

Application of Innovative Financial Products in the Real Sector of Economy

¹A.A. Ajupov, ²O.E. Medvedeva, ³A.V. Freze, ⁴A.G. Savin and ⁵A.S. Karataev

¹Kazan Federal University, 420008 Kazan, Russia

²ITMO National Research University, 197101 St. Petersburg, Russia

³Togliatti State University, 445020 Togliatti, Russia

⁴Samara State Technical University, 443086 Samara, Russia

⁵Surgut State University, 628400 Surgut, Russia

Abstract: Free temporary diversion of funds for a long term negative effect on the financial and economic activity of the enterprise, it becomes ineffective in periods of inflation, particularly when necessary mobilization of own circulating assets. The model of double SWOP-contract suggested in this study is used in payments between contractors and suppliers and allows acceleration settlement system, decreasing debts receivable and increasing the efficiency of financial resources with minimal losses. Risk hedging in innovation products activity now is one of the main issues for real companies. As the market expands the number of risks increases. This research provides an example of utilization of financial market instruments as means of risks decrease. This will allow the companies working on a real market to expand the sphere of their activities, increase efficiency and number of deals secured by money earned on the stock market.

Key words: Innovative financial products, financial market, option contract, financial risk, the model of double SWOP-contract, derivative financial instruments

INTRODUCTION

One of the actual problems in activities of Russian enterprises is debts receivable building up due to non-payment for goods and services (Arakelyan and Serrano, 2016). Gratuitous temporary withdrawal of financial resources for a long period of time has negative effects on financial and business activity of the enterprise which becomes inefficient during periods of inflation when it is necessary to mobilize working assets (Rafikov *et al.*, 2017).

Innovative financial products form specific relationships between economic players in the process of their innovative activities on the financial market which contributes to satisfaction of demands of these players in risks redistribution, ensuring liquidity and improvement of final financial results for various market players (Marquez and Yavuz, 2013). But, innovative financial products also complicate economical relationships inducing new needs in financial innovations (Lau, 2016). This characterizes dialectics of relationships of real sector of economy and financial market and also allows considering the latter as the most important factor of economic development accelerating and production efficiency increase (Pylypenko, 2016).

There is no unambiguous solution for the problems of payment system improvement and reduction of overdue debts receivable. Practical economy of the developed countries demonstrates that this problem should be solved by developing and application of various methods (Ajupov *et al.*, 2015a, b). There cannot be a uniform solution for all specific situations. It is necessary to develop for each subject complex solutions on improvement of payment system and to carry out highly qualified policy aimed at prevention and payments of debts receivable, control toughening over payments between consumers of goods and services (Buchanan, 2016).

MATERIALS AND METHODS

In view of the above let's take a look at the model of double SWOP (Xiao *et al.*, 2016) application as the most efficient method (in researchers opinion) in cases when the company has some problems with payments acceleration (Fig. 1).

In this model there are four participants: enterprise, its contractors, factoring company and bank. The first stage (Fig. 1) is characterized by debts of Enterprise B to Enterprise A as a result of non-payment for goods and services.

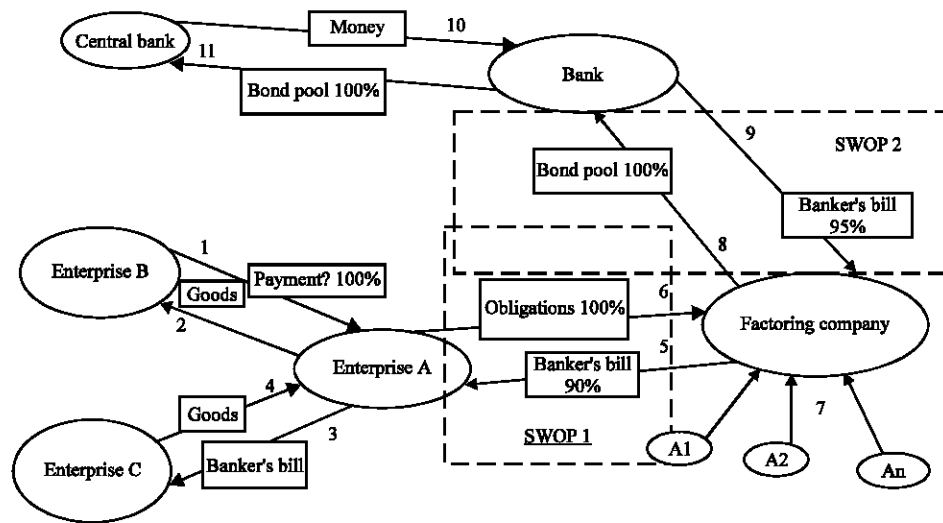


Fig. 1: Model of double SWOP application in accelerated payment with suppliers

Consequently, Enterprise A cannot pay its debt to contractor C. There are two possible solutions in this situation. The first variant is the simplest all participants wait to be paid in their due turn (Ajupov *et al.*, 2016). The second variant in researchers opinion is the most efficient; it requires application of derivative financial instruments.

RESULTS AND DISCUSSION

Derivative financial instruments are not so well studied economic category although first instruments appeared several centuries ago (Ajupov *et al.*, 2015). As economic relationships became more complicated and increasing the possibilities of financial resources redistribution the derivatives appeared that helped not only manage risks but also use new variants of financial resources redistribution and that is the most significant in rational running the business.

Derivative financial instruments (Pandey and Snekenes, 2016) arose in the process of traditional financial relationships (such as loan, credit) and as a matter of fact are traditional instruments catered for new contractual relationship. Essence of these contracts is linked with overcoming the limitations resulting from traditional commitments to future purchase or sale and also rights for future purchase or sale-classical financial instruments with priced fixed at the given moment of time.

SWOP-agreement (Ajupov and Polteva, 2014) binds each party with liability to make regular payments for counterparty in accordance with agreement conditions

which defines the sum of payments relative to various indicators, change of positions, ceasing of actions and transfer of rights for SWOP-operation.

Enterprise A transfers payment obligations of Enterprise B to factoring company which forms bond pool and places it in a commercial bank against bill. Then factoring company endorses a bill to Enterprise A as a payment for enterprise B's obligations.

Factoring company acts to solve a problem of payments risk-to receive them in full and timely (Thakor, 2013). Using factoring company services an entrepreneur has a possibility to turn future debt into cash when he or she needs it by presenting a bill to a bank. Financial situation of the enterprise gets better, expenses for accounts receivable decrease (Zolfaghari and Sahabi, 2017). In other words, factoring is a purchase of supplier monetary claims for a buyer by a bank or specialized company and the following encashment for a fee.

In the suggested model at the third stage we can clearly see the application of percentage SWOP-contracts. As SWOP-contract is a derivative financial instrument it is quite complicated market agreement made with a whole package of contracts and agreements (Jofre *et al.*, 2017; Kurmanova *et al.*, 2016). The main thing in this situation is that all these agreements are between the same parties but these parties take opposite positions differing according to how the price of the agreement subject is defined. Each party of a SWOP always has 2-way obligation as opposed to an ordinary contract where the party has only one obligation or takes one of the two possible positions: buyer (debtor) or seller (creditor).

SWOPs providing for exchange of firm (fixed) obligations are made only if parties' assets differ (different

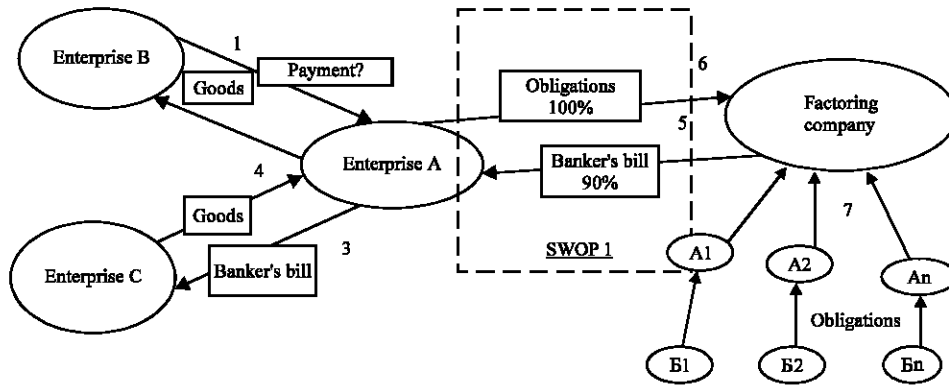


Fig. 2: Model of SWOP application in accelerated payment settlement with suppliers

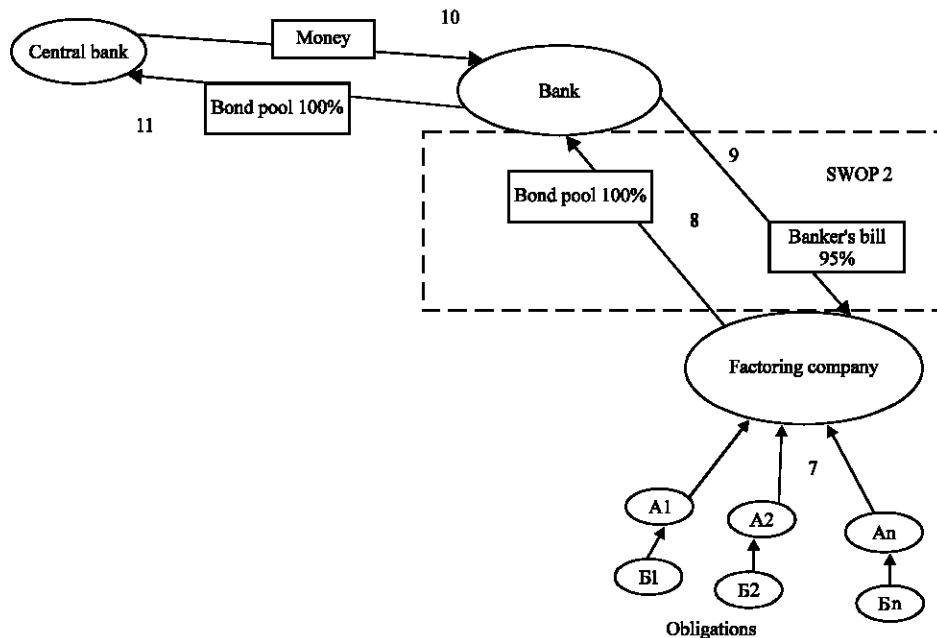


Fig. 3: Model of double SWOP application in accelerated payment settlement with suppliers

goods, different currencies). Otherwise, SWOP does not have sense from the economical point of view as it is an exchange of the same asset but with different price.

SWOP is mainly made about payment (receiving) of specified interest payments. For some reasons parties are not willing to get rid of obligations they have (e.g., this can lead to loss of fixed capital) but they would like to exchange them for obligations more suitable in the current market situation. SWOP-contracts are the market instrument which allows carrying out this exchange in a quite specific form by payment or receiving the difference between the obligations in possession and obligations needed.

Let's examine in more detail which SWOP-contracts are applied on the third stage of the proposed model (Fig. 2) where Enterprise B's obligations are exchanged for

commercial bank bill (SWOP1). SWOP1 is a means of insurance for factoring company from unpaid obligations of Enterprise B. Application of this financial instrument reduces risks arising during changing of financial situation at the enterprise. Percentage for payments is defined at the moment of closing the deal. 100% obligations of Enterprise B are exchanged for a banker's bill worth 90% of the obligation. Thus, factoring company decreases losses making a deal with an exchange rate defined in advance.

So, SWOP1 is an agreement between two parties about exchange of obligations expressed with different financial instruments, calculated on different bases and with different percent rates.

At the fifth stage (Fig. 3) factoring company transfers bond pool to a commercial bank on the condition of

underwriting in exchange for Banker's bill (SWOP 2). Sum of banker's bill is 95% of sum of total obligations transferred to bank, banking margin on the bill is 5%.

Banker's bill is a strictly formalized written promissory note warranting unconditional and abstract obligation of one party to pay at certain moment of time specified sum of money to the other party and the right of the latter to demand this payment. Using of banker's bill in business activities promotes national economy, attracts investment and lessens the negative effects of payment crisis and also accelerates payments among businesses.

Parties of banker's bill relationships are interested in development of banker's bill market in Russia; they strive to make functioning of economic system more efficient. Transaction partners control each other trying to decrease possible risks for the future. Seller (holder of a banker's bill) analyses debtor economic standing and solvency. So, both parties are interested in improving quality of their activities. Combination of banker's bill mechanisms and obligation loan gives the opportunity to accelerate system of payment with minimal losses for all participants and also to decrease debts among businesses.

The nature of this operation is such that obligations with future date of payment are exchanged for banker's bill which can be presented for payment at any moment of time to both bank and factoring company. This process is called risk hedging.

After investing in bond pool bank puts it out on the stock exchange among potential investors acting as an underwriter. Financial underwriting on the equity market is taken as activity of investment middlemen on guaranteed floatation of a loan or issuance of securities on the primary market. On the equity market underwriter is a party guaranteeing the issuer revenue from sale of securities. Actually, underwriter buys securities from issuer and resells them to investors (in our case).

Underwriter buys securities in order to resell them to private investors. Services on primary issuing of corporate securities underwriting are provided by investment and commercial banks, broker firms, investment and financial companies.

To issue a considerable volume of securities issuing syndicates are formed groups of underwriters (investment institutions) on the principles of profit-sharing these syndicates place and guarantee securities issue. Issuing syndicate is not a juridical entity, it is a temporary consolidation of investment companies for completing of one task on the basis of taking joint obligations concerning specific issuer and securities issue.

Currently, there are number of specific details in underwriting in Russian practice. Namely: insufficient capitalization of financial middlemen, uncertainty in

liquidity and future dynamics of issuer securities lead to applying underwriting basically 'under best efforts basis' (or Russian specifics with delayed redemption, i.e., progress redemption of securities as investment company sells them to a public).

Issuing syndicates are barely formed; stock exchange is used for primary distribution; large issuers act independently as organizers and managers of issuing syndicates (Buchanan, 2016).

Underwriter can act on equity market as a principal and as an agent. Agent is essentially the same as broker who has rights to operate with securities on behalf of the client and at the client's expense. Principal at his own expense buys (issues) securities in order to offer them later on the equity market difference between buying and selling price is underwriter's revenue which is bank's margin for services.

Active role of the banks on equity market is caused by attraction of investment market. This is explained by delayed maturity date, offering the securities without pledge and by some other technological details that make equity market different from banking services market. Because of this equity stock component of lending agencies activities became a solid addition to their main banking activity.

It is profitable for bank to offer bond pool at the equity market as it avoids obligations with unknown redemption date. So, actually owner of Enterprise B (Bn) obligations is securities investor (individual or juridical entity). Bank makes profit using the same resources several times: for bond pool discounted bill is issued; commission is paid for underwriting services; bank is a temporary owner of monetary funds received from sale of bond pool, bank can use this money as it sees fit, e.g., provide a loan and receive an interest payment.

This mechanism really gives each party what they want. Process of payment and monetary funds movement is continuous.

CONCLUSION

Positive features of the proposed model use are the following: this model of financing is at the same time model of settlement hedging between suppliers and their contractors as Enterprise C can demand payment on promissory note not only from enterprise A and factoring company but also from a commercial bank.

Combination of promissory note mechanism and obligation loan gives an opportunity to accelerate settlement system with minimal losses for each party and also to decrease debts between businesses.

Practical application of derivatives by commercial banks is complicated by several factors: the legal status of agreements with derivative financial instruments is not clearly defined there are no by-laws clearly regulating operations with such instruments there is no working mechanism for them in Russian accounting system (Ajupov *et al.*, 2016).

Due to existence of various kinds SWOP-contracts are the most flexible financial instruments able to satisfy various categories of sellers and buyers. Since, participants of economic relationships assess future market opportunities differently there will be need for those contracts. This is one of the reasons of success and quick development of SWOP market.

Some of the methodical aspects suggested in this research can be currently used in the process of crediting. Risk hedging in innovation products activity now is one of the main issues for real companies. As the market expands the number of risks increases. This research provides an example of utilization of financial market instruments as means of risks decrease. This will allow the companies working on a real market to expand the sphere of their activities, increase efficiency and number of deals secured by money earned on the stock market.

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