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FINANCIALISATION AS A RESULT OF THE NETWORK ECONOMY'S DEVELOPMENT

JOANNA CICHORSKA¹, MONIKA KLIMONTOWICZ²

Abstract

In the last thirty years, the world's economies have changed significantly. New technology developments have enabled the transition from the industrial economy to the network economy. The network economy is based on information technology, connectivity and human knowledge. Its development has caused changes in the way of life, consumer behaviour on the markets and companies' business models, especially the process of goods and services creation and distribution. Electronic commerce and services have become one of the fastest developing fields of the economy. As a result, the role of government has diminished while the role of markets has increased economic transactions between countries and their citizens have substantially risen, and financial transactions have grown remarkably. This changing landscape has been characterised by globalization and financialisation.

The increasing role of financial motives, financial markets, and financial institutions have influenced domestic and international transactions. A new category of finance called e-finance has been created and implemented. Despite the advantages of electronic finance networks, concurrently there are some disadvantages of their diffusion. The purpose of the paper is to present both aspects of financialisation and its influence on the financial and banking system. This purpose determines the structure of the paper. As financialisation is a relatively new term the first section of the paper focuses on defining its phenomenon. This part presents different authors' perspectives and definitions. Next, the influence of financialisation on the Polish financial system's quantitative and qualitative structure is discussed. The last section focuses on the current role and functions of banks in the finance system network structure as a result of a rapidly changing technological environment.

JEL classification: G21, D53, O33, O43

Keywords: financialisation, network economy, banking network structure

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INTRODUCTION

The modern economy, called the money-goods economy, has been subordinated to money circulation since the industrial revolution. Money has become the condition and the basis of goods' creation, gathering, division and exchange. Both the economic and social spheres rely on the access to cash and cash equivalents. The process of contemporary civilisation's creation is inextricably interlinked with money and other funds.

As a result, the role and importance of financial institutions have been systematically increasing. According to Merton (1993), financial intermediation is usually analysed in the context of the structure of financial institutions or their functions. The first perspective focuses on existing financial intermediaries as banks, insurance companies, mutual funds, and others, and their market performance and the conditions that help them to remain stable. In contrast, the functional perspective does not posit that existing institutions, whether operating or regulatory, will necessarily be preserved. It assumes that financial functions are more stable than financial institutions which means that functions change less over the time and vary less across geopolitical boundaries. Furthermore, according to this approach, competition will cause the changes in institutional structure to evolve toward greater efficiency in the performance of the financial system.

This functional perspective goes together with a dynamic approach to intermediation and is useful for analysing both micro and macro issues evolving within the financial system. As the importance of financial institutions' specific functions and objectives for the economy's development have been changing over the last few decades this approach seems to be adequate for analysing the process of its financialisation and is applied in this paper. As financialisation is a relatively new term the first section of the paper describes its taxonomy. The opinions on financialisation are still very much in flux, and the analysis of its phenomenon is quite tentative. This part of the paper presents different perspectives and attempts to define it. It further discusses the influence of financialisation on the Polish financial system. The last section presents the banks as the dominant intermediaries on the Polish financial market and their role and functions in the finance system network structure in an environment of rapidly changing technology and financial innovations.

The theoretical, empirical, managerial and public policy implications of financialisation are quite vast. Even the partial synthesis of the subject must, therefore, be selective in the comparison with the complex whole. Thus, from the substantive perspective, the paper should be treated as a foundation for further research. Nevertheless, the paper serves a current synthesis of understanding financialisation and presents its impact on the national economy, banking sector and society.

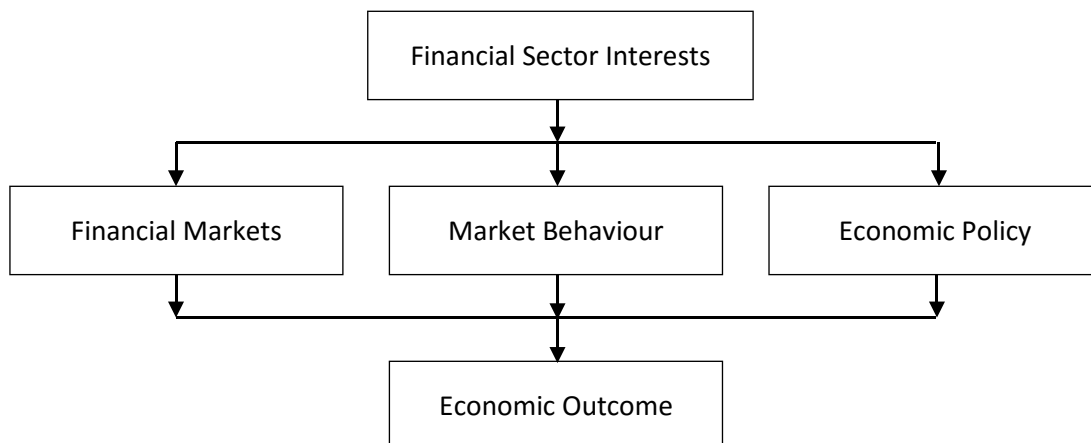
THE TAXONOMY OF FINANCIALISATION

The recent crisis has renewed investigations into the paramount role that finance plays in present day capitalism. Today individuals, firms and the macroeconomy are increasingly mediated by new relationships with a financial market. Financialisation combines quantitative assessments of new accumulation processes and patterns with qualitative analyses of finance as socio-cultural change. In general, the literature on financialisation provides a powerful account of how finance is increasingly embedded in contemporary social, political and economic life (Montgomerie, 2008). Critics of financialisation emphasise the extraordinary levels of remuneration paid to those at the top of the financial industry and state that something is wrong in society today. Whereas its supporters respond that, in most countries, finance is one of the most successful sectors, contributing hugely to the economy through employment, taxes paid and exports. The financial crisis of the last five years has revealed the significant risks associated with having a large financial sector. This situation has led to a more sympathetic hearing for those who criticise finance and financialisation: the increased role of financial institutions, markets and agents in the economy. (Dolphin, 2012).

The channels of financial sector interests spread over the whole economy are illustrated in Figure 1. The first channel concerns the structure and operation of financial markets. The second channel affects the behaviour of market actors (individual customers and non-financial corporations) while the third channel concerns economic policy. Though not shown in the diagram for reasons of simplicity, these channels also interact. Thus, economic policy affects the structure of financial markets and changes customers and organisations' market behaviour. On the other hand, market actors also lobby to affect economic policy.

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Figure 1: The channels of financialisation



Source: Own work

Financialisation is a relatively new term. There is still no common agreement about its definition and even less about its significance. In general, the most frequently cited is Epstein's definition. According to Epstein (2005), financialisation means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies. This broad definition suits most purposes. It encompasses most of the aspects of financialisation that economists and other commentators have chosen to emphasise at various times over the last ten years. Among them financialisation is considered in the context of:

the rapid growth of financial activities relative to the rest of the economy characterised by value accommodation (an increasing share of total output or value-added) made rather in financial than in the productive or commercial sphere (Freeman, 2010),

1) an increase in political power, which has caused policymakers to give a disproportionate weight to the needs of the financial sector in their considerations, and so to an increase in political inequality (Palley, 2007),

2) an increased participation of financial players in commodity markets which changes the nature of the information that drives commodity price formation (Flassbeck, 2012),

3) an ever increasing number of markets that exist to exchange a wide range of financial products and assets. Exotic names such as swaptions, mezzanine finance or other different acronyms add layers of complexity to constantly innovating practices (Montgomerie, 2008),

4) the rapid growth in the capital market associated with a surge in financial trading (especially over-the-

counter) and in the types of financial instruments, particularly derivatives, available to trade,

5) shareholder value and the impact of the stock market's increasing demands for financial returns on corporate behaviour and performance (Gleadle & Cornelius, 2008; Andersson et al., 2010),

6) the increased household and company debt (Palley, 2007),

7) the international capital flows enabled by the relaxation of capital controls (O'Connell, 2005, Barbosa-Filho, 2005).

These different perspectives are reflected in the definitions of financialisation. Despite Epstein's neutral definition, financialisation is seen by most authors as an unwelcome phenomenon (see Table 1).

Financialisation can be considered in the narrow and broad sense. The narrow perspective discusses the growing importance of finance in non-financial companies' market activity which results in the increase of financial revenues' share in non-financial revenues. The broad attitude to financialisation focuses on financial sphere autonomisation and gaining the dominant position in the economy in the relation to the real sphere (Ratajczak, 2012). Both perspectives emphasise the economy's and social life dependency on the finance sector's development which is usually criticised.

Regardless of definition and the presented opinions, the data presented in this paper leave little doubt about the importance of financialisation in recent years and its impact on financial systems and the role of banks in the network economy.

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Table 1: The selected definitions of financialisation

Author	The definition of financialisation
Hilferding (1981)	the increasing political and economic power of a particular class grouping: the rentier class (an increasing concentration and centralization of capital in large corporations, cartels, trusts and banks)
Strange (1986)	casino capitalism – the unregulated excesses of financial markets associated with the ‘boom and bust’ cycles of large speculative ventures
Krippner (2004)	the pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production
Gunnoe et al. (2010)	the overarching shift from productive to financial forms of capital accumulation
Epstein (2005)	the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies
Froud et al. (2006)	the process that leads to coupon pool capitalism ¹ , where the capital market stands between households and firms both of which invest in coupons or securities. Under financialisation, the behaviour of companies is changed so as to create open dynamics and variable results distinguished by instability, reversibility, and unpredictability.
Ratajczak (2009)	a new stage of capitalism called stock market capitalism, coupon capitalism or annuity capitalism
Dembinski (2011)	the system of current human relationships, moulded by the financial and market model: impersonal, short-term, calculating and mistrusting characterized by a focus on profits made by financial instruments’ investments
Księżyk (2013)	free market euphoria and investment utopia as a foundation of profit maximisation

Source: Own work based on: Epstein, 2005; Gleadle & Cornelius 2008; Peet, 2011; Dolphin, 2012; Carrol & Jarvis, 2014; Gostomski, 2014

FINANCIAL SYSTEM DEVELOPMENT AS A RESULT OF FINANCIALISATION

The financial system plays a significant role in the process of a country’ economic development. The fundamental changes in the Polish financial system started in the 1990s. The major part of a general restructuring of the Polish economic system from one based on central planning and government ownership of a business to one based on free market and private ownership was the financial system reform. The history of free retail banking in Poland started in 1998. The new Act of Banking introduced a regulation that enabled the establishment of non-state banks in Poland.

The primary function of any financial system is to facilitate the allocation and deployment of economic resources in an uncertain environment. The financial

system should also provide:

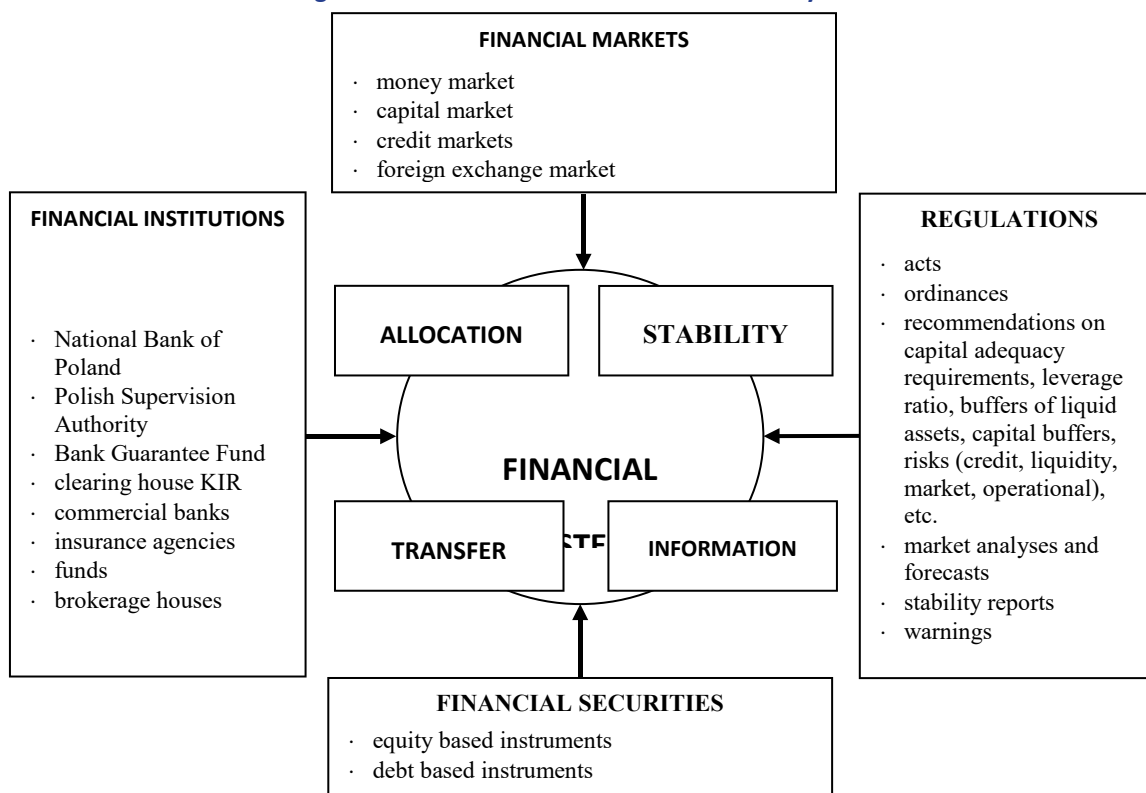
- 1) a payment system for the exchange of goods and services,
- 2) a mechanism for pooling of funds to undertake the large-scale indivisible enterprise,
- 3) a way to transfer economic resources through time and across regions and industries,
- 4) a way to manage uncertainty and control risk,
- 5) price information that helps coordinate decentralised decision-making in various sectors of the economy,
- 6) a way to deal with the asymmetric information problem when one party to a financial transaction has information that the other party does not.

From the functional perspective, the financial system institutional form follows its function (Merton, 1993). Figure 2 shows the Polish contemporary financial system

¹ Froud et al. (2002, p. 120) define coupon pool capitalism as existing ‘where the financial markets are no longer simple intermediaries between household savers and investing firms but act dynamically to shape the behaviour of both firms and households (as cited in Gleadle & Cornelius, 2008, p. 1220).

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Figure 2: The structure of the Polish financial system



Source: Own work

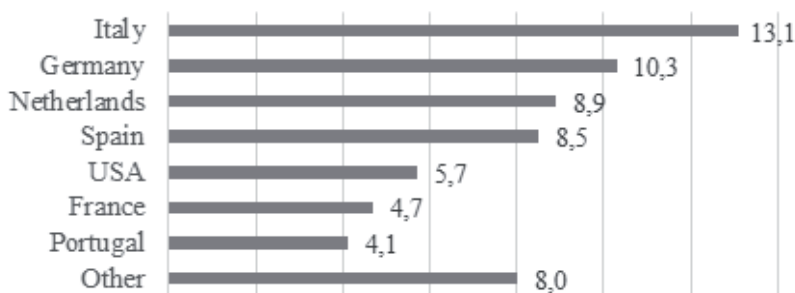
structure. The system consists of the financial institutions and markets as well as the regulations and the basic payment system through which virtually all transactions clear.

The Polish financial system is a bank-based model. The analysis of financialisation in European bank-based financial systems mostly focuses on equity (Stockhammer, 2004). The global, network aspect of financialisation can be seen in the transformation of the economy and social life made by a wave of mergers and acquisitions from large Western European banks (Raviv, 2007). They

significantly impacted the performance and structure of the entire banking sector (Kozak, 2013). As a result, a considerable amount of Polish banks' equity (63,2%) is controlled by foreign investors (Klimontowicz, 2015). The origin of capital is Italian, German, Dutch and Spanish (see Figure 3).

Mergers and acquisitions lead to the creation of a financial institutional new segment called Systematically Important Institutions (SII). They are strategically important for international financial markets and characterised by large size and numerous business links

Figure 3: The foreign investors' share in Polish banking sector assets (2013)



Source: Polish Financial Supervisory Authority (2014)

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(McGrane et al., 2014). Other, smaller institutions may also be systematically important if they act on the market as a group. In this case, they can create or increase the systemic risk. That is why the most crucial criterion is the number and strength of links or the level of leverage. The concentration of the financial institutions' size becomes less important factor also when financial product and services are highly substitutable (Cichorska, 2015).

The other results of financialisation include the increase of:

- 1) number of financial institutions and their assets per capita,
- 2) number of bank accounts and daily settlements,
- 3) entities and individuals' dependence on intermediaries and outside funds,
- 4) credits' number and value,
- 5) number of financial securities, including derivative securities,
- 6) invest funds on the international market,
- 7) the turnover on the stock market and other-the-counter markets,
- 8) financial institutions' viability by the increase of actual profit margin,
- 9) the importance of financial institutions' creation of gross national income.

The first of the financialisation consequences is the increase in financial institutions' number. For seven years, this number increased from 1082 to 1457 (35% increase). The largest increase has been recorded by investment funds – 164%, while the number of cooperative banks has decreased which is the result of banking sector consolidation. The number of commercial banks remains stable (see Table 2).

An even higher pace than the number of financial institutions was noted in the increase of their assets.

In 2013 financial institutions total assets in the relation to 2006 increased by 48,78%. In this period, the value of assets' share in GDP also increased. This ratio shows the degree of market saturation and financial sector contribution to the building of economic growth. In 2013, the relation of financial institutions' assets to GDP was 126,1% which means 30% growth compared with 2006 (see Figure 4). When the level of the market saturation index is higher than 100%, it shows a good situation in the financial sector. In Poland, it is still lower than in eurozone countries where its level is 480,8%.

The biggest share in the structure of financial institutions' assets was held by banks. In 2006-2013, the average level of this share was 69,32% of total financial assets. Since 2008 when it reached the higher level of 73,7% the share of banks' assets has slowly declined to the level of 67,1% in 2013 (see Figure 5). Banks are systematically, but slowly, losing their market share to the benefit of investment funds and open pension funds. The future of banks' intermediation will be influenced by financial market development. Financial markets are examined as an institutional alternative to financial intermediaries and replace traditional intermediaries as the main provider of many financial products (Merton, 1993, p. 19).

The next result of financialisation is the increase of credits and other financial securities' number and value. The level of financing the economic growth by these services is measured by their relation to GDP. In Poland, the level of market saturation measured by this ratio remains low (below 100%) – see Figure 6. In comparison in Europe the ratio level is over 400%. It means that in general the Polish borrowers are still dependent on banks to a small extent.

Despite the small decrease of share in financial market

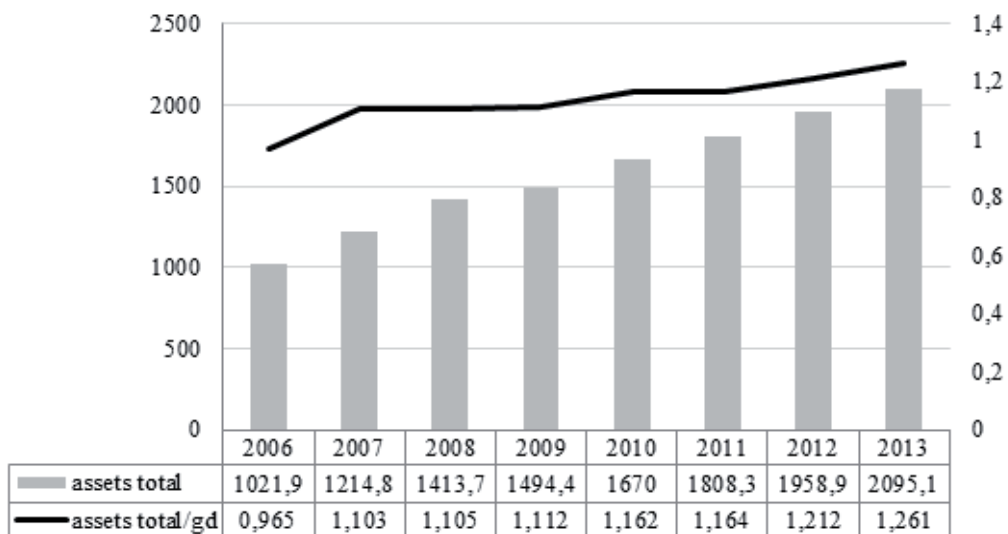
Table 2: The number of financial institutions in Poland (2006-2013)

Entity:	2006	2007	2008	2009	2010	2011	2012	2013
Commercial banks	60	61	67	64	67	66	68	67
Cooperative banks	584	581	579	576	576	574	572	571
SKOK	70	67	62	62	59	59	55	55
Insurance agencies	65	67	66	64	63	61	59	58
Investment funds	241	277	319	369	407	482	580	636
Pension funds	15	15	14	14	14	14	14	13
Brokerage houses	47	53	58	59	50	51	53	57
Total:	1082	1121	1165	1208	1236	1307	1401	1457

Source: National Bank of Poland (2014)

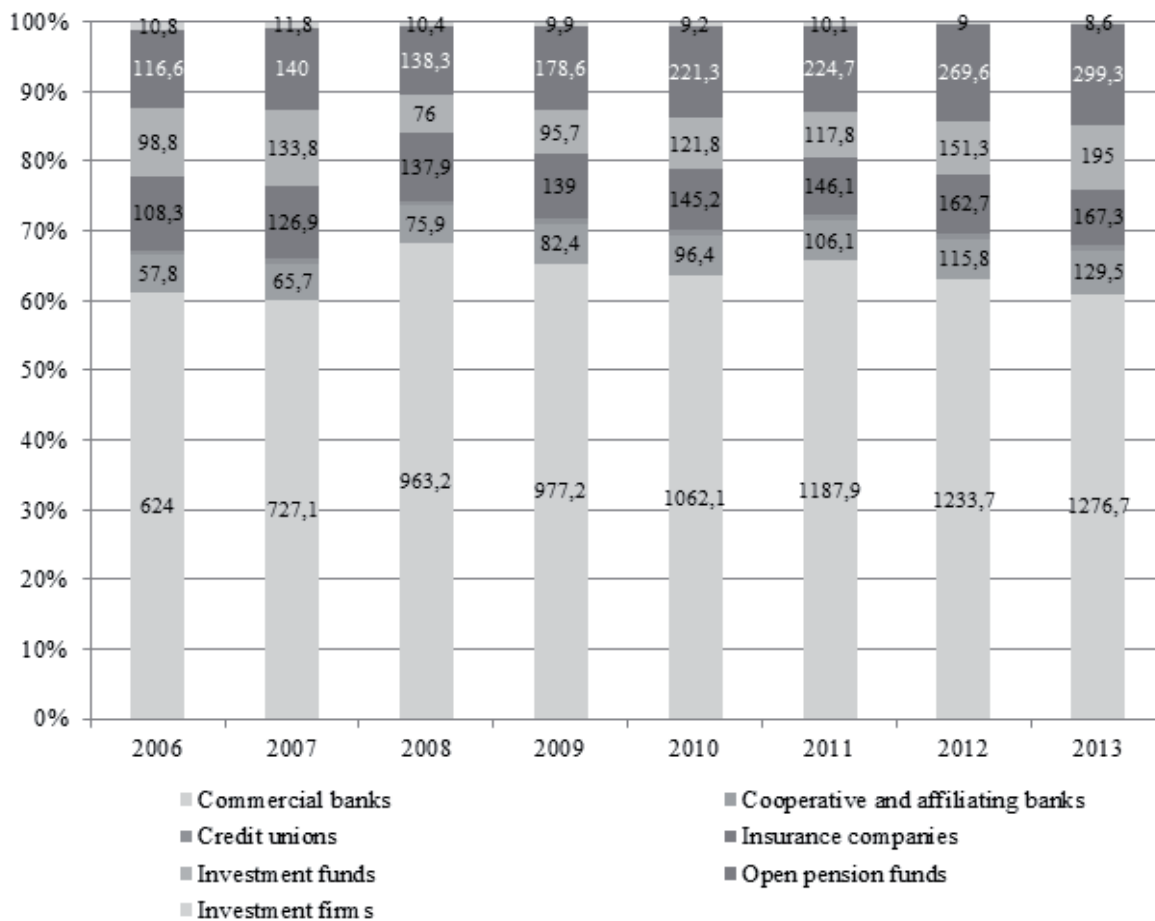
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Figure 4: The value of financial institutions' assets and assets-to-GDP ratio (2006-2013)



Source: National Bank of Poland (2014)

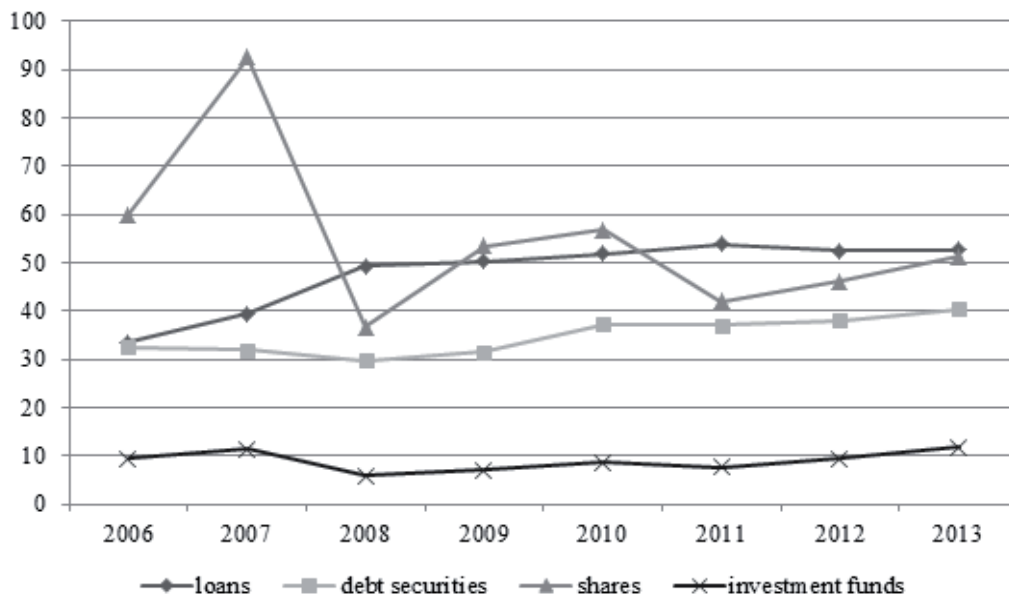
Figure 5: The structure of financial institutions' assets (2006-2013)



Source: National Bank of Poland (2014)

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Figure 6: The structure of financial institutions' assets (2006-2013)



Source: National Bank of Poland (2010, 2014), GUS

assets, banks remain the crucial financial institutions in Poland. They play a significant role in the money creation process and influence the stability of the whole financial sector. As banks adopted new equity market prerogatives to generate revenue, the European model has been adapted to the onslaught of foreign ideas and ownership (Vitols, 2004; Johal & Leaver, 2007). So far financialisation in Poland does not engage with global aspects, virtually ignoring important geopolitical dynamics. As a result, financialisation offers an insular account of financial markets' impact on socio-economic life.

THE ROLE OF BANKS IN A NETWORK ECONOMY

The contemporary banking system is characterised by the increase of horizontal institutional structures' importance. These structures create links between entities, markets, different kinds of securities and distribution channels. These links influence the banking system development. The ability to create networks results in the increase of efficiency. In the complicated framework of links and interplays, the basic foundation of this process is rather building the supplier-user than the seller-buyer relation. This process is accompanied by (Paszkowski, 2008):

- 1) the decrease of tangible assets' importance,
- 2) the conversion of traditional services into virtual

services,

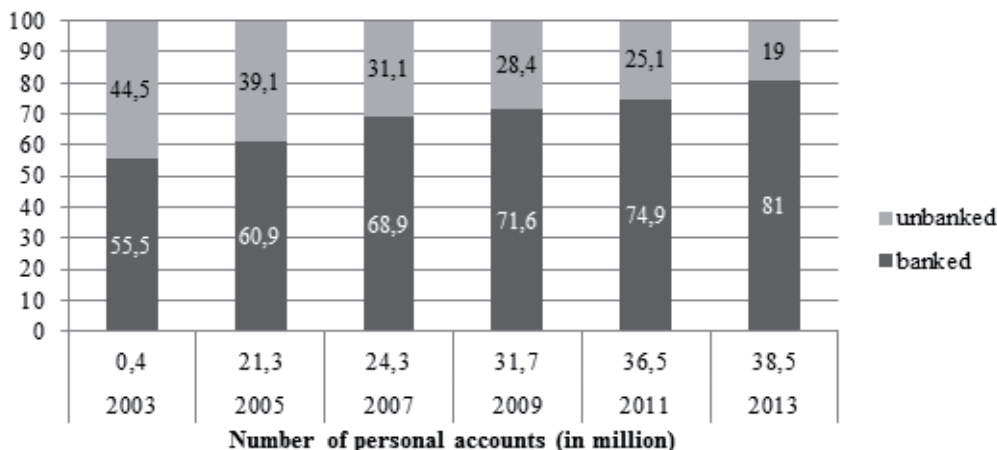
- 3) the increase of intellectual knowledge and property's importance,
- 4) focusing rather on marketing and building long-term relations than on sales,
- 5) the commercialisation of interpersonal relations and human experiences.

The cooperation networks may differ in nature and are not always equivalent to legal forms and entities. Taking into account the market coverage the banking networks can be divided into international (e.g. large financial and banking conglomerates), domestic (e.g. commercial banks) and local (e.g. cooperative banks) networks. These networks are made up of bank branches, other companies of the capital group, clearing houses and safety net entities. The banking networks' links and interplays have a multilateral or bilateral character. They create dense or dispersed structures. The dense structures usually have a tangible character (branches' operational activity and resource management) while dispersed structures are rather intangible (information exchange, cultural exchange, lobbying, etc.).

Creation of the internal and external banking networks has changed the banking system remarkably. New communication possibilities enable the creation of different kinds and levels of banks' cooperation with subsidiaries and other entities. Developed network relations may influence customers' decisions and let

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Figure 7: The use of banking services in Poland (2003-2013)



Source: Polish Bank Association (2014)

banks influence different aspects of economic and social life. On the other hand, the new technology has made the access to bank and financial services easier and cheaper for a customer. Banks are forced to compete not only with other banks but with non-financial institutions providing similar services, e.g. Internet and mobile payments.

Today one of the most important determinants influencing the banking network is the relationship between banks and customers. The results of financialisation in this field include the number of customers' accounts, number of settlements and loans number and value.

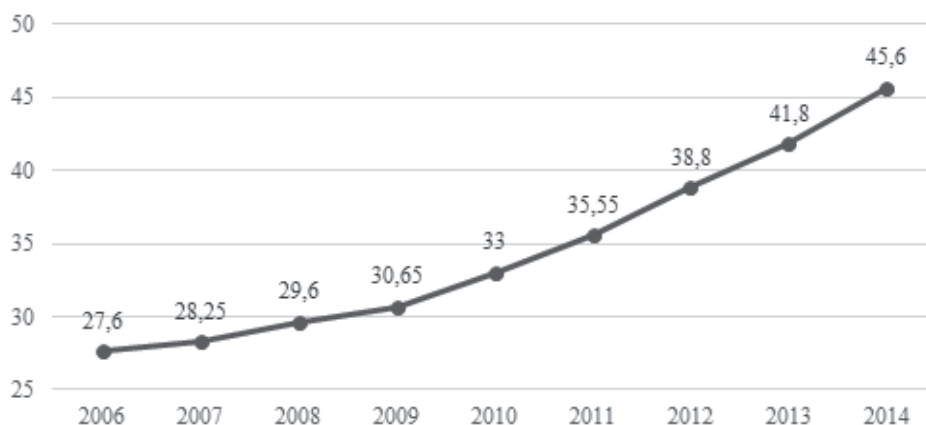
Comparing with western European countries the use of banking services is still low thus it will be increasing significantly and systematically. In 2013, it was 81% and reached the European average level. In comparison, in well-developed countries such as Austria, Germany

or France it comes almost to 100% (Austria - 99,4%, Germany – 99,2%, France – 98,7%). Over the next ten years the possibility of attracting new customers will make the Polish banking market very attractive (Polish Bank Association, 2014) - see Figure 7.

In 2006- 2014 the customer activity per one account was systematically growing. In 2014 the non-cash transaction ratio reached the level of 45,6 transactions per one account (see Figure 8). This mostly results from the increase of payments made by credit cards (National Bank of Poland, 2015).

The next result of financialisation is excessive debt. The comparison of households' credit value with their income (per capita) shows the tendency of deepening financialisation negative phenomena. Each year the spread between the disposable income and loans decreases which represents Polish society's debt accumulation. This

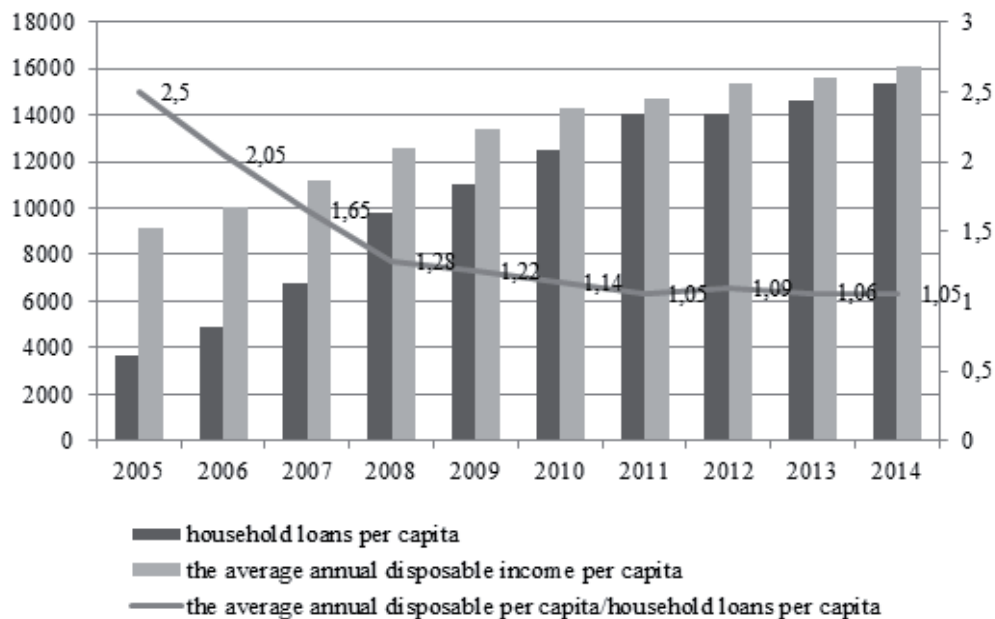
Figure 8: The use of banking services in Poland (2006-2014)



Source: National Bank of Poland (2015)

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Figure 9: The structure of financial institutions' assets (2005-2014)



Source: National Bank of Poland (2010, 2014), GUS

process is strengthened by the low pace of real wages' growth. In 2005 the disposable income per capita was two and a half times higher than the value of credit per capita, while currently these levels are equal. Thus, Polish consumption is financed to the same extent by income and bank loans (see Figure 9).

For customers, the network economy also means the connectivity and permanent access to financial products. Bank have already realized the importance of the internet and mobile distribution channels. The number of customers using these channels systematically increases. In 2014 it reached the level of 23,4 million which means 13% annual growth (Polish Bank Association, 2015). The internet and mobile access is also used for creating new financial needs and virtual products. It causes the changes in the structure of consumers' needs. Some of them are fulfilled by shadow banking institutions that are usually not controlled by the state regulatory institutions.

CONCLUSIONS

The characteristic feature of financialisation is the economy's and social life dependence on financial sphere development. The modern societies' organization follow the financial market rules which results in a deep change of communities' basic elements – relations and

transactions. The role of different kinds of transactions is systematically growing. The process is especially criticised in the aspect of social relations. Most authors are terrified by the perspective of health, safety, education, art and culture subordination to market demand and supplier-buyer relations. However, equating financialisation with the commercialisation of some aspects of social life is an oversimplification. The demand for education and health services, art or culture may also be the foundation for their development. Of course, it may cause some excesses, such as providing only basic and profitable products sacrificing quality and social higher needs. However, in this context, financialisation does not mean the commercialisation but the detachment of the financial sphere from the real sphere.

The financial sphere detachment may also result in financial speculations. From this perspective, financialisation has been changing the role of financial markets. They are becoming the alternative to traditional financial intermediaries. Fortunately, the presented data showed systematic growth and expansion of financial intermediaries. In the case of safety, the number and the size of intermediaries cannot be assessed as a negative factor because it helps to maintain the financial system functions as providing payment systems, funding or safety under institutional control. The central trend is greater custom tailoring of intermediaries' products to

meet specific needs of their customers. On the other hand, basing economic well-being on unreal financial transactions despite the real production and commerce promotes financial recession.

The analysis of contemporary financial systems leads to the conclusion that its proper functioning depends on the network of entities, securities and distribution

channels. This organisational network increases the efficiency of market activity and enables fast and easy information transfer. It helps in creating the demand for financial products and influencing customers' decisions. Unfortunately, it may also generate complicated, unreal, speculative instruments that have a potential to raise systemic risk on financial markets.

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