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'NEW TRENDS IN FINANCIAL INNOVATIONS'



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### ABSTRACT

The term 'Innovation' has great importance in business and industrial world. In a situation of cut throat competition, only the fit has the right to survive however, the fitness in the business system depends upon agility, efficiency, acumen and innovative approach. The simple mantra for business survival is 'Innovate or Perish'.

Innovations in the field of finance are equally important. Financial markets are extremely volatile and are influenced by a large number of determining factors. There is no single factor or segment that decides success in the financial market. As such growth and development of financial markets

depends to a great extent on innovative ideas and new techniques. The development of variety of financial instruments and products is the result of many creative ideas used effectively by the businessmen.

The main purpose of financial innovations is to make money easily available at low cost and in an efficient manner. It also helps the investors to select a right investment option and develop a suitable portfolio. The marketers can identify appropriate source of acquiring finance and reduction of financial risk. The role played by financial innovations is thus very vital for effective market development.

The present paper deals with important financial innovations and their market applications.

**KEYWORDS :** *Financial Innovations , business and industrial world.*

### INTRODUCTION

The basic purpose of a business is to create wealth. Wealth creation is the true objective of any business agency. Wealth is created in many ways. However, the principal source of wealth creation is developing a sound financial system. Financial market is rightly termed as the power houses of the economy. It streamlines the mechanism of circulation of money and monetary resources. It encourages development of channels that promotes effective and disciplined use of wealth. The flow of funds is mobilized in a systematic manner and thus returns on capital employed are multiplied. Therefore, the basic requirement of infrastructure is development of sound financial and money

markets.

Money markets are influenced by a variety of factors. Many of them are external and uncontrollable. However, the internal discipline and growth depends on the capacity, efficiency and the ability of the player. Their innovative approach and novel ways of funds deployment are in many ways responsible for promotion of a sound financial system. Hence the true catalyst for growth of financial market is the ability to innovate new instruments of finance, capability to modify the system and flexibility in changing the regulatory framework. The present paper deals with the innovative aspects related with ten developments of financial markets.

#### OBJECTIVES OF THE PAPER:-

- 1.To identify various elements responsible for financial innovation
- 2.To gain insight as to determinants of financial innovations
- 3.To understand the role played by financial innovations in development of financial and money markets
- 4.To enlist the benefits of financial innovations to investors and other stakeholders.

#### Key Terms Defined:-

- 1.Financial innovations
- 2.Financial instruments
- 3.Financial markets

#### Hypothesis:-

The growth of money market is a major phenomenon in the liberal and market driven economy. Money markets are not only the barometers but the nerves of financial system. It is difficult to imagine growth of free economy without the development of sound financial system. The very basis of sound financial system is sound financial and money market. The present paper lays down following premises:-

- a.Growth of money and financial market is responsible for advancement of economy and financial system
- b.The impetus to the development of financial market by using creative and innovative ideas

#### DISCUSSION:-

##### What drives financial innovations?

Financial innovation is a very important aspect of monetary system. The players in the capital, financial and money markets require funds for a variety of purposes. They demand money at a cheap rate however, the pricing of money as a commodity is determined by a variety of factors. Money is not an easily available resource. The fabric of financial market is woven by different types of money and money related instruments.

Unless and until money is effectively utilized, channelized and put to high return usages, its value cannot be realized. A player in money market is not interested in getting the reward for risk but at the same time, he wants a right and justifiable rate of return. If this rate of return is not maintained then the cycle of money market is disturbed to a great extent.

The determinant of demand and supply for money in the capital market are manifold. There is no one single factor that is responsible for change in the demand for money. Similarly, the usage of

money is also decided by the composition and structural aspects of money markets. Different players and stakeholders in the money markets change their positions considering the following aspects:-

- demand and supply of money
- Risk associated with usage of money
- Business, finance and market risk elements
- Expected present and future rate of return
- Opportunity cost and alternative usage of funds
- National economic scenario
- Regulatory aspects governing capital market
- Composition and constitution of financial institutions
- Changes in the international market
- Prevailing inflationary trends and growth rate of economy
- Phase of trade cycle dominating the economy
- The economic philosophy adopted by the governing agency
- Inter and intra institutional relationship
- determinants of financial innovations

#### What determines of financial innovations?

Financial innovations are the crucial inputs to improvise financial markets. These markets change the flow of funds, methods of mobilization and investor's response in a big way. However, in a volatile and uncertain market, the response cannot be determined by one single determinant. There are many dimensions and divergent factors that decide the course of funds flow from one sector to another. Similarly, contemporary market situation, international financial markets and domestic financial regulatory and economic policies also influence the diversion of funds. The principal factors that determine the financial innovations can be enlisted as follows:-

- 1.the growth stage of the economy
- 2.resource availability, resource requirement and resource crunch
- 3.type of organizations and their demands for funds
- 4.the ability and appetite to accept the risk shown by financial experts and fund managers
- 5.the mechanism of economy and development and the philosophy of economy development adopted by the managers of the economy
- 6.growth stage in which different industries in the economy are working
- 7.the extent of open and liberal approach adopted by economic managers
- 8.the various aspects of regulatory framework governing the financial systems

#### How financial innovations strengthen money markets?

Financial innovations can rightly be called as the drivers of change. It is not the shortage of funds or ample availability of funds that can provide desired returns on the funds deployed. Real mobilisation of funds is the approach and the mechanism used in a given economic system. Financial innovations actually help to optimize the rate of return by balancing the tradeoff between the risk, reward, returns and fund requirement of the sector of the economy. The role played by financial innovations is basically like a conduit which motivates the transfer of funds in adequate quantity in the desired direction.

### Financial innovations and the stakeholders:-

In every financial market, there are different stakeholders. All these stakeholders are divergent and often have opposite views. Most of the stakeholders look at finance from a unidirectional point of view, when the shareholders expect higher rate of returns and more dividend, advocate high taxation or payment of taxation from the surplus made by the company. The company that wants to have more returns, wants to retain higher amount of earning and cut the cost of capital. The creditors and bondholders expect high interest and low risk profile instruments. These are all contradictory expectations. To satisfy these requirements, it is essential that the financial innovations should have a broader and larger application. An instrument which comes out as a result of research and analysis of stakeholders expectations usually satisfies all these expectations. Therefore, the only way to balance the critical and apparently opposite views is the development of innovative financial instruments.

### CONCLUSION:-

In this paper, the author has justified the role of financial innovations in emerging financial markets. Economies with open monetary systems cannot grow without sound, flexible and well-designed financial markets. However, development of financial market is not mere a matter of regulation but it also needs an appropriate innovative approach. Hence, the true driver of financial market is innovative approach which invents, promotes and introduces various instruments of finance.

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