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Role of commercial banks in economic development of India: A critical review

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Abstract

The Indian banking industry is crucial for socio-economic growth, offering both traditional and new services, including payment systems and small financing institutions. The RBI's recent steps might significantly aid in the reform of the local banking sector. Micro, Small, and Medium Enterprises (MSMEs) need substantial financial support from commercial banks to start and expand their business operations in order to compete globally. The RBI has established many regulations concerning funding for key sectors, notably small companies in the nation.

This research examines the function of banks in capital accumulation and economic development. The economy of all market-oriented countries relies on the effective functioning of intricate and finely tuned systems of finance and credit. Banks are an essential component of these systems. The variables that are dependent are Gross Fixed Capital Formation (GFCF) & Gross Domestic Product (GDP), which serve as indicators of a nation's economic performance and growth. In this particular case, various tests conducted revealed that the deposit liabilities of commercial banks are elastic in relation to gross fixed capital formation in India.

The positive coefficient of Commercial Banks Deposit Liabilities aligns with the economic a priori hypothesis of a beneficial effect on Gross Fixed Capital Formation. It is therefore advised that monetary authorities undertake measures to efficiently regulate the banks' maximum lending practices. This legislative initiative would likely lead to heightened investment activity, hence facilitating capital creation in India essential for real sector investments & industrial expansion.

Keywords: Economic development, commercial banks, RBI, India, GDP

1. Introduction

The activities of commercial banks in India are developing rapidly in the post-Independence era. There are both territorial and functional aspects. Conservative and traditional banks have emerged from their confines to confront the difficulties of planned economic development. In recent years, unconventional industries have garnered the interest of commercial banks in India. A comprehensive understanding of the ramifications of commercial banks funding the nonconventional sector can only be achieved by examining the status of commercial banks in the pre-nationalization period. Commercial banks are entities that often take deposits from individuals and provide loans. In India, only those banks formed in conformity with the terms of the Banking Regulation Act of 1949 are designated as Commercial Banks. Commercial banks may be classified as scheduled banks or non-scheduled banks. As to Section 5(c) of the BR Act, a banking company is defined as a corporation that conducts banking operations in India. As per the Reserve Banks of India Act 1934, a 'Scheduled Bank' is defined as a bank included in the second schedule of the Reserve Bank.

2. Review of Literature

Manish, M. K. (2020) [8] Banks have historically been vital elements of national economies, significantly contributing to the development of industry and trade. They act as essential catalysts for economic advancement, facilitating wealth creation and providing as foundational supports for national development. In India, commercial banks, including the State Bank of India (SBI), nationalized banks, foreign banks, and regional rural banks, provide financial services to people and businesses, therefore promoting economic stability and sustainable development. Commercial banks, with a network of over 50,000 branches and 8,000 regional rural banks nationally, generally provide short-term and, in some

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instances, medium-term financing to small-scale enterprises, addressing their financial needs via specialized divisions. Tiwari, V. (2020) ^[9] Banks are essential to a nation's economic development by gathering individual savings and allocating them to capital expansion and entrepreneurship. This promotes investment in diverse ventures, enhancing overall economic development. The agricultural and industrial sectors, as significant employment and contributors to GDP, depend substantially on financial institutions, particularly banks, for their development. Moreover, exports are essential for generating foreign currency, and commercial banks significantly contribute to this sector by providing financing and facilitating currency transfers. Moreover, commercial banks contribute to mitigating the parallel economy and restricting unlawful transactions by regularly executing initiatives to identify unreported revenue. This research highlights the significance of commercial banks in promoting economic development.

Subbareddy, K. (2020) ^[7] Commercial banks are essential to a nation's development by mobilizing financial resources to support various sectors of the economy. They specifically act as catalysts for economic progress by managing a significant percentage of the money supply. In India, financing is augmented for both local and international commerce, while also providing long-term financial assistance for agricultural and consumer initiatives. This research examines the role of commercial banks in economic growth, emphasizing critical areas such as manufacturing, agriculture, and commerce. Furthermore, it evaluates progress achieved under Financial Inclusion Plans from 2011 to 2019.

Dube, P., & Gupta, K. (2018) ^[13] The Indian economy has some unique characteristics, such as fast urbanization, slow rural development, significant migration from rural to urban areas, and inadequate infrastructure and job prospects in rural regions. Addressing these difficulties requires extensive rural development initiatives, which include enhancing financial services in rural regions. Banks are essential in collecting and directing cash from several sources to different sectors. This research examines the growth of banking services in rural areas and the provision of loan facilities from 2006 to 2016.

The study analyzes trends including the development of bank offices and branches, the increase in account numbers and deposits, and the distribution of funds, using public data from the Reserve Bank of India and existing literature. Drawing on these findings, the study presents proposals to augment rural banking services and facilitate access to loans.

Bandlamudi, K., & Taidala, V. R. (2017) ^[16] The aim of the study was to analyze the impact of cooperation between universities and companies on the development of banking and financial diploma programs, as assessed by educators and industry experts in relation to employability. The research highlighted the need of developing skill frameworks tailored to each profession or job, facilitating the acknowledgment of graduates' accomplishments based on shown talents in particular work settings.

Saini, P., & Sindhu, J. (2017) ^[15] Banks are essential for a nation's economic development by mobilizing idle savings, creating demand deposits, enabling commerce, and enhancing capital mobility. As of March 31, 2009, all commercial banks in India have effectively complied with Basel II criteria. A strong banking system in India is

essential for capital accumulation, reducing speculation, and directing resources into important areas. Commercial banks enable credit distribution, promote job expansion in rural areas, and substantially enhance the comprehensive development of the Indian economy.

3. Objectives of the Study

The objectives of the current investigation are as follows:

- To objectively examine the role of Indian banks on capital formation and economic development.
- To examine the influence of bank deposit mobilization on capital creation and economic development in India.
- To ascertain the correlation between capital creation and economic development in India.

4. Methodology

The study article is empirical in character and relies on descriptive analysis. We collected secondary data for the study by reviewing previous research articles on the same topic.

5. Function Performed By Commercial Banks

Commercial banks provide a multitude of functions. They fulfil the financial requirements of several sectors, including agriculture, industry, commerce, and communication, and are vital in meeting economic and social needs.

Recently, banks have been broadening their activities and enhancing their customer-centric approach. The responsibilities of a commercial bank are often categorized into two groups: major responsibilities and subsidiary responsibilities. The following graphic elucidates the functioning of commercial banks. Commercial banks provide many critical functions, some of which are included here. Commercial banks accept various deposits from customers, including savings accounts, recurring accounts, and fixed deposits. These deposits are payable after a certain duration. Commercial banks provide a range of loans and advances, such as money at call, cash credit, bill discounting, and overdraft protection, among others. Furthermore, they provide term loans and demand loans to various consumers in return for appropriate collateral. The principal function of commercial banks is to generate credit. Upon accepting a loan for a customer, the lender does not disburse funds to the borrower.

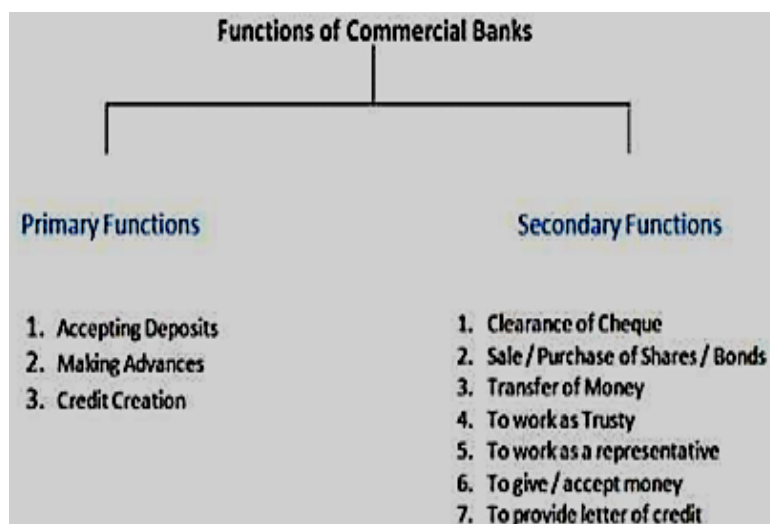
A bank account is established, from which the borrower may subsequently withdraw monies. In essence, when a loan is approved, deposits are concurrently generated, a process referred to as credit creation by commercial banks.

Commercial banks perform a range of ancillary functions alongside their primary responsibilities, including various agency or general utility jobs. Commercial banks' secondary functions may be categorized into agency functions and utility functions.

The functions of the agency are as follows:

Engage in foreign currency transactions, trade stocks, serve as trustee, attorney, correspondent, and executor, and facilitate the collection and clearance of checks, dividends, and interest warrants. To remit rent, insurance payments, and other expenses. To receive tax revenues and tax filings.

The utility functions include: offering safety deposit box services to customers, facilitating money transfers, issuing traveller's cheques, acting as referees, accepting various bills for payment such as phone, gas, and water bills, providing merchant banking services, and issuing various types of cards including credit, debit, and smart cards.



Source: Dr. Parizaad Bhesania (2024) ^[19]

Fig 5.1: Role played by commercial Banks

6. The Role of Banks in the Country's Growth

One of the most important parts of any country is its banks. These days, money and the need for it are very important. The country will grow if its banking system is well-developed. A modern bank helps a country in important ways. It is important to have a well-developed banking system that supports both the economy and society in order to progress. In this way, a modern bank is very important to the country's economy and society. The following are some of the most important things that banks do to help a country grow.

a. Teaching people how to save money: Banks get people to put money by offering good saving plans and giving benefits in the form of interest. There are different types of saving plans that banks offer to their customers. It helps people get into the habit of spending or saving money.

b. Raising money and encouraging business: One of the most important parts of any business or field is capital. It's what keeps businesses going. Capital formation is increased by banks taking deposits from people and lending these savings to businesses as payments.

c. Making trade and business run more smoothly: Trade and business are very important between countries in this day and age. So, it should be easy for people to send and receive money. These days, banks let their customers send and receive money from anywhere in the world. If your banking system is well-developed, it offers many useful services, such as mobile banking, internet banking, debit cards, credit cards, and more. These services make transfers quick and easy. In this way, banks help trade and business grow.

d. Make job opportunities available: Since banks encourage business and investment, they automatically create job opportunities. In other words, a bank helps a business create jobs.

e. Help the growth of agriculture: One important part of any business is the agricultural industry. Not having to worry about food is the main task and goal of every country. Modern banks help the farming sector by giving loans and

advances with lower interest rates than other types of loans and advances.

f. Putting the Monitoring Policy to Use: This is a very important strategy for every country. One of the main goals of monitoring policy is to protect the country's financial system from risks like inflation, unemployment, crises, and so on.

g. Development That is Fair: There are modern banks that do business all over the world. There are a lot of big banks there, like City Bank, Baroda Bank, and others. It's good for a country to have banks in rural and semi-urban places. With banks opening branches all over the country, it's easier for rural places to get the growth they need. A modern bank is very important to the country's social and economic growth. With a well-developed banking system, the country can grow in a way that doesn't favor the rich or the poor, towns or rural areas, etc.

7. The Importance of Banks in National Economic Development

Commercial banks are one way for small businesses to get money. The main thing that private banks do to help the economy grow is act as financial middlemen. In this role, private banks help make sure that investment cash moves around the market. The main way that capital is distributed in the economy is through loans, which helps commercial banks figure out how risky it is to do business.

a. Risk: Risk assessment is one of the most important things that private banks do for economic growth. This mostly happens when banks lend money to people or companies. For example, when someone applies to receive money from a bank, the bank looks at their accounts, including their income, credit score, and amount of debt, among other things. This study helps the bank figure out how likely it is that the user will not pay back the loan. Commercial banks lower the chance of losing money by getting rid of risky customers. This means that loans that are paid off without any problems give the bank more money to lend, which helps the economy grow even more.

b. Individuals: When private banks look at risk, they help make sure that loans go to people who can pay them back.

In turn, borrowers usually use the loan money to pay for big purchases like homes, schooling, and other personal items. People who borrow money from private banks spur economic activity because they now have the money to pay for their own projects.

c. Small Business: There are different ways that commercial banks can pay for business loans. For the start-up costs of a small business, a business owner may ask for a loan. Once the small business has the money it needs, it can start running and make plans for growth. An important part of jobs across the country is created by small businesses working together. The U.S. Census Bureau says that between one and nineteen employees worked for 4.4 million companies in 2004. On the other hand, there were only 1.2 million companies with more than 20 workers that same year.

d. Government Spending: Commercial banks also believe that the federal government should play a part in helping the economy grow. Companies that deal with money usually help the government pay for its spending by buying Treasury notes. Long-term and short-term Treasury bills both help the government pay for its operations, programs, and deficit spending.

e. Wealth: There are also types of accounts at commercial banks that can be used to hold or grow personal wealth. In turn, business banks use the cash they get from account services to give money and make investments. For instance, commercial banks often get deposits by giving people and businesses the usual range of savings and checking accounts. In the same way, banks give different kinds of timed deposit accounts, like money market accounts and certificates of deposit.

8. The Indian Banking Industry: New Investments and Advancements

- Mergers and acquisitions involving India reached a new high of \$171 billion in 2022. Refinitiv found that in 2022, domestic M&A activity hit new highs, reaching US\$ 119.2 billion, an astounding increase of 156.3% from the previous year. In 2022, there were a number of mergers and acquisitions involving companies including Essar Ports, Mindtree, L&T Infotech, Ambuja Cements, ACC, Adani Group, Biocon, HDFC Bank, and HDFC.
- Jan Dhan bank accounts had deposits of Rs. 1.68 trillion (US\$21.56 billion) in June 2022, and the number of bank accounts started via the government's main financial inclusion program, Pradhan Mantri Jan Dhan Yojana (PMJDY), reached 45.60 crore.
- The biggest private bank in India, HDFC Bank, announced a groundbreaking merger with HDFC Limited in April 2022.
- The first-ever worldwide hackathon, 'HARBINGER 2021 - Innovation for Transformation,' with the topic 'Smarter Digital Payments,' was announced by the Reserve Bank of India (RBI) on November 09, 2021.
- Kotak Mahindra Bank said in November 2021 that it has acquired a 9.98% interest in KFin Technologies for Rs. 310 crore, or \$41.62 million.
- The planned National Asset Reconstruction Company Ltd. (NARCL) was announced in October 2021 with

the announcement that Indian Bank has acquired a 13.27% interest.

- Flexi-Loans is a digital lending platform for micro, small, and medium-sized enterprises (MSMEs), and in July 2021, Google Pay for Business collaborated with them to help small businesses get access to loans.
- Axis Bank paid Rs 90.8 crore (about \$12.32 million) in February 2021 to purchase a 9.9% interest in Max Bupa Health Insurance Company. The Digital Lenders' Association released an updated code of conduct for digital lending in December 2020 in reaction to the RBI's warning letter.
- After getting the green light from the National Payments Corporation of India (NPCI) to roll out UPI progressively, WhatsApp launched its UPI payments service in India on November 6, 2020.

9. Conclusion

The banking system is a big part of the economy of a country. A business organization is an important part of modern life. The money market in an advanced country is built around it, and it is very important to the economic growth of that country. It is very important to stress how important these organizations are to the growth paths of emerging countries that are just now becoming industrialized. But, as we already said, neoliberal financial deregulation is changing the way finances are set up.

The importance of online and mobile banking has grown with the arrival of new technologies. As a result, financial institutions are putting more effort into improving customer service and updating their technology systems to make customers' experiences better.

Rising incomes encourage the expansion of India's credit industry, which can have far-reaching effects on the nation in the future. The expansion of the credit market, faster loan disbursement, greater alignment with rising demand, and support for economic growth rates may be expected in the credit-constrained Indian market if a new class of credit reaches critical mass. Through the provision of low-interest loans, banks significantly contribute to the preservation of traditional agricultural traditions, benefiting people from all walks of life. As a result, commercial banks are crucial for promoting all-encompassing economic development.

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