Chapter 7
Financial Innovation:
Theories, Models, and Future

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ABSTRACT

Financial innovation offers cheaper and available services to financial system and it increases quality of service and products in a long run. The functions of financial innovation are decrease in the cost of payments and increase in the speed of determination of fraud, mechanism for the pooling of funds, management of uncertainty and controlling of risk, manages agency costs, and enhancement of liquidity. Technology contributes to the design and pricing of new instruments and facilitates the identification, measurement, and monitoring of risks in portfolios containing complex instruments. Innovation research has shown that the increase in countries' innovation performance plays a key role in economic and social development, prosperity, and development. Financial innovation is the most important driving force for the transition to the information economy. Globalization and global competition require innovation. Hence, the future is mobile and should be innovative.

INTRODUCTION

One of the most important characteristics of human beings throughout history is that they are not satisfied with what they find, but they long for better. The foundation of creativity and continual development is also creating a better search impulse. Companies are always yearning for the better in the world. In addition to feeling better, companies under the influence of very rapid changes in internal and external environmental conditions are trying to meet the requirements of competition while trying to adapt to the changing trends.

It can be said that there is more competitive environment for firms in the phenomenon of globalization. The most important factor affecting the competitiveness of today's enterprises is the continuous and sustainable productivity increase due to innovation. Companies using innovations, new products or services will increase their operational efficiency and profitability. The success of firms in a competitive environment and in changing world conditions is driven by their ability to perceive and innovate these innovations and creativity.

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Recently, companies are increasingly focusing on innovation. This is because they will gain a competitive advantage through differentiation. Indeed companies developing innovative products or services have the advantage and they are becoming more advantageous in the face of competition.

Innovation gives companies the chance to adapt to the environment they are in. Also more importantly it allows them to identify and control change in the external environment, which is crucial for the operator to achieve long-term competitiveness. Innovation can achieve firm's short term outputs such as increased financial performance and market share, creation of new markets, reduction of production costs.

However, when viewed from a broader perspective, innovation is one of the means by which the level of prosperity and standard of living of society can be improved. With the innovations realized, many environmental problems can be solved and users can raise their living standards by using products that are more affordable and meet their needs better. Moreover it can solve some social problems, especially health-related problems. Thus it can have a positive impact on human life.

INNOVATION

Innovation is one of the most recent words used in science and technology in recent years. Innovation is derived from the Latin "innovare" that means "to do something new and different". Innovation means "renewing science and technology to provide economic and social benefit".

The innovation derived from Latin word 'innovatus', means "the introduction of new methods in the social, cultural and administrative environment". The Webster dictionary defines innovation as a 'new and different result'. In this context, innovation can be defined as new ideas, new applications, new solutions and new technologies for a business (Jenssen & Jorgensen, 2004: 63).

Innovation as a new and contemporary concept, is emphasized in terms of dictionary, as well as innovation itself; refers to an economic and social process depending on differentiation and change. Innovation is first described by economist and policy scientist Joseph Schumpeter as the "driving force of development". Schumpeter describes innovation as having a new organization to have a new product of a product or an existing product that the customer does not already know, the introduction of a new production method, the opening of a new market, introduction of raw materials or semi-finished products. (Elçi et al., 2008: 25-26).

According to the OECD literature, innovation means 'transforming an idea into a marketable product or service, a new or improved manufacturing or distribution method, or a new method of social service'. Innovation is both a process and a consequence (Oslo Manual, 2005).

In a rapidly changing competitive environment, companies need to constantly change and renew their products, services and production methods to enable businesses to survive and to retain their assets. This replacement and renewal process is defined as "innovation".

Today, enterprises are at the center of the innovation process. The productivity and competitive structures of the enterprises are determined by their business competencies and their technological expertise. Firms that are the source of economic growth in the market are developing new technologies. Technological innovations lay the groundwork for new technological developments within these enterprises. In this context, reasons forcing firms to innovate in a changing competitive environment are listed below (Dulupçu et al., 2007: 8):

- Speed to respond to market needs.

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