JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue

JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)

An International Scholarly Open Access, Peer-reviewed, Refereed Journal

AN OVERVEIW OF FINANCIAL INNOVATIONS IN INDIA.

DR.WALTER D'SOUZA. .ASSISTANT PROFESSOR,DEPARTMENT OF COMMERCE,

GOVERNMENT FIRST GRADE WOMENS COLLEGE, BALMATTA.

MANGALORE.KARNATKA.575001

KARNATAKA.

ABSTRACT;

The paper examines the existing literature relevant to the problem of financial *This paper discusses the role that financial innovations play in the modern financial system, aiming at identifying and systematizing the core problems and definitions related to this issue.*

The paper first describes the importance of the financial system and financial markets in the economy, explaining their functions and presenting their particular characteristics, focusing on their innovativeness. Then, based on the theoretical studies, the broad definition of the financial innovations is developed, stating that any new developments in any elements of the financial system, including: markets, institutions, instruments and regulations, can be regarded as financial innovations if they are perceived as new by the end-user of innovation. Next, the systematization of the most important types of financial innovations *is presented regarding different classification criteria, such as: sources of innovations, motives for innovations, their effects or functions. As financial innovations are not a homogenous group of financial developments, their implications for the financial system can be ambiguous, thus the final assessment of their role can not be generalized and should be made on a case-by-case basis. The information presented in this paper can be regarded as an introduction, encouraging to do further research, as the complexity of the financial innovations makes them an interesting and* important.

Keywords: financial system, financial market, financial innovations.

INTRODUCTION;

The dominant feature of the modern financial system is a high pace of innovations, both in terms of their number and value. Thus, it is important to analyze their influence on the financial system. Recently, many studies devoted to this problem have been published, however, they concentrated mainly on the global financial crisis perspective or on a single type of financial innovations. In addition, there is neither a unified definition of financial innovations nor uniform classification of their types applied in these studies.

Therefore, the main aim of this conceptual paper is to undertake an attempt to systematize the current state of knowledge relating to the financial innovations and their role in the financial system. Based on this survey, taking into consideration the definition of financial system, a definition of the financial innovations in the broad and narrow meaning is Financial innovation is an essential force motivating the financial system toward greater economic competence with considerable economic advantage accruing from the changes over the time. In the process of creating a new financial product, a financial engineer needs to acquire knowledge of optimization and financial modeling techniques beyond the basic

theory of finance. This chapter focuses on theories contributed towards financial innovation by various pioneers in the area of finance.

Financial innovation is the act of creating new financial instruments as well as new financial technologies, institutions, and markets. Recent financial innovations include hedge funds, private equity, weather derivatives, retail-structured products, exchange-traded funds, multi-family offices and Islamic bonds (Sukuk). The shadow banking system has spawned an array of financial innovations including mortgage-backed securities products and collateralized debt obligations (CDOs).

Importance for Financial Innovation;

Financial innovation creates financial instruments on a continual basis.Whenany drawbacks are found in the existing instruments, new instruments are engineered to replace or supersede the existing financial instrument a product/service/contract is engineered before a need for the engineered features is felt, it is a hard sell. It takes a long time for the product to come into use in the financial markets. However, when engineering is applied as a cure for the nagging limitations of the existing products, markets certainly welcome, adopt and absorb such innovations. Further, this would bring about a change in the attitude of the households in such a way they desire to invest more. This attitudinal change on the part of the households may

even persuade the government to restructure or even privatize the public sector financial institutions. While such things have been increasing the complexity of the
financial system, there has been a growth in general economy, variety of financial
transactions, sums and risks involved, and the number of market participants. The quantitative modeling has been replacing the intuitive modeling in the financial markets. The unending reforms of the economies and the financial sector in particular have started plugging the existing loophole at a faster pace. Apart from this, globalization of most of the financial marketsis demanding newer financial products, services, and contractual concepts.

REVIEW OF LITERATURE;

The breakdown of the Bretton Woods agreement in 1972 led to major increases in volatility and competition. Smith, Smithson, and Wilford (1990)1 document the increase in the volatility of interest rates, exchange rates, and commodity prices, and draw a relation between increase in riskiness and financial innovation.Levich et al (1988)2 made a broad assessment of the recent developments surrounding financial innovation, including their impact on financial stability and national policy-making. His theory addresses a basic question: What financial product and process changes have occurred over the last twenty to twenty-five years in the United States and international financial markets?

Verghese (1990)3 states that it is necessary to take a close look at the main features of the current wave of financial innovation and evaluate objectively what it has achieved and at what cost. It is also important to identify the lessons of the financial change and innovation. He started with a comprehensive study of financial innovations in India.

Marshall and Bansal (1992)4 have classified the causes of increasing risk into two: environmental and intra-firm. And this classification is used to analyzethe reasons why the increase in risk and major developments in finance, taken together, created the right environment for rapid growth in financial innovation.

Miller (1992)5 focused on the future perspective of financial innovation andhe explained functional perspective of financial intermediation. His study isabout financial innovations, lower cost of capital, reduce financial risks, improve financial intermediation, and hence welfare enhancing. He stated thatis to him "the growing need of financial innovation in stimulating economicgrowth and businesses operations indeed can be viewed by explaining functions.

FINANCIAL INNOVATION TYPES ;

Engineering of financial instruments is the description of promised yield, liquidity, maturity, security, and risk. Given that innovation has the same characteristics in different packaging to suit the constantly varying needs ofthe issues and the investor's constitute the indivisible condition of such concept.

There are two kinds of innovations:

1. Innovation for the tax planning.
2. Facilitate adaptive changes in the available financial instruments.

1. Innovation for the tax planning: Financial engineers are called upon to develop special instrument or a combination of instrument to attract more investors which will enables them to reduce tax burden. They need to design a product which reduces other expenses like agency costs, commission, incentives etc.

2. Facilitate adaptive changes in the available financial instruments:

Financial engineers are expected to design new features, which facilitates adaptive changes in the existing financial instruments of the capital market. For instance, profit-linked interest rate securities, optionally dual currency bonds, rating-linked interest rate bonds, and special incorporation equity etc. Some recent developments in the financial products area. Instruments that offer security with a fixed interest rate coupon and a percentage of the profits derived on the projects.

Conclusion;

The modern financial system is characterized by high pace of innovations that can occur in any of its elements: markets, institutions, instruments and regulations. The financial innovations observed in the financial system can be classified according to various criteria, indicating their heterogeneity. Despite the differences in the applied classifications, the theory of financial innovations is mainly focused on their effects upon the financial system.

The sustainable financial innovations are required, as they enhance the efficiency of the financial system and by this they can improve the economic growth and increase the social wealth. However, some of the financial innovations can have some negative side-effects upon the financial system, offering benefits to the single participants and simultaneously being harmful to others. Thus, the efficient usage of particular financial innovation requires an extensive knowledge about its way of functioning and a thorough analysis of its consequences. As this survey indicates, the problem of financial innovations and their role in the financial system is highly complex and can be an important and interesting subject for further research,

REFERENCE

1) Dr Joanna Błach, Department of Finance, Faculty of Finance and Insurance, University ofEconomics in Katowice, 40-226 Katowice, ul. Bogucicka 14, Poland, jblach@ue.katowice.

2) Ehrhardt, M. C., Brigham, E. F. (2009). *Corporate Finance. A Focused Approach.* Mason: South-Western, CENGAGE Learning.

3) Fabozzi, F. J., Modigliani, F. (2003). *Capital Markets. Institutions and Instruments*. Upper Saddle River: Pearson Education International.

3) Richard M. Levich, Gerald Corrigan E, Charles S. Sanford Jr, George J. Votja (1988),"*Financial Innovations in International Financial Market*" in The United States in the World Economy, Editor: Martin Feldstein, University of Chicago Press, ISBN: 0-226-24077-0, 215 – 277

4) Verghese, S K (1990), Financial Innovation and Lessons for India, Vol. 25 (5), 03 Feb.

5) Marshall John F, and Bansal Vipul K (1992), *Financial Engineering: A Complete Guide to*