# Pros of financial innovations essay examples

Technology, Innovation

Financial Innovation- the term which was in limelight during global crisis of 2008 refers to advances and developments over time in financial products and the borrowing-lending process. The advances and developments can be in the form of risk diversification, financial technology and fund raising procedure. Thus financial innovation in recent half of the past decade has provided the banks and financial institutions new innovative methods of rasing less costly capital along with less risky hedging of their investments. As financial innovation in the form of Adjsuted Rates Mortgage (AMR's) were the primary reason behind global financial credit crush in 2008, there is a definite need to analyze the pros and cons which financial innovations offers:

Technological Advancement and related Benefits:

Technical Change is an important part of financial innovation. Financial innovation has propelled in recent decades that has changed not only the way financial products are offered to clients but it has also changed the lifestyle of people to a substantial level. The Automated Teller Machine(ATM) was the most revolutionary technological innovation in finance world.

Also the introduction of new financial products like the early advancement of money market mutual funds in 1970's and then sub prime lending that was at its peak from 2003-2006 in US, was an important pros of financial innovation that during 2004 accounted for 7% of total GDP of US Economy(The number was more than double the average share in 1960's). In some cases, the new financial products like Asset backed Commercial Papers(ABCP) and Credit Default Swaps were made for use by finance professionals only, they returned high benefits to the economy as whole as being an important part of financial intermediation.

## Thus, atleast prior to financial crisis, the tools of financial innovation propelled the financial sector of US Economy.

Moderate Business Cycle Fluctuations:

Before the nightmares of 2007, Financial innovations have also helped to moderate business cycle fluctuations. Innovations in the form of credit cards expansions, easy availability of home equity loans helped in maintaining a sound consumption expenditure even though their expenditure was more than their income.

Also business cycles were improved as the period of 2003-2006 saw an increased and easy availability of credit to businesses which allowed them to increase their spendings even though their revenue margins were not enough to cover up the interests cost. Thus as a result of these innovations, the private spendings on consumption and business expenditure amplified economic cycles of US Economy.

## Achieved Public Goals:

Post the great depression of 1930's the federal government always prompted for the public goal of home ownership in its citizens. Howeevr, it was only with advent of financial innovation with supportive taxation policies over mortgages, the american people were able to own their own houses. Federal Government in order to promote self housing, allowed mortgage payments to be part of expense for the purpose of calculating Income for Taxation Purpose and also created Government Sponsored Enterprises(GSE) to finance home mortgages.

## Cons of Financial Innovation: The Financial Crisis of 2007

The financial crisis of 2007 was a big set back for global economy and this resulted from over exploitation and negligent use of Financial Innovation. The underestimation of risk factors by finance professionals and intermediaries led to a big slash in housing market when people lost their houses as it was impossible for them to refinance their already subprime mortgages.

Innovated products like Asset Backed Commercial Papers and over the counter derivatives that facilitated the transfer of risk, led to seizing up key markets for liquidity such as inter bank lending market.

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