Financial Innovation & Economic Growth

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ABSTRACT
This paper argues that some of those problems stem from the failure to account for the impact of financial innovation. We study the demand for money for entrepreneurship employing various proxies for financial innovation, and provide an assessment of the relative importance of this variable. This paper reviews the extant studies of financial innovation. Adopting broad criteria and spanning a long time horizon we found surprisingly few studies. It suggests that for conceptual and methodological reasons mostly concerning problems of scale and complexity, that approach may be complemented in important ways by national focus. Especially striking is that only financial hypotheses advanced in many descriptive articles as to the economic environmental conditions that encourage financial innovation. We find that financial innovation plays an important role in economic growth.

KEYWORDS: Financial innovation, Economic Growth, Money demand, Systems,

INTRODUCTION
Financial innovation refers to advances over time in the financial instruments and payment systems used in the lending and borrowing of funds. These changes which include innovations in technology, risk transfer and credit and equity generation, have increased available credit for borrowers and given banks new and less costly ways to raise equity capital. Certainly the financial services industry has taken advantage of technological innovation you can now access your financial statements and pay your bills online, for example. However, these innovations do not affect the core function of the financial sector which is financial intermediation moving funds from one place where they are not needed to another place where they are worth more. The classic example of financial intermediation is the archetypal community savings bank. Ordinary people put their excess cash into savings accounts the bank accumulates those deposits and loans out as equivalent amount as mortgages or commercial loans. Savers earn interest, homebuyers can buy homes without having to save for decades or entrepreneurs can start or expand businesses and the bank makes a profit on the spread the difference between the interest paid to depositors and the interest charged to borrowers.

A principal purpose of financial innovation is to make financial intermediation happen where it would not have happened before. And that is what innovation has given us over the last thirty years. New vehicles like hedge funds gave investors like pension funds and endowments vastly more to choose from than the time honored choice among cash, bonds and stocks. Likewise innovations like securitization lowered borrowing costs for most consumers.

LITERATURE REVIEW
Duffie and Rahi also devote a considerable section to examining the utility and efficiency implications of financial innovation. The usefulness of spanning the market appears to be limited. Ross (1989) develops a model in which new financial products must overcome marketing and distribution costs. Persons and Warther (1997) studied booms and busts associated with financial innovation.

OBJECTIVES OF THE STUDY
1. The main objective of the study is to understand financial innovation needs and growth.
2. To understand the effect of financial innovation on economic growth.
RESEARCH METHODOLOGY
The specific type of information and data needed to conduct a secondary analysis will depend on the focus of study. For this research purpose, secondary data analysis is usually conducted to gain in-depth understanding of "Financial innovation & economic growth ". Secondary data review and analysis in value and collecting information, statistics, and other relevant data at various level of aggregation In order to conduct a requirement analysis of the rural area and mostly the paper is based on the information retrieved from the internet via journals, research papers and expert opinions on the same subject matter.

THE ROLE OF TECHNOLOGY IN FINANCIAL INNOVATION
1. Some types of financial innovation are driven by improvements in computer and telecommunication technology. For example, Paul Volcker suggested that for most people, the creation of the ATM was a greater financial innovation than asset-backed securitization.
2. Other types of financial innovation affecting the payments system include credit and debit cards and online payment systems like e-wallet.
3. These types of innovations are notable because they reduce transaction costs. Households need to keep lower cash balances if the economy exhibits cash-in-advance constraints then these kinds of financial innovations can contribute to greater efficiency.
4. These types of innovations may also affect monetary policy by reducing real household balances. Especially with the increased popularity of online banking, households are able to keep greater percentages of their wealth in non-cash instruments.

THE EFFECTS OF FINANCIAL INNOVATION
1. Countries where financial institutions spend more on financial innovation are better able to translate growth opportunities into GDP per capita growth.
2. Industries that rely more on external finance and more on R&D activity grow faster in countries where financial institutions spend more on financial innovation and it also experience more volatile growth in countries where financial institutions spend more on financial innovation.
3. In countries where banks spend more on financial innovation they are also more fragile. This relationship is especially strong for banks with smaller market shares banks with faster asset growth and banks with higher shares of non-traditional intermediation activities. This higher fragility is due to higher profit volatility of banks in countries with higher levels of financial innovation.
4. In countries where banks spent more on financial innovation before the crisis they suffered greater reductions in their profits, relative to both total assets and equity.

IMPLICATIONS FOR INDIA
While India’s financial system is multi-faceted, with some world class segments such as its equity market, other segments notably, the corporate bond market remain less developed. Because of the limited size of India’s debt capital markets, banks are the main source of loans to both firms and households. Moreover, India has enormous infrastructure needs, but infrastructure financing remains largely dependent on bank financing, with all its attendant inadequacies and risks. There are also important issues of access to credit and financial services for Indian corporations, but especially for SMEs, and households.

CONCLUSION
This research found that financial innovation can stimulate economic growth (GDP) but that it also leads to greater fragility. Financial innovations that improve the effective allocation of capital can be complementary to stability and economic growth. However, new financial products that disguise or repackage risks, particularly those associated with derivatives and speculative trading, increase volatility in the global financial system. Despite the current difficulties and challenges financial innovation will continue to play an important
role in promoting global growth, especially in emerging markets and developing countries. Our findings show that financial innovation provides significant benefits for the real economy but also contains risks that have to be managed carefully.

REFERENCE