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FINANCIAL INNOVATION: AN INFLUENTIAL TOOL FOR GROWTH

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ABSTRACT

Financial innovation has replaced the driving forces of promoting economic growth and considered as front runner by various nations for its acceleration. Achieving high quality economic growth with maintaining its sustainability is burning issue and financial innovation is the key for opening the path of this journey. The aspiration for making more profit by searching new ways is the main reason behind the occurrence of financial innovation. Financial innovation has provided many new financial products to the financial institutions and also stands as a strong pillar for financial development as well. The concept which is strategic in nature will prove worthwhile only if it will facilitate sustainability in the financial sector of an economy. This paper has aimed at understanding the concept of financial innovation and discussing the various segments where it is prevalent and exploring.

KEYWORDS: ***Financial Innovation, Technological Innovation, Sustainable Development***

INTRODUCTION

Financial innovation is strategic in nature and an economy will have fruitful results only if its sustainability can be assured in long run. The zeal of earning greater profits is a key driving force behind the emergence of financial innovation and every market participant wants to earn these higher profits but at the cost of bearing minimum risk. Fundamentally, there is an inverse relationship between profits and risk, but financial innovation aims at avoiding and reducing the risk element in various schemes and financial products originated under its flagship. So, financial innovation makes an attempt to provide such financial services and instruments which are more profitable in nature.

Globalization has also played a vital role in raising the demand for this concept as reducing cross border restrictions has increased the volatility factor in the financial markets and which ultimately multiplied the risk factor in monetary transactions in these markets. Globalization has pushed up the deregulation and reduced the restrictions on the flow of foreign capital in economy in various sectors and facilitated the promotion and use of newly innovated financial instruments in financial and insurance sector for increased profitability. On the other hand, competition has also increased because of globalization and financial innovation has widespread as a significant tool for facing and overcoming this. The interdependence between competition and financial innovation has also magnificent effect.

Regulatory monetary authorities also participate in the process of financial innovation directly or indirectly by imposing or relaxing restrictions on the financial institutions and new financial instruments comes as a solution in different situation for benefiting the market participants. It is not always necessary that all financial innovations have a positive beneficial impact for the consumers but it may also have negative impact. The interest of the market participants must be protected and this leads to the importance for the role of monitory authorities to interfere and maintain a financial stability. That's why these financially innovated products are issued in respective markets which are regulated by set of rules and laws by a monetary authority.

The rest of the paper is structured as follows: section II presents the objectives of the study and section III explains the methodology follows for this paper. Further, section IV briefly shows the reviewed literature for this area under study. Afterwards, section V explains the meaning of the concept of financial innovation and section VI discusses the various types of financial innovation. Finally, section VII concludes the paper.

OBJECTIVES

This research paper aims to achieve the below mentioned objectives:

1. To discuss the concept of financial innovation
2. To explain the types of financial innovation

RESEARCH DESIGN

This study is exploratory in nature and the concept of financial innovation has been studied for understanding its importance for the financial sector and economy. The study has used secondary data for exploring its depth and intensity.

LITERATURE REVIEW

This section gives a glimpse of the already available literature in the area of financial innovation and the key studies has been discussed as under:

Zixing Wang et.al (2022) studied the impact on economic growth by taking the variables financial innovation and technological innovation under consideration and applied regression analysis of fixed effects models. The results presented that financial innovation and technological innovation have a considerable impact in boosting economic growth. However, full use of foreign businessmen and maintaining the increase in natural population growth has also been used as an important parameter in economic growth.

Folorunsho M. Ajide (2016) investigated the effect of financial innovation augmented with bank competition on sustainable development in eight West African countries. The results of the study has confirmed that after using panel data an increase in banking efficiency driven by competition and financial innovation would improve economic growth and development. The results revealed differential effect of different financial product adopted in financial system. The study has concluded that policies which would drive competition and efficiency in the banking industry as well as financial innovation should be introduced to ensure effective functioning of the financial system.

Dr. R Ramakrishnan (2017) discussed the relationship between financial innovation and regulation and explained that there should be some modifications in the regulatory system for facilitating the financial innovation in the economy. The concept of financial innovation has also elaborated in relation to its various impacts and functions.

Professor Michael Mainelli & Simon Mills (2016) emphasized that tools of financial system ar very helpful for achieving sustainable development goals provided there is an element of sustainability in these tools itself. The study discusses the financial innovation in different areas like blockchain technology for mutual distributed ledgers, digital currencies, mobile money, policy performance bonds etc.

Morarji A. (2015) explained the significance of financial innovation and further discussed that how with the changing technology and deregulation in Indian capital market has made it possible to adapt and facilitate newly innovated financial instruments for growth and profitability. The paper has suggested various types of financial products for Indian capital market and also suggested that these should be used with cautious also.

MEANING OF FINANCIAL INNOVATION

Finance is a significant resource for any organization whether it is private or government and it flow like blood in a human body and just like the survival of a human being is not possible without blood on the same line, the organization will stop functioning sooner or later without the sufficient finance. Organization needs funds for arrangement of infrastructure and running its business and investors demands profitable ventures on which they can invest their savings at minimum risk. In ongoing changing and complex business world there is need of such financial instruments which can fulfill the requirement of both organizations and investors respectively in terms of risk and return.

Innovation is the only measure for meeting the demand of such investor ventures which can benefits the end party by avoiding or mitigating related risk. Further, in a competitive era every business enterprise facing risk at micro and macro level and for overcoming these factors it is essential for every organization to utilize such risk mitigating financial instruments. It is not necessary that there will be some invention in this area so innovation can be used as an effective tool for searching and producing financial products which are meant for modern economy and are able to satisfy the needs of market participants.

Therefore, innovation in financial sector has proved as milestone in bringing creativity in financial products and services while keeping in mind the element of risk factor. These days financial innovation has become an important tool, which enables business enterprises for competing in highly global and competitive environment. Without the application of financial innovation no one can guarantee any success in future, however, there is a possibility of facing sluggishness in business. So, every business firm must use financially innovative products for their survival and healthy growth.

Financial innovation is a course of action which includes developing new financial instruments by using new financial technologies and popularizing and facilitating these instruments in financial institutions and markets. The technological advancement in financial sector leads to easy access of information and modes of trading and financial innovation opens the doors for the emergence of new financial instruments. The new forms of business firms and more developed and technology equipped financial markets all are the part of financial innovation. So, financial innovation focused on the following key areas which are presented in Figure No. 1:

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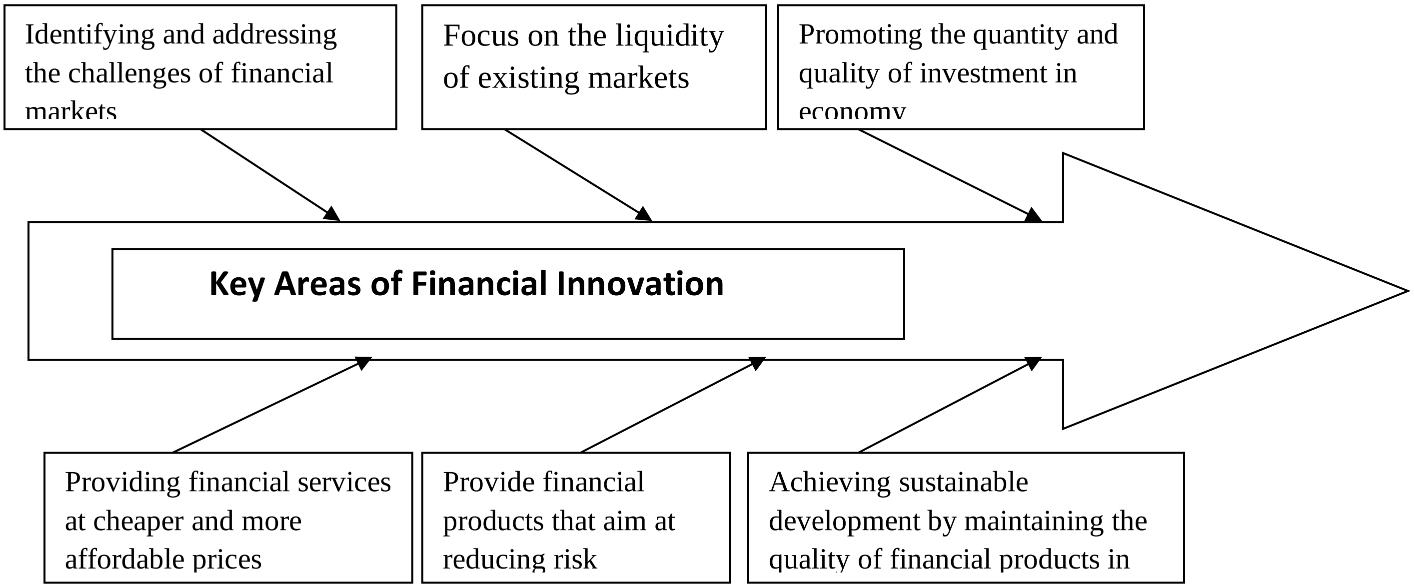

Figure No. 1: Key Areas of Financial Innovation

TYPES OF FINANCIAL INNOVATION

Financial innovation which covers innovation related to financial products, financial services, financial markets and financial institutions can be divided in three categories (Morarji A., 2015)

1. Process Innovation: The more efficient method is formulated for providing existing financial products or services.
2. Product Innovation: It includes the innovation of all together a new financial product which does not already exist in financial markets.
3. Institution Innovation: This is associated with institution and includes changes in the framework or structure of business enterprise and also establishes new type of intermediaries. In this category there will a requirement of changes or formulation of legal frameworks for the related institution.

Further, financial innovation has been discussed under following sections:

1. Financial Innovation in Indian Banking Industry

Indian banking industry has created landmarks in its history from establishment of Banking Regulation Act, nationalization of banks, privatization and mergers of banks from time to time. With this remarkable journey, the banking industry has also adopted new technological advancement in its system and also come up with newly innovated products, schemes and system for its clients. The products and services which are innovated under this industry are listed below:

i) Debit Card
ii) Credit Card
iii) Automated Teller Machine (ATM)
iv) Internet Banking
v) E-Banking
vi) Mobile Banking
vii) Real Time Gross Settlement (RTGS)
viii) Electronic Clearance Service (ECS)
ix) National Electronic Fund Transfer (NEFT)
x) Cheque Truncation System (CTS)
xi) Corporate Banking
xii) Digital Wallet
xiii) Banking Apps/Payment Apps like PAYTM, BHIM, PHONE, PAY etc
xiv) Banking system like Unified Payment Interface (UPI)
xv) Central Bank Digital Currency (CBDC)
xvi) Banking Services on Smart Watch

2. Financial Innovation in Indian Capital Market

Indian capital market is a platform where companies and investors irrespective of geographically boundaries come in contact with each other for the purpose of raising and investing funds. With the changing time where each and every day a new technology is hitting the economy and markets, this place is not untouched with this technologically advancement and a number of innovated products, services and modes of operations have been identified and applied which are discussed below:

i) Indian Depository Receipts
ii) Non-Voting Shares
iii) Inflation Linked Bonds
iv) Junk Bonds
v) Floating Rate Bonds
vi) Zero Interest Bonds
vii) Deep Discount Bonds

viii) Securitization of Debt
ix) Specialized Debt Funds For Infrastructure Financing
x) Mortgage Backed Securities
xi) DEMAT Account
xii) Pension Funds
xiii) Government initiatives in pension funds reforms
xiv) Green Bond
xv) Municipal Bond

3. Financial Innovation in Derivatives Market

Derivative markets deals with financial instruments which are meant for avoiding or reducing risk which may be arising from the future transactions. These contracts derive their values from the underlying asset and include different types under its flagship. This market has also benefitted from the financial innovation and utilized newly formed financial instrument for its market participants. The innovation that has taken place in this market is listed below:

i) Swap
ii) Debt for Equity Swap
iii) Equity for Debt Swap
iv) Currency Futures
v) Currency Options
vi) Stock Index Futures
vii) Stock Index Options
viii) Stock Options
ix) Stock Futures
x) Interest Rate Derivatives
xi) Credit Derivatives
xii) Weather Derivatives
xiii) Insurance Derivatives
xiv) Energy Derivatives

CONCLUSION

Financial innovation has experienced a long journey in terms of growth and achievements across different sectors and market participants has benefitted in terms of reduced risk and increased profit margin. The financial intermediaries are required to facilitate the financial innovated instruments among target market but this is also obligatory that the concerned regulatory requirements must be considered for mandatory approvals and other procedural amendments if necessary. In the era of ongoing technology advancement and deregulated capital market, innovation is the need of the market but these newly innovated financial instruments are supposed to be applied cautiously.

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