

Application of the New Growth Theory to Financial Risk Management

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Abstract:

The aim of this research was to look at certain trends in the New Growth Theory. A literature search study was done with the purpose of establishing linkages between the New Growth Theory on Financial Risk Management and other aspects of financial impacts. The findings indicate that economic development policy is affected in a number of ways by the New Growth Theory. This may include the generation of new knowledge, which is crucial for growth sustenance brought about by increasing demand for production due to an increase in the needs and wants of the population. All of the elements that encourage the formation of new knowledge, including research and development, the educational system, and entrepreneurship, require careful consideration on the part of policymakers. By attributing production growth to externalities produced by investments in human capital and technology, the new growth theory endogenizes the drivers of growth; some variations also incorporate policy variables. The new growth theories warn against overprotecting intellectual property rights, but they also suggest that in a situation where there is a significant and expanding information gap between wealthy and developing nations, some trade restrictions may be justifiable. The New Growth Theory is significantly correlated with the value of human capital, quality education, new knowledge, and the government's provision of incentives for the private sector's research and development (R&D).

Keywords: New Growth Theory, Financial Risk Management, Technology, Endogenous

1. Introduction

The New Growth Theory is an economic theory that takes into account two key ideas. The first is that it sees technological advancement as an outcome of economic action. In the past, ideas viewed technology as a given or as the result of forces outside of the market. The New Growth Theory, which incorporates technology into

a description of how markets operate, is frequently referred to as "endogenous" growth theory. The second idea of this theory states that, in contrast to tangible items, knowledge and technology are defined by increasing returns, and that these increasing returns are what drive growth. The New Growth Theory examines the dynamic processes and complex interactions that enable societies to continually increase their material well-being. (McCann, 2019a). According to this theory, knowledge is what fuels growth, and this enables us to amass ideas indefinitely because they may be shared and used again and again. They do not experience what economists refer to as "diminishing returns." Instead, economic growth is fueled by the rising returns to knowledge (Coccia, 2019).

The new growth hypothesis holds that the driving force behind increased rates of output and continued economic expansion is human desire. A basic premise of the new growth theory is the assumption that competition flattens profit and motivates people to look for better, more efficient ways of doing things in order to maximize their ability to generate profit. This paradigm thus places a strong emphasis on innovation, entrepreneurship, knowledge, and technical advancement as the main forces behind economic progress. According to the "new growth theory" of economics, people's infinite needs and insatiable appetites encourage rising productivity levels and economic growth. It asserts that the real gross domestic product (GDP) per person will continue to increase as a result of people's unrelenting pursuit of profits (Faggian, 2019).

The fundamental pillars of this theory are commonly considered to be the neoclassical models from the 1950s to the 1960s and the endogenous growth models from the 1980s to the 1990s, respectively. Despite this, recent academic research has also been able to provide important new insights that have considerably improved and updated the theory. This survey of recent literature on new growth theory highlights some of the most significant recent advancements in the subject and offers a critical assessment of the discipline's present state and potential for future expansion (Akcigit & Ates, 2019). The study of resource allocation and societal results requires the expertise of economists. These specialists provide valuable information on important economic trends, consumer behavior, changes in the financial markets, and problems relating to the job market. We'll look into the New Growth Theory and its implications for the financial health of society (McCann, 2019b).

2. Literature Review

Economic history and the New Growth Theory work better together than they do separately to provide a fuller picture of technological progress. The main theoretical finding is that larger markets and larger resource stocks produce far more incentives for coming up with new methods to exploit the resources. This straightforward realization explains why mass manufacturing methods initially appeared in the United States in the first half of the 19th century (Morlin et al., 2022). First, the New Growth Theory causes us to reconsider how history influences economic growth. The growing returns associated with knowledge lead to "path dependence," where possibilities for the future are limited by choices made in the past. A view of economic transformation that emphasizes evolution and the New Growth Theory are often

compatible. Furthermore, this evolution occurs through a process known as "creative destruction," in which new concepts and businesses displace the ones that have already existed (Aghion et al., 2021).

The new growth theory provided a novel perspective on the factors that promote economic progress. In contrast to the exogenous growth theory of neoclassical economics, which holds that economic advancement is governed by uncontrollable external forces, it places a strong emphasis on the importance of entrepreneurship, knowledge, innovation, and technology (Acs & Sanders, 2021). The hypothesis contends that invention and the development of new technologies do not happen by pure chance. It rather depends on the quantity of people looking for new discoveries or technology and how diligently they search. People may influence their knowledge capital as well, including what they learn and how hard they study. If the potential for profit is high enough, people will decide to invest more in their human resources and work harder to develop new technologies. The notion that knowledge is viewed as an asset for growth that is not subject to finite limits or diminishing returns like other assets such as capital or real estate is a key component of the new growth theory. Knowledge can be developed within a company or sector and is an immaterial, as opposed to material, characteristic (Liu & Wu, 2019).

3. New Growth theory and Risk Management

The New Growth Theory contends that changing consumer preferences and needs encourage innovative and self-improving company tactics. Growing a company, an institution, or an economy implies risks, challenges, and hazards. The finest businesses, as a result, not only manage risks but also use them as a source of long-term competitive advantage (El Baz & Ruel, 2021). Financial risk refers to the extent to which financial objectives are being or have been achieved (Murori, 2022). Risk refers to the possibility of future earnings or results differing from expectations. Risk is a measure of how much unpredictability an investor is willing to accept in order to profit from their investment. Risk management is the process of determining, assessing, and limiting risks to the resources and earnings of an organization.

In today's fast-changing climate, businesses need a dynamic, tech-enabled approach to risk management in order to move swiftly, make judgments, and act bravely and boldly. It may play a value-creating role when risk management is integrated across the board of the company. The adoption of operational models, frameworks, and a shift in mindset can help a company focus, defend, and grow its strategies. Regarding brand differentiation, agility, and innovation, these strategies emphasize the importance of knowing risk management (Nobanee et al., 2021).

In addition to others, risks associated with the New Growth Theory may include brand and reputation risk, criminal and cyber security risk, environmental and geopolitical risk, operational and financial risk, regulation and governance risk, and the risk of technology disruption. Recognizing, minimizing, and managing the risks connected to your area of business expansion is crucial to avoiding disruptions to operations. This can help you create a strong organization while promoting the company's growth to new heights.

Organizations need to modernize by implementing tech-enabled solutions. Risk-powered techniques are designed to help your business make the risk transformation

it needs to respond to market and regulatory concerns at a speed that will benefit it rather than harm it.

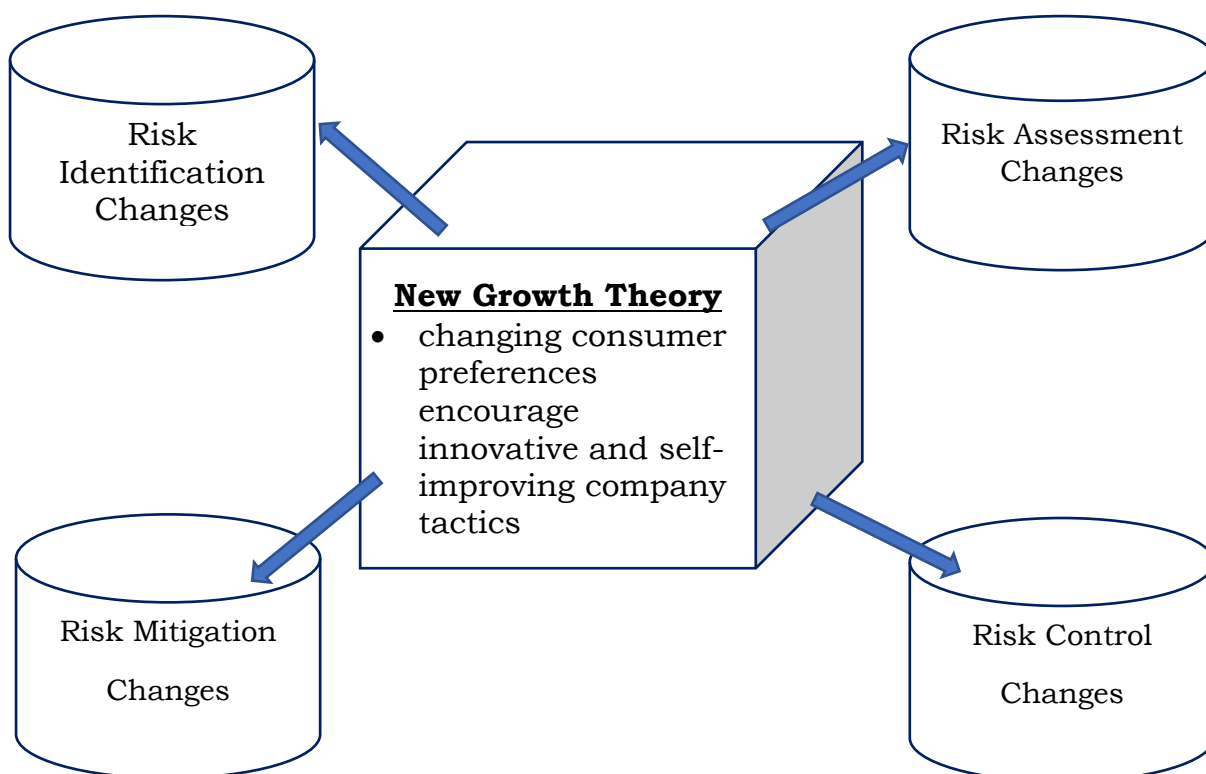


Figure 1: New growth and Risk management

Figure 1 illustrates the interconnection between new growth theory and risk management processes. A new growth model entails embracing innovative approaches and adapting to changing market trends. One important aspect is diversification, which involves exploring new markets, products, or services. By reducing reliance on a single revenue stream, businesses can tap into new opportunities for growth and shield themselves from potential downturns in specific sectors. This could involve expanding into new geographical regions or developing new products that cater to evolving customer needs.

Regular monitoring, evaluation, and adaptation of the growth model and risk management framework are crucial. Businesses must continuously assess their performance, make necessary adjustments, and stay agile in response to evolving market dynamics. By staying proactive and nimble, businesses can position themselves for sustained growth while effectively managing potential risks.

The risks mentioned above can be minimized in the manner listed below:

3.1 Brand and reputation

We noticed a number of behavioral alterations that we think could last well after the virus has subsided and into the ultimate emergence of a new post-COVID-19 reality. These include people shopping locally, putting more emphasis on consumer trust, and embracing the speed of technology (Song et al., 2019).

Due to the epidemic, customers of all ages are using digital channels more frequently to stay connected and streamline their everyday tasks. Companies will need to increase, expand, and promote their investments in customer contact in order to keep up with changing customers while retaining their Some brands are experiencing a confidence crisis as a result of an increase in data breaches, the loss of credit card information, and the requirement that this now be transparently reported. Trust in the data custodians will be essential as the number of digital transactions grows and organizations become the guardians of a growing amount of customer data. risk mitigation methods, particularly with regard to customer data and privacy.

3.2 Crime and cybersecurity

Because of cyber dangers, in our opinion, daring expansion shouldn't be curtailed. Your company can embrace innovation, opportunity, and growth with a strong cyber culture that helps it overcome fear and uncertainty. Companies should prepare for, safeguard against, detect, react to, and recover from breaches, cyberattacks, and cybercrime (Yin et al., 2022). We put a lot of emphasis on culture and take an integrated approach to people, processes, and technology to enable you to prosper.

3.3 Environmental and geopolitical

These current tendencies are being quickly accelerated and made worse by COVID-19, and enterprises are now faced with significant difficulties that cannot be ignored. Understanding political reasoning and incorporating it into trade, tax, and investment activities Ensuring that supply systems and trade channels are resilient to unforeseen political, climatic, and medical catastrophes. Building trust and completing due diligence with business partners to ensure they fulfill legal, investor, and community requirements When entering strategic markets, navigating uncertainty is necessary.

3.4 Regulatory

An organization's creation and implementation of new processes to ensure compliance with quickly changing legislation is a laborious and expensive endeavor as regulatory environments change and compliance duties alter. It can be devastating for tiny organizations. When significant problems are disregarded or neglected because compliance feels like an impossible effort, compliance requirements may be neglected, putting the customer at risk, the organization at risk of loss, and responsible parties at risk of punishment.

To speed up growth, several businesses have started integrating cutting-edge automation technology into their workflows, such as robotics, machine learning, and natural language processing. While this offers businesses a great opportunity to improve their operational efficiency, they also need to take into account the hazards and exposure to data breaches, cyberattacks, money laundering, and other similar activities that come with growing digitalization. Organizations should think about how their risk and compliance functions are run and whether they are still keeping up as the nature of operations and the risks connected with them continue to change.

3.5 Technology

Organizations are adopting new technology more than ever. Artificial intelligence (AI), machine learning, the Internet of Things (IoT), and automation are new and

disruptive technologies that are assisting in providing better outcomes and experiences for both employees and customers while also lowering costs. However, the risk profile is shifting as a result of developing technology. Emerging technology use and trialing is increasing swiftly, which has the ability to exacerbate minor problems quickly and introduce unforeseen challenges that could do significant harm to an organization.

With regulators focusing more on the use of these technologies and new waves of legislation on the horizon, it is critical that our CEOs and boards take action to make sure they have a risk framework in place that is appropriate for the situation and reflects the organization's culture, conduct, and ethics.

One of the challenges related to technology is getting people to trust electronic services so that business risks can be minimized. There is a clear and significant correlation between perceived risk and trust and how consumers will feel about and use technology (Kamau et al., 2023). Trust is crucial for the widespread acceptance and usage of electronic services. Perceived risk plays a significant role in shaping consumer trust, and service providers must address these concerns to minimize business risks. By prioritizing security, transparency, education, customer support, and compliance, technology providers can establish trust and encourage consumers to embrace electronic services, resulting in mutual benefits for both consumers and businesses.

4. Conclusion

New growth theorists contend that governments should devote more resources to investing in human capital because they feel that businesses typically undervalue the value of knowledge. Governments are urged to make it easier for people to obtain higher-quality education and to promote and incentivize private-sector research and development (R&D).

The findings in regard to the new growth theory include that economic growth and productivity will continue to be driven by public desires and wants. According to a fundamental principle of the new growth theory, competition drives down profit, encouraging people to continuously seek out more profitable methods of doing things or develop new goods. The theory also disproves the widely held belief that external, uncontrollable causes dictate economic growth by emphasizing the role of entrepreneurship, knowledge, innovation, and technology. Finally, knowledge is viewed as a growth asset that is neither constrained by limiting resources nor susceptible to decreasing returns like other assets like money or real estate.

Even though it supports the claim that we can grow more quickly, current economic research is far from clear. However, it's possible that the introduction of new technologies will open up the possibility for far more economic development than we've seen for most of the time since 1973 in the coming several decades.

New growth theorists argue that governments should invest more in human capital due to the undervaluation of knowledge by businesses. They recommend facilitating access to high-quality education and incentivizing private-sector research and development. The theory suggests that economic growth and productivity are driven by public desires and competition, promoting innovation and technology. Knowledge

is considered a growth asset with unlimited potential. While current economic research is not definitive, the introduction of new technologies holds the potential for significant economic development in the coming decades.

A new growth model and effective risk management go hand in hand. By embracing innovation, diversification, strategic partnerships, and customer-centric approaches, businesses can unlock new growth opportunities. Simultaneously, robust risk management strategies, compliance measures, data security, and scenario planning enable businesses to mitigate potential risks and navigate challenges successfully. By integrating these practices into their operations, businesses can position themselves for long-term success in an ever-changing business landscape.

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