Tactful Management Research Journal
ISSN: 2319-7943
Impact Factor : 2.1632(UIF)

ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT: INDIAN PERSPECTIVE

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Abstract : This study investigates the role of banks in capital formation and economic growth: The case of India for the period 1980-2009. The economies of all market-oriented nations depend on the efficient operation of complex and delicately balanced systems of money and credit. Banks are an indispensable element in these systems. The dependent variables are Gross Fixed Capital Formation (GFCF) and Gross Domestic Product (GDP), which is a measure of a nation's economic performance – economic growth in this instance from the various test carried out it was find out that Commercial Banks Deposit Liabilities is elastic to Gross Fixed Capital Formation in Nigeria. This positivity of the coefficient of Commercial Banks Deposit Liabilities is in conformity to the economic a priori expectation of a positive impact of Commercial Banks Deposit Liabilities on Gross Fixed Capital Formation. It is therefore recommended that efforts should be made by the monetary authorities to effectively manage the banks' maximum lending. This policy thrust will most likely result into increased investment activities which will enhance capital formation in India needed for its real sector investments and industrial growth.

Keyword: deposit, liability; credit; capital formation and economic development

INTRODUCTION

THE HISTORY OF BANKING IN INDIA:

Bank is a financial institution that performs several functions like accepting deposits, lending loans, agriculture and rural development etc. Bank plays an important role in the economic development of the country. It is necessary to encourage people to deposit their surplus funds with the banks. These funds are used -for providing loans to the industries thereby making productive investments. A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities. They are the active players in financial market. The essential role of a bank is to connect those who have capital with those who seek capital. After the post economic liberalization and globalization, there has been a significant impact on the banking industry. Banking in India originated in the 18th century. The oldest bank in existence in India is the State Bank of India, a government-owned bank in 1806. SBI is the largest commercial bank in the country.

After the independence, Reserve Bank of India was nationalized and given wide powers. Currently, India has 96 Scheduled Commercial Banks, 27 public sector banks, 31 private banks and 38 foreign banks. Today, banks have diversified their activities and are getting into new products and services that include opportunities in credit cards, consumer finance, wealth management, life and general insurance, investment banking, mutual funds, pension fund regulation, stock broking services, etc. Further, most of the leading Indian banks are going global, setting up offices in foreign countries, by themselves or through their subsidiaries.

2OBJECTIVES OF THE STUDY:

a)The central objective of the study is to empirically investigate the role of Indian banks in Capital

Formation and economic growth.
b)To analyze the impact of banks' deposit mobilization on capital formation and economic growth in India.
c)To determine the association existing between capital formation and economic growth in India.

3REVIEW OF RELATED LITERATURE:

Rose (1986) sees the importance of savings beyond capital formation. To her, savings are a catalyst for capital formation but equally, a major determinant of the cost of credits based on the law of scarcity, which holds that 'when the former is low and scarce, it becomes more costly to obtain'. The classics 5 as well as modern growth models hold that savings constitute the principal parameter, and determinant of economic growth.

Thillairajah (1994) and Padmanabhan (1988) sharing the same opinion, explain the high marginal propensity to save by the unstable economic conditions that generally prevails in these areas (unstable incomes, fluctuations in harvest etc).

(Kaminskyand Schmukler, 2002, p. 30). Currently, there are opposing views concerning the mostpreferable coordination mechanism. According to the development and political view of stateinvolvement in banking, a government is through either direct ownership of banks orrestrictions on the operations of banks better suited than market forces alone to ensure thatthe banking sector performs its functions. The argument is essentially that the governmentcan ensure a better economic outcome by for example channeling savings to strategic projectsthat would otherwise not receive funding or by creating a branch infrastructure in rural areasthat would not be build by profit-maximizing private banks. The active involvement of government thus ensures a better functioning of the banking sector

4IMPORTANCE OF BANKS IN THE DEVELOPMENT OF THE COUNTRY:

Banks are one of the most important part of any country. In this modern time money and its necessity is very important. A developed financial system of the country ensure to attain development. A modern bank provides valuable services to a country. To attain development there should be a good developed financial system to support not only the economic but also the society. So, a modern bank plays a vital role in the socio economic matters of the country. Some of the important role of banks in the development of a country are briefly showing below.

❖PROMOTE SAVING HABITS OF THE PEOPLE:

Bank attracts depositors by introducing attractive deposit schemes and providing rewards or return in the form of interest. Banks providing different kinds of deposit schemes to its customers. It enable to create banking habits or saving habits among people.

❖CAPITAL FORMATION AND PROMOTE INDUSTRY:

Capital is one of the most important part of any business or industry. It is the life blood of business. Banks are increase capital formation by collecting deposits from depositors and converts these deposits in to loans advances to industries.

❖SMOOTHING OF TRADE AND COMMERCE FUNCTIONS:

In this modern era trade and commerce plays vital role between any countries. So, the money transaction should be user friendly. A modern bank helps its customers to sent funds to anywhere and receive funds from anywhere of the world. A well developed banking system provides various attractive services like mobile banking, internet banking, debit cards, credit cards etc. these kinds of services fast and smooth the transactions. So, bank helps to develop trade and commerce.

❖GENERATE EMPLOYMENT OPPORTUNITY:

Since a bank promote industry and investment, there automatically generate employment opportunity. So, a bank enables an economy to generate employment opportunity.

❖SUPPORT AGRICULTURAL DEVELOPMENT:

Agricultural sector is one of the integral part of any economy. Food self sufficiency is the major challenge and goal of any country. Modern bank promote agricultural sector by providing loans and advances with low rate of interest compared to other loans and advances schemes.

❖APPLYING OF MONITORY POLICY:

Monitory policy is a important policy of any government. The major aim of monitory policy is to stabilize financial system of the country from the dangerous of inflation, deflation, crisis etc.

❖BALANCED DEVELOPMENT:

Modern banks spreading its operations throughout the world. we can see number of big banks like citi bank, Baroda bank etc. It helps a country to spread banking activities in rural and semi urban areas. With the spreading of banking operations around the country, helps to attain balanced development by promoting rural areas.

Modern bank plays vital role in the socio- economic development of the country. A developed banking system enables the country to attain balanced development without any special consideration of rich and poor, cities and rural areas etc.

5ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT:

Commercial banks are one source of financing for small businesses. The role of commercial banks in economic development rests chiefly on their role as financial intermediaries. In this capacity, commercial banks help drive the flow of investment capital throughout the marketplace. The chief mechanism of this capital allocation in the economy is through the lending process which helps commercial banks gauge financial risk.

❖Risk

One of the most significant roles of commercial banks in economic development is as arbiters of risk. This occurs primarily when banks make loans to businesses or individuals. For instance, when individuals apply to borrow money from a bank, the bank examines the borrower's finances, including income, credit score and debt level, among other factors. The outcome of this analysis helps the bank gauge the likelihood of borrower default. By weeding out risky borrowers, commercial banks lessen the risk of financial losses. As a result, loans that mature without any problems generate a larger pool of funds for the bank to lend, further supporting economic development.

❖Individuals

When commercial banks assess risk, they help ensure that loans go to creditworthy borrowers. In turn, borrowers typically use loan proceeds to finance major purchases, such as homes, education and other consumer spending. The effect of commercial bank lending generates economic activity from individuals who now have the necessary funds to finance their own endeavors.

❖Small Business

Commercial banks also finance business lending in a variety of ways. A business owner may solicit a loan to finance the start-up costs of a small business. Once funded, the small business may begin operations and embark on a growth plan. The aggregate effect of small business activity generates a significant portion of employment around the country. According to the U.S. Census Bureau, businesses employing between one and 19 people accounted for 4.4 million jobs in 2004. In contrast, businesses with more than 20 employees only accounted for 1.2 million in the same year.

❖Government Spending

Commercial banks also support the role of the federal government as an agent of economic development. Generally, commercial banks help fund government spending by purchasing bonds issued by the Department of the Treasury. Both long and short term Treasury bonds help finance government operations, programs and support deficit spending.

❖Wealth

Commercial banks also offer types of accounts to hold or generate individual wealth. In turn, the deposits commercial banks attract with account services are used for lending and investment. For example, commercial banks commonly attract deposits by offering a traditional menu of savings and checking accounts for businesses and individuals. Similarly, banks offer other types of timed deposit accounts, such as money market accounts and certificates of deposit. Some investors use these interest bearing, low risk accounts to hold money for investment purposes, waiting for attractive investment opportunities to materialize

6STATISTICS AND FACTS:

INDUSTRY-WISE DEPLOYMENT OF GROSS BANK CREDIT:

(` Billion)								
Sr. No.	**Industry**	**Outstanding as on**						
		2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
2.1	Mining & Quarrying (incl. Coal)	122.77	142.41	180.84	254.76	324.46	346.39	353.26
2.2	Food Processing	493.97	537.79	656.77	772.49	941.45	1173.68	1479.78
2.2.1	Sugar	160.80	173.09	192.55	250.94	315.79	329.76	347.76
2.2.2	Edible Oils & Vanaspati	72.43	67.63	103.80	120.14	132.37	170.53	212.60
2.2.3	Tea	24.83	27.31	19.95	21.09	19.91	25.82	32.41
2.2.4	Others	235.91	269.76	340.46	380.33	473.38	647.57	887.01
2.3	Beverage & Tobacco	62.94	84.05	109.69	133.73	150.55	165.11	185.99
2.4	Textiles	963.98	1026.95	1213.75	1461.03	1594.14	1835.36	2039.98
2.4.1	Cotton Textiles	477.46	513.07	612.28	774.44	838.96	924.95	1011.22
2.4.2	Jute Textiles	10.80	14.69	13.80	14.55	13.95	21.97	20.08
2.4.3	Man-Made Textiles	52.85	63.98	116.72	152.63	159.16	189.07	215.68

2.4.4	Other Textiles	422.88	435.21	470.96	519.42	582.06	699.36	793.00
2.5	Leather & Leather Products	57.42	61.46	62.32	73.70	76.33	86.73	102.66
2.6	Wood & Wood Products	31.63	41.38	43.71	49.71	61.45	76.69	93.50
2.7	Paper & Paper Products	134.69	159.83	190.74	213.16	249.80	282.67	331.40
2.8	Petroleum, Coal Products & Nuclear Fuels	420.67	681.47	785.79	509.90	611.75	643.27	634.88
2.9	Chemicals & Chemical Products	625.62	755.55	857.13	1088.52	1269.93	1592.44	1676.70
2.9.1	Fertiliser	91.86	142.65	138.47	144.70	157.62	268.98	306.14
2.9.2	Drugs & Pharmaceuticals	235.02	297.55	359.80	407.64	460.46	495.42	491.99
2.9.3	Petro Chemicals	87.79	87.82	100.46	238.52	332.82	441.41	435.21
2.9.4	Others	210.96	227.53	258.40	297.66	319.02	386.63	443.35
2.10	Rubber, Plastic & their Products	112.13	135.87	156.17	259.08	299.04	312.17	368.22
2.11	Glass & Glassware	27.83	42.40	48.31	54.78	62.69	74.48	87.11
2.12	Cement & Cement Products	125.44	192.20	247.22	296.15	369.10	458.58	541.16
2.13	Basic Metal & Metal Product	1075.93	1287.63	1629.29	2144.48	2618.09	3141.16	3619.69
2.13.1	Iron & Steel	826.96	991.59	1274.64	1657.44	1959.00	2365.97	2685.29
2.13.2	Other Metal & Metal Product	248.99	296.04	354.65	487.04	659.09	775.19	934.40
2.14	All Engineering	544.39	658.07	738.21	933.22	1130.10	1284.47	1455.73
2.14.1	Electronics	158.43	189.12	221.00	207.37	287.20	334.39	367.34
2.14.2	Others	385.96	468.95	517.22	725.85	842.90	950.08	1088.39
2.15	Vehicles, Vehicle Parts & Transport Equipment	293.23	346.42	387.80	457.93	517.81	588.63	677.38

2.16	Gems & Jewellery	251.01	285.37	317.51	400.12	513.26	611.44	719.68
2.17	Construction	279.45	385.05	442.19	434.48	486.16	521.66	614.13
2.18	Infrastructure	2053.36	2699.72	3798.87	5234.13	6299.91	7297.21	8397.80
2.18.1	Power	950.75	1244.47	1878.40	2674.19	3309.26	4158.49	4883.46
2.18.2	Telecommunications	382.82	503.26	593.62	936.70	939.95	877.65	903.93
2.18.3	Roads	344.76	470.60	735.69	909.43	1109.41	1313.12	1573.99
2.18.4	Other Infrastructure	375.01	481.59	591.15	713.81	941.29	947.96	1036.42
2.19	Other Industries	906.98	1020.28	1248.21	1360.46	1797.24	1809.68	1849.70
Industries		8583.44	10543.90	13114.52	16131.83	19373.26	22301.82	25228.75
Note : Data are provisional and relate to select 47 banks, which account for 95 per cent of total non-food credit extended by all scheduled commercial banks.								

7CONCLUSION:

Over a significantly long period of time, countries embarking on a process of development within the framework of mixed, capitalist economies have sought to use the developing banking function, embedded in available or specially created institutions, to further their development goals. The role of these institutions in the development trajectories of late industrializing, developing countries cannot be over-emphasized. However, as noted above, with financial liberalization of the neoliberal variety transforming financial structures, some countries are doing away with specialized development banking institutions on the grounds that equity and bond markets would do the job. This is bound to lead to a shortfall in finance for long-term investments, especially for medium and small enterprises. Fortunately, there are some countries such as Brazil that have thus far not opted for this trajectory.

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