International Journal Of Business Management
Available at www.ijbm.co.in
ISSN NO. 2349-3402
VOL. 2(1),2015

IS Financial Innovations boon or bane: Indian Economy

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Abstract

Financial innovation is not a recently generated phenomenon as it has a long history of success and proven benefits that have left great impact on the Indian economy. Innovation is a broadly positive force within financial services. Financial Innovation is playing a vital role for the redical changes underwent by international and domestic financial markets . The approach adopted in the paper is covering these aspect of financial innovation: Concept , features and forms of financial innovation, its determinants and its effects . In this paper i have discussed the impact of these financial innovations on financial markets and the development of Indian economy. There are also many financial innovations that have had a significant positive effect on the economy like Venture Capital and also various financial technologies like National Electronic Fund Transfer (NEFT), Mobile-Banking. E-banking have played a significant role in changing India. With time all these innovations have become a crucial part of India and have brought many improvements in the financial environment of the country necessary to meet the needs of present global turbulent financial environment. Appropriate efforts should be taken to promote the innovations in the financial sector for continued growth and development as these innovation and technologies drive economic growth and increase standards of living.

Keywords: Innovation, Technology, Indian economy, financial environment, economic growth.

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VOL. 2(1),2015

Introduction

Financial innovation defined as, ”design of any new financial product” . It is normally defined as the introduction of a new product to a market or the production of an existing in a new manner.Financial innovations occur because market participants are constantly searching for new ways to maximize profitability.In order to expand access to capitalover to stimulate economic development, there is need of creative ideas as well as financial innovation. Innovations in products and services have been continuously boosted.

It is the act of creating and then popularizing new financial instruments, as well as new financial technologies, institutions, markets and business models with its application. The innovations are sometimes divided into product or process variants, with product innovations exemplified by new derivative contracts, new corporate securities, or new forms of pooled investment products, and process improvements typified by new means of distributing securities, processing transactions, or pricing transactions.

Financial innovations are broadly classified into three categories. These are based on whether they (a)facilitate the transfer of value through time;

(b) allow the ability to contract on future values

(c) permit the negotiability of claims.

.The term financial innovation has broad range of implicit and explicit definitions..It usually implies progress as well, but it is not necessarily be case. Roger(1995, p. 11)defines innovation as an idea practice, or object that is perceived as new by an individual or other unit of adoption. Innovation is a two-edged sword and the internet has been a great boon to all society, but it also promotes pornography, fraud and a great deal of time wasting activities. Innovation in financial services is no exception of it but it has done considerably more good than harm.

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Objectives of the Study:

1. **To give an insight about the innovation of financial sector.**
2. **To highlight the black and white side of financial innovation.**
3. **To highlight the role of financial innovation on financial development.**

Survey Of Literature

Scherer and Ross (1990) suggested that smaller firms may be more comfortable to become rapid innovators if Research & Development in larger firms is undermined by loss of managerial control and/or a bureaucratic approach to innovation. Schumpeter (1942) states that large firms prefer to go for innovation becayseResearch & development projects usually involve huge expenses that can only be recovered with exhaustive sales. They enjoy scale and scope economies in the process of innovation and have relatively better access to external monetary resources. In a model developed by Aron and Lazear (1990), new (or start-up) firms are more likely to initiate new research programs and introduce new products that may result in higher profits over the longer term. Another factor that is differentiating new and existing firms is Cannibalization. Unlike new firms, incumbents must consider potential lost revenues from sales of an existing product if it is a near-substitute for the innovation. An existing firm might also suffer if the cost of producing the current product is adversely affected by the introduction of a new one, possibly causing scope diseconomies.

B hattacharyya and Nanda (2000) show that higher market share and more developed client relationships increase the incentive of investment banks to innovate. Technological shocks stimulate innovation: Shocks to technology are thought to provide a “supply-side” explanation for the timing of some innovations. IT and other inventions and innovations in telecommunications has facilitated a number of

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innovations (not all successful), including new methods of underwriting securities, new methods of assembling portfolios of stocks (folioFN), new markets for securities and new means of executing security transactions. White (2000) articulates this technological view of financial innovation.

Main functions of Financial Innovation

Merton's (1992) and Crane et al.'s 8 (1995) schemes share the feature of looking through to the underlying functions performed by the innovations. In particular, they identify six functions that innovations—and more generally, economies—perform:

- Moving of funds across time and space (e.g., savings accounts);
- share the feature of looking through to the underlying functions performed by the innovations
- The pooling of funds (e.g., mutual funds) .
- Facilitating the sale or purchase of goods and services through a payment system (e.g., cash, debit cards, credit cards).
- Managing risk (e.g., insurance and many derivatives products)
- Extracting information to support decision-making (e.g., markets which provide price information, such as extracting default probabilities from bonds or credit default swaps)
- Addressing moral hazard and asymmetric information problems (e.g., contracting by venture capital firms)
- It provide the ways of clearing and settling payments to facilitate trade
- Facilitate in transferring economic resources across boarders and among industries
- Through online banking the user can instantly transfereing money from muitipal accounts

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Determinants of Financial Innovation

There are interactive relationship among different determinants and financial innovation. An analysis of literature shows that technological, market and and regulatory factors are the major determinants of financial innovation. Llewellyn (1992) emphasizes that, "financial innovation should be viewed as a reflection and partly a cause of structural changes evident in many financial system." These are the major determinants of financial innovation:

- Macroeconomic conditions
- Technology
- Policy and Regulation
- Globalization
- Customer Needs
- Increased competition

Here macroeconomic conditions means changes in general economic and political conditions as high level of inflation, Increase in volatility of interest and foreign exchange rates, decreased economic growth. Increased customers need leads to increase in the wealth and sophistication of market participants in most world economies to increased diversity of new financial instruments .Many financial innovations are occurred post 1980s when most developing countries implemented deregulatory policies which leads to increase in competition and requirement of innovation is felt to meet the increased competition. Globalization made is necessity of Financial Innovation in order to managing risk by cross boarder financial trade, new investment vehicles and rise to hedge funds

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Driving forces behind Financial Innovation:

It is generally believed (cf. Merton 1990) that the driving forces behind financial innovation fall s into three categories

(a) A demand for opportunities for risk sharing, risk pooling, hedging and intertemporal or spatial transfers of wealth that are currently not available.

(b) The lowering of transactional cost

(c) Reduction in agency cost

Apart from it there are some other forces required for the success of financial innovation in future are

- Well trained human capital
- Smooth flow of investments into the market to facilitate future innovation efforts.
- Development of technological leadership.
- Ability to adapt to changes in innovation projects in financial markets.
- Facing dynamism in public support systems for innovations.

Benefits of Financial Innovation

Here is the list of some of the financial innovations since 1960's which proved significantly more positive than negative

- Automated Teller Machines (ATMs)
- Increased usage of Credit cards
- Treasury Inflation protected securities(TIPS)
- Massive Use of Debit cards
- Credit scoring to assist in lending decisions
- Money Market funds
- Indexed Mutual funds

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- Exchange traded Funds
- Securitization
- Venture Capital
- Currency Swaps

The creation of technological advanced product have increased the available credit for the borrowers and given the banks a way out to raise equity capital in a new and economical way . Financial innovation is beneficial for financial system. Certainly, the world economy benefits from financial innovation through increased level of saving and increased level of economic growth. Further benefits of financial innovation are as :it reduces agency, transactional costs and intermediaries costs; improve risk allocation, market efficiency and economic growth; minimizes the impact of taxes and regulation and volatility of economic activities.

Constraints of financial innovation

Constaints to innovation are usually the high costs and perception of risk in a volatile market. Firms that protect their innovation via parents or strategies moves do neither generate greater revenue, which confirms the common view that financial innovations are too easily copied. Similarly financial innovations are considered as root cause for financial crises. New and complex financial products are blamed for the reduction of transparency.

The above said constraints can be reduced through overhaul rating agencies, new product transparency, Resist over regulation, Promote risk management and strengthen infrastructure

Financial innovation and development

financial innovation can be defined as the emergence of new financial product or service, new organizational form, or new processes for a more developed and

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complete financial markets that reduce costs and risks, or provide an improved service that meets particular needs of financial system participants. It helps to reduce the costs of production and better satisfy the customers' needs, and yield higher profits. The transformation of the payments mechanism for goods and services that starts with the invention of the plastic cards would have a large impact on the demand for cash and its role in the economy. Financial innovation enhances sustainability of institutions and their outreach to the poor by meet demand for variety, convenience and new services. Such innovations affects the financial sector as a whole, relate to changes in business structure, to the establishment of new types of financial intermediaries or to change in legal and supervisory framework. It reduces access barriers for women and set up completely new structure. So it can be said that Rapid innovation is changing the array of financial services and payment options available to customers while causing uncertainty and complexity. Development in payment systems and media create a very close substitute for the notes from the banks and thus affecting the core value and part of central banking (Karl, 2011). A perfect example is the use of debit and credit cards which allow for the application of electronic means of payment. This greatlysubstitutes payments by physicalcash and speeds up the velocity of narro w money

Conclusion

These financial innovations and technologies have become vital part of the financial system of India and they have also brought many improvements in the financial environment of the country that is necessary to meet the competition and the needs of dynamic financial environment of the world. So, the role of the financial innovations in the present financial system of today should be properly understood to reduce the

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complexities and take full advantage of these innovations. The growth of the financial innovations in the financial sector should be promoted in every possible manner for continued growth and development as these innovation and technologies drive economic growth and economic development of the country.

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