Financial innovation implications on a company financial management

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Abstract: *The paper tries to analyze the implications of financial innovation on a company financial management starting with a synthesis of the ways of financing a company. The differences between these ways have significant importance on how financial innovation has an impact. Another essential issue is highlighted by the characteristics and the typology of instruments issued by financial innovation. The impact of financial innovation is reflected in many aspects that best can be highlighted through the benefits and disadvantages of creating, implementing and using innovative financial products and services*

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1. Introduction

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2. Ways of financing a company

The general problem of finances is to meet financial needs on account of the existing financing capacities in a country's economy, where all economic agents are involved, each of them having either financing deficits or surpluses.

In the economy of a country, there are two categories of economic agents whose interests are complementary. Surplus agencies have funding capacities: By transferring some of these funds to other agents, they accumulate claims. Deficient agencies have to meet certain financing needs: by raising funds from surplus agencies they accumulate debts to them. Excessive and deficient agencies meet either directly, face to face, or indirectly, contacting them through specialized institutions or capital markets and using various tools (Leoveanu, 2008).

Depending on the origin of the money funds, a step by step classification of the financing methods can be made (Dictionary, 1999):

A. Internal or external financing. The funds of the economic agent used for funding are either own resources (internal financing) or lent resources (external financing). External financing can also be done in two ways:

B. Direct or indirect funding. One type of external financing is not to appeal to a financial intermediary, which is why it is called direct funding. Indirect external funding is provided through credits, which are provided by a financial intermediary. Direct funding is in line with the notion of a financial market economy (J. R. Hicks), and indirect funding has a correspondent in the leverage economy.

Indirect external financing is also divided into two categories, as the involvement of financial intermediaries is of a monetary or non-monetary nature:

C. Monetary or non-monetary financing. In indirect non-monetary financing, the financial intermediary justifies its name since it is placed right between the surplus cashier who has funds available and the deficient agent who needs these funds. The financial intermediary will facilitate the financing operation without the two agents being forced to have direct contact, to meet or to meet. A type of financing that is proper to banks is the indirect monetary financing that is based on money creation. The financial intermediary offers money to this agent in exchange for a debt instrument but, as this is not a non-monetary financing, this money is not made on the basis of a previously collected deposit, it is simply created.

The financial intermediary can also be defined as an individual or organization that

ensures the transformation of at least one of the above: a. Maturity transformation: for example, making long-term funding on the basis of short-term resources; b. Interest rate swaps: variable interest-rate loans funded at a fixed interest rate; c. Risk mitigation: for example, loan finance for business equipment on the basis of exigible and risk-free resources (monetary banking resources).

Modern economic analysis explains the existence of financial intermediation based on the following two main reasons (s):

1. Low transaction costs. Financial intermediaries allow the cost of financial transactions to be reduced, thereby achieving scale-level savings that mean lowering the unit costs of production of financial products / services as the quantity produced increases.

2. Reducing information asymmetry, which can generally take two forms:

a. Adverse selection (hiding information about the debtor); b. Moral hazard (hiding information about the debtor's shares).

In many countries, financial systems have undergone tremendous transformations over the last half-century, with spectacular growth in capital markets, with the acceleration of introducing financial innovations, new financial products (from different types of mortgage-backed securities such as Swap transactions, options or futures). In fact, there has been a rapid shift from direct participation of individuals in capital markets to participation through different types of financial intermediaries. They also underwent changes in activity, banks and insurance companies seeing a decline in their assets, while mutual funds and pension funds have increased unexpectedly in size, while new types of intermediaries such as non-banking financial companies.

The evolution of financial systems dynamics has highlighted the fact that among the favorable factors that have led to the development of the capital markets can be quoted: improvement of the financial situation of the companies; The dynamism of financial intermediaries and innovations; Tax incentives; The state's increased appeal to financial markets to finance its deficits; The development of collective investments (mutual funds, pensions, etc.).

These factors favorable to the growth of the importance of the capital markets have led to the emergence of ways to avoid financial intermediation, among which can be listed:

- the securitization, i.e. the mobilization of funds through the issue of securities by firms, but also by the public authorities, a phenomenon that replaces traditional recourse to bank lending;
- marketability, includes the previous phenomenon plus the phenomenon of alignment of bank credit characteristics with market conditions;
- disintermediation, representing the replacement of financing through banks with direct business financing between them;
- the institutionalization of markets, a phenomenon illustrated by the massive intervention of financial intermediaries on the capital markets, on behalf of their clients as titular negotiators. There is a new way of brokerage, which corrects the previous disintermediation by issuing negotiable securities and the purchase by intermediaries themselves of securities issued by deficient agencies.

The fall in transaction costs in capital markets, as well as easier and cheaper access to information, as important elements

in risk management, have led to a diminishing financial intermediation. This trend was facilitated and also developed by financial innovation.

3. Characteristics of financial innovation

Based on its lexicon, The Financial Times gives the following definiton: "Financial innovation is the act of creating and then popularising new financial instruments as well as new financial technologies, institutions and markets".

Financial innovation has its roots in financial market imperfections such as tax regulations, transaction costs, legal contraints, information asymmetry, financial globalization and risk exposure. In this respect, the financial market participants have tried to get as many advantages and benefits as possible in order to increase profitability under conditions of risk mitigation associated with investment vehicle transactions.

There are some companies considered to be the most innovative in finance worldwide such as: PayPal – for leading the payment system on digital money; Citibank - for developing a new model for retail banking, based on tech engineering; SecondMarket - for creating the largest "secondary market" for private-company shares; StockTwits - for building the Web's most comprehensive and accessible virtual trading floor (Macsai, 2011). What are the factors that have prompted these companies to innovate financial tools and services for individuals and companies?

The realities of trading on financial markets show us the directions that financial innovations have developed over the years, and those are the core functions of financial services: payments, market provisioning, investment management, insurance, deposits and lending and capital rising. Associated with them there are eleven clusters of innovation that changed traditional business models (McWaters, 2015):

1. Payments – with clusters like Emerging Payment Rails (e.g.: Mobile Money) and Cashless World (e.g.: Mobile Payments). In this case appears new functionalities for consumers that will change consumer behavior;

2. Market provisioning – with New Market Platforms (Market information platforms) and Smarter & Faster Machines (Artificial Intelligence/ Machines Learning. Algorithmic trading conduct to faster response to real-life events on financial markets;

3. Investment management – with Process Externalization (e.g.: Cloud computing, Open Source IT) and Empowered Investors (Automated Advice and Management, Social Trading). Automated advisors determine accessibility to sophisticated financial management;

4. Insurance – with Insurance Disaggregation (Securitization and Hedge Funds, Autonomous Vehicle) and Connected Insurance) – online insurance marketplaces and connected devices conduct to changed strategies and personalized insurances;

5. Deposits and lending – with clusters like Alternative Lending and Shifting Customers Preferences (Virtual Technologies). Changes in credit evaluation and loan origination opened non-traditional sources of financing;

6. Capital rising – with Crowd funding – open a wide access to capital raising activities.

A 2015 study of World Economic Forum (WEF, 2015) highlights some characteristics regarding financial innovation:

- a deliberate and predictable process;
- the greatest impact on business models based on virtual platforms and data analysis;
- a need for collaboration between regulators and operators regarding changes in risk profile of the industry;
- a continuous pressure for change on customer behavior and business models.

4. Implications of Financial Innovation for a company

The impact of financial innovation is reflected in many aspects that best can be highlighted through the benefits and disadvantages of creating, implementing and using innovative financial products and services. Here below are some positive / negative aspects of new financial instruments.

As advantages of financial innovation for financial management of a company they can underline:

- Reducing the use of cash as a result of electronic transactions, thus lowering cash needs in circulation;
- Reduction of costs associated with transactions and cash management;
- Increased access to information of financial institutions and state authorities on transactions for taxation and transparency;
- Protection of clients and merchants against fraud;
- Increasing direct connectivity between participants - financial institutions, individuals, traders;
- The ability of financial institutions to provide better services than competition;
- Increased access and availability of financial institutions to individual customer data and financial history;
- Creating customized product and service offerings tailored to the customer's specific needs
- Managing risks in a proactive manner and increasing the level of financial education of clients;
- Unlike traditional financial intermediaries - which provide protection based on deposit guarantee and minimize default risk based on sophisticated savings and credit schemes, alternative lending platforms ensure transparency for both debtors and creditors and reduce transaction costs;
- Wide access of the financial institution to customer base and more accurate understanding of the risks associated with clients;
- Designing more sophisticated products in terms of financial conditions;
- Integration of different types of services into innovative financial products.

In spite of multiple positive aspects, financial innovation could have a lot of disadvantages for financial management of a company as the following:

- Inaccessibility of electronic payment systems as a result of reluctance on the part of traders to associated payment fees, investment and operating costs and delays;
- The increased possibility of fraud in the electronic payment system;
- Increased security risk and high volatility
- Difficulties in implementing new technologies and staff training, as well as customer access;
- Increasing the risk of moral hazard or adverse selection for some innovative financial instruments;

- The risk of losing customers' confidence as a result either of disturbing access to use or the risk of fraud;
- Financial institutions or clients may become addicted to technology providers;
- Loss of customer loyalty due to the possibility of making comparisons between products and financial institutions;
- Difficulty of regulation and certification for highly personalized products;
- The difficulty of choosing the product / service according to its needs as a result of multiple and diversified offers;
- The possibility of losing unusual customers with new tools or unwanted tools to use them.

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