providing a practical metric for quantifying financial stability. The empirical application to América Móvil demonstrates that the index captures the balance among liquidity, profitability, and leverage, with the firm's moderate FHI value (0.36) reflecting constrained stability due to high leverage [5], [6].

Empirical Insights: The analysis of América Móvil highlights that financial stability is not solely determined by strong individual indicators, but by the balance among them. In particular, the results underscore the dominant role of leverage in shaping the firm's homeostatic condition, consistent with empirical findings that leverage significantly affects financial performance and distress probability [14].

Theoretical Contributions

This study makes several theoretical contributions to the literature on financial analysis and corporate finance:

Integration of Dynamic Systems and Finance: By developing a formal dynamic model with explicit feedback mechanisms, this work advances beyond traditional static ratio analysis and contributes to the growing literature on system dynamics in corporate finance [1], [2], [3]. The use of differential equations and Jacobian stability analysis provides a rigorous mathematical foundation for understanding financial stability as an emergent property of dynamic interactions.

Biological Inspiration in Finance: The application of the RAAS analogy to financial regulation represents a novel interdisciplinary contribution, bridging concepts from physiology and corporate finance. While biological

analogies have been proposed conceptually [3], [15], this study provides a concrete mathematical formulation grounded in regulatory feedback mechanisms. This approach opens new avenues for applying insights from biological systems to economic and financial modeling.

Homeostasis as a Unifying Concept: The concept of financial homeostasis provides a unifying framework for understanding how firms maintain stability. Unlike traditional equilibrium models that assume static optimality, the homeostasis perspective recognizes that stability is a dynamic process requiring continuous adjustment [2], [3]. This aligns with recent research emphasizing resilience, adaptation, and feedback-driven behavior in complex systems.

Practical Implications

The proposed framework has several practical implications for financial analysts, managers, and policymakers:

Enhanced Financial Analysis: The FHI provides a complementary tool to traditional ratio analysis, capturing the balance among liquidity, profitability, and leverage in a single metric. Analysts can use the FHI to assess financial stability more holistically, identifying firms that may appear healthy based on individual ratios but exhibit imbalanced feedback structures [7], [8].

Early Warning System: The dynamic model and FHI can serve as components of an early warning system for financial distress. Firms with low FHI values or unstable dynamic behavior (positive eigenvalues in the Jacobian) may be at higher risk of distress, enabling proactive intervention [14].

Strategic Financial Management: Managers can use the framework to guide strategic decisions regarding capital structure, liquidity management, and investment policy. By understanding the feedback mechanisms that govern financial stability, managers can design policies that enhance homeostatic capacity and resilience to shocks [1].

Regulatory and Policy Applications: Policymakers and regulators can apply the framework to assess systemic risk and financial stability at the firm or sector level. The homeostasis perspective emphasizes the importance of feedback mechanisms and dynamic interactions, which are critical for understanding systemic vulnerabilities [3].

Limitations

Several limitations of this study should be acknowledged:

Model Simplification: The proposed dynamic model is a simplified representation of complex financial interactions. Real firms are subject to numerous additional factors, including market conditions, competitive dynamics, regulatory constraints, and managerial decisions, which are not explicitly captured in the model. Future research could extend the model to incorporate additional variables and nonlinear interactions [2].

Parameter Estimation: The system parameters (α , β , γ , δ , ϵ , ζ) are not empirically estimated in this study. Calibrating these parameters using real financial data would enhance the model's predictive power and enable more precise stability analysis. Econometric techniques such as structural estimation or Bayesian inference could be employed for parameter identification [12].

Static FHI Application: While the FHI is derived from a dynamic model, its empirical application in this study is static, based on a single point in time. A longitudinal analysis tracking the FHI over time would provide deeper insights into how financial homeostasis evolves and how firms respond to shocks [8].

Sector Specificity: The normalization ranges and weights used in the FHI calculation are sector-specific. Applying the framework to other industries would require recalibration of these parameters based on industry benchmarks. Future research could develop sector-specific FHI models and compare homeostatic patterns across industries [4], [5].

Causality and Endogeneity: The dynamic model assumes specific causal relationships among liquidity, profitability, and leverage. However, these relationships may be subject to endogeneity and reverse causality. Advanced causal inference techniques, such as dynamic Bayesian networks or instrumental variable methods, could be used to validate the assumed causal structure [12].

Future Research Directions

Several promising directions for future research emerge from this study:

Empirical Validation: Conducting large-scale empirical studies to validate the dynamic model and FHI using panel data from multiple firms and industries. This would involve estimating system parameters, testing stability conditions, and assessing the predictive power of the FHI for financial distress and firm performance [4], [5], [6].

Extension to Nonlinear Dynamics: Incorporating nonlinear terms and threshold effects into the dynamic model to capture more complex behaviors such as financial crises, regime shifts, and chaotic dynamics. Research has shown that excessive liquidity can generate instability through nonlinear feedback [2], suggesting that nonlinear extensions could enhance model realism.

Integration with Machine Learning: Combining the dynamic model and FHI with machine learning techniques to improve prediction accuracy and identify patterns in financial data. Hybrid approaches integrating econometric models and machine learning have shown promise in financial analysis [4].

Multi-Firm and Systemic Analysis: Extending the framework to model interactions among multiple firms, capturing contagion effects, systemic risk, and network dynamics. This would align with research on systemic financial feedbacks and macroprudential regulation [3].

Behavioral and Managerial Factors: Incorporating behavioral and managerial factors into the model, such as managerial overconfidence, risk preferences, and strategic decision-making. This would provide a more comprehensive understanding of how human factors influence financial homeostasis [15].

Longitudinal Case Studies: Conducting in-depth longitudinal case studies of firms experiencing financial distress or recovery, tracking the evolution of the FHI and dynamic behavior over time. This would provide rich qualitative insights into the mechanisms of financial homeostasis [8].

VIII. Conclusions

This paper has introduced a novel Financial Homeostasis Model that reinterprets financial stability through the lens of biological regulation, specifically the Renin–Angiotensin–Aldosterone System. By conceptualizing firms as adaptive systems that regulate liquidity, profitability, and leverage through feedback mechanisms, the proposed framework advances beyond traditional static ratio analysis and provides a more comprehensive understanding of how firms maintain equilibrium in complex and uncertain environments.

The main contributions of this study are threefold. First, a system of differential equations is developed to model the dynamic interactions among core financial variables, with stability conditions derived through Jacobian analysis. This formalization reveals that financial homeostasis emerges from balanced feedback loops, where damping mechanisms counteract positive feedbacks to maintain stability. Second, a biologically inspired interpretation of financial statements is provided, mapping liquidity, profitability, and leverage to physiological functions and emphasizing the role of continuous regulatory adjustments. Third, a Financial Homeostasis Index (FHI) is proposed as a practical metric to quantify stability, bridging dynamic theory and empirical application.

The empirical application to América Móvil demonstrates the utility of the framework. With an FHI value of 0.36, the firm exhibits moderate financial homeostasis, constrained by high leverage typical of capital-intensive telecommunications operations. This finding underscores that financial stability is not determined by strong individual ratios in isolation, but by the balance and interaction among liquidity, profitability, and leverage. The analysis highlights the dominant role of leverage in shaping homeostatic capacity and the need for continuous financial management to maintain equilibrium.

From a theoretical perspective, this study contributes to the growing literature on dynamic systems in corporate finance, systemic financial feedbacks, and interdisciplinary approaches to economic modeling. The biological analogy provides a fresh conceptual lens for understanding financial regulation, while the mathematical formulation offers a rigorous foundation for future research. From a practical perspective, the FHI provides a complementary tool for financial analysts, managers, and policymakers, enabling more holistic assessment of financial stability and early detection of distress risk.

Several limitations and future research directions have been identified. Empirical validation using large-scale panel data, extension to nonlinear dynamics, integration with machine learning, and incorporation of behavioral factors represent promising avenues for advancing the framework. Longitudinal case studies and multi-firm systemic analyses could further enrich our understanding of financial homeostasis in practice.

In conclusion, the Financial Homeostasis Model offers a novel and integrative perspective on financial stability, emphasizing the dynamic, feedback-driven nature of financial regulation. By bridging concepts from

physiology, systems theory, and corporate finance, this framework provides a foundation for more realistic and comprehensive financial analysis, ultimately contributing to better understanding and management of firm stability in an increasingly complex and volatile business environment.

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