Chapter 4

An Assessment on Inflation Risk and Its Effects on Business Operations

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ABSTRACT

The latest economic crisis in the world affected business operations and decision making process at management rank. One of the major components of financial system is business organizations within the financial environment, which injects cash to the system and individuals. Therefore, fluctuations in financial system regarding inflationary trends should be evaluated and risk management functions for banking operations should be facilitated. In this chapter, operating mechanism of financial system, risks, inflation and the effects of inflation on business operations have been outlined from a theoretical perspective.

INTRODUCTION

Actors in financial system and competitive business environment compete to take an advantage over scarce resources. Economists argue that the market is perfectly competitive at the point of minimizing the total and marginal costs with intrinsic efficiency Kolasky (2002). Inflation which is attached to financial risks has impacts over the effectiveness of financial system and business operations. The effective company strategies determine the fate of companies in volatile market conditions. Johnson and Scholes’s study (2002) on the strategy statement is one of the most comprehensive studies. The authors describe the strategy as a long-term management gaining an advantage over the organization to meet

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the expectations of shareholders and the market in order to ensure the needs of the environment through regulation of resources (Johnson, 2005).

There are many factors that affect the competitiveness of companies. Innovation, technological progress, the effective management of organizational activities, brand, product and service quality and human capital are defined as the main sources of competitiveness for the company. The basic ideas on strategic thinking provide the key elements of competitive advantage for the use and knowledge of the organizational development that is faster than the competitors. At the same time, in terms of increasing global competition, information derived from the external environment through the inter-organizational networks and inter-firm relations have also great importance (Dincer & Hacioglu, 2014).

This chapter begins with a theoretical explanation on operating mechanism of financial system by introducing financial markets. Second section of the study continues with inflation and financial risks which are affecting financial markets and business operations.

**OPERATING MECHANISM OF FINANCIAL SYSTEM AND FINANCIAL RISKS**

According to Hacioglu & Dincer (2009), a financial system is the environment that provides cash flow in order for a country’s economy to systematically maintain its continuity. Persons that derive profit may choose not to spend in certain circumstances, which enables them have the opportunity to achieve savings. Apart from this, there are also debtors who are bound to spend; these are, in other words, those who demand funds. The aim of the system is to help transfer funds from those who have fund surplus to those with funding gaps. During this exchange process, one party lends money while the other borrows it. The borrower demands a bill of debt which specifies under which conditions it will be borrowed and when the debt will be paid. In the event that the funds change hands, financial assets will change hands as well.

As per the research done by Sener (2012), while the foundation of the financial system of some countries is comprised of banks, this foundation is constituted by direct finance resources. Solutions should be sought by taking into consideration how the financial system should be. Therefore, growth is supported by increasing investment instruments and capital accumulation, allocating resources equally and providing economic stability via carrying out various comparisons among the economic indicators of countries.

According to Agayev (2013), economists conduct research for many years in order to identify the position of financial systems in the economy world. It is observed that the functions of markets and intermediaries have influence on developing a financial system and providing economic growth. Information, along with technological developments, lowers costs and secures economic progress and development. In accordance with the aforementioned research, there are five known basic functions of financial systems in economy.

As per the stages formed by Gunes (2013), these functions first serve to gather information by providing preliminary studies about investment decisions in order to acquire knowledge. Secondly, they enable the transfer of the money belonging to those who have fund surplus to the financial system; in other words they are used for intermediation duties in capital distribution. At the third stage, they provide financing opportunities for savers and the effectiveness and efficiency of these are measured after some observation. At the fourth stage, they provide risk assessment and management via the product range offered to both savers and investors. The last stage involves supporting trade by providing intermediation