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THE ROLE OF COMMERCIAL BANKS IN ACHIEVING ECONOMIC DEVELOPMENT IN INDIA

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ABSTRACT

Commercial banks are financial institutions that accept deposits from the public and provide loans for consumption and investment purposes for profit. This implies that they play an integral part in the economic development of a nation. Examples of commercial banks in India are The State Bank of India, Kotak Mahindra Bank, HDFC Bank, IDBI Bank etc. There are more than 50,000 commercial bank branches and approximately 8,000 regional rural banks branches covering the 280 districts in the country. These banks offer short term/ long term loans (home loans, car loans, personal loans etc). The findings of the research analyses how commercial banks help achieve economic development. This study describes how loans and credits affect GDP and hence the growth rate of the Indian economy.

The objectives of the study are:

1) To factually investigate the role of Indian Banks in economic growth.
2) Analyse the impact of bank deposit mobilization on economic growth of India
KEYWORDS: loans, investment, GDP, credits.

INTRODUCTION

Commercial banking activities, in India, have gained popularity after Independence. Conservative banks have adapted to the rapidly changing times, and have faced the challenge of economic growth. They play an important role in attaining short-term and mid-term credit requirements in an economy. Funds parked in community-owned commercial banks can be withdrawn on short notice; commercial banks provide credit for short periods of time that are guaranteed by tangible and easily negotiable securities.

CLASSIFICATION OF COMMERCIAL BANKS.

1) **Public Sector Banks**: These are the nationalized banks undertaken by the Government of India, in a way or other.

Eg: State Bank of India

2) **Private Sector Banks**: These are similar to public banks, but are owned by private owned; the major stakes in the equity are owned by private stakeholders or businesses.
   Eg: HDFC Bank
3) **Foreign Banks:**The headquarters of these banks is outside the country. Its offices are run as a private entity outside that country.

Eg: JP Morgan Chase Bank

4) **Regional Rural Banks**: These banks provide credit support to the economically weaker sections of the society.
   Eg: Maharashtra Gramin Bank

DEVELOPING NATURE OF THE INDIAN ECONOMY.

India is a developing economy, and has a low per capita income. Over 30% of the total population of the country, earn less than $1.25 (around Rs. 90)per day available. India has a poverty rate of 21.9% - which is just close to the average poverty rate of the world (23.46%).

India leans towards a capitalistic economy. A common belief about a capitalistic economy is- ‘the rich get richer, and the poor get poorer’. A large factor contributing to India’s developing economy is the income disparity.

Also, India is an agricultural based economy. The agriculture sector provides around 14.2% of India’s GDP. Moreover, 53% of the Indian population is employed in the agricultural sector. This supports the point that India has a low standard of living.

Due to the high population rates in India, it is clear that Indian production technique is more labour oriented in nature.There is also a large backwardness of infrastructural development; inadequate availability of health facilities, and poor sanitisation facilities.

RELATIONSHIP BETWEEN THE RESERVE BANK OF INDIA, AND THE GOVERNMENT OF INDIA.

The Reserve Bank of India (RBI) is India's central bank and regulatory body under the jurisdiction of Ministry of Finance, Government of India. It is responsible for the issue and supply of the Indian rupee and the regulation of the Indian banking system. It also manages the country's main payment systems and works to promote its economic development.

THE ROLE OF THE RESERVE BANK OF INDIA IN CREDIT CREATION

A bank's ability to create credit distinguishes it from other financial firms. Credit creation is the expansion of deposits in plain terms. Furthermore, because demand deposits are the primary means of trade, banks can increase their demand deposits to a multiple of their cash holdings.

Demand deposits are a key component of the money supply, and increasing demand deposits indicates increasing money supply. The entire banking system is predicated on credit. Credit is defined as obtaining purchasing power today while promising to repay at a later date. The term "bank credit" refers to bank loans and advances.

A bank holds a portion of its deposits as a minimum reserve to meet depositor demands and lends out the rest to generate revenue. The borrower's account gets credited with the loan. Every bank loan generates a corresponding bank deposit. As a result, credit creation entails an increase in bank deposits.

The bank’s credit creation process is based on the assumption that during any time interval, only a fraction of its customers genuinely need cash. Also, the bank assumes that all its customers would not turn up demanding cash against their deposits at one point in time.

Example 1: Credit creation by a single bank

Assumption: The cash reserve ration of the bank is 20%

- If a person (person A) deposits 1,000 rupees with the bank, then the bank keeps only 200 rupees in the cash reserve and lends the remaining 800 to another person (person B). They open a credit account in the borrower's name for the same.
- Similarly, the bank keeps 20 percent of Rs. 800 (i.e. Rs. 160) and advances the remaining Rs. 640 to person C.
- Further, the bank keeps 20 percent of Rs. 640 (i.e. Rs. 128) and advances the remaining Rs. 512 to person D.

Rounds	**Primary Deposits**	**Cash Reserves (r = 20%)**	**Credit Creation or Derivative Deposits (ΔD)**
1. (Person A)	Rs. 1000 (Initial primary deposits)	Rs. 200	Rs. 800 (Initial excess reserves ΔR)
2. (Person B)	800	160	640
3. (Person C)	640	128	512
4. (Person D)	512	102	410
-	-	-	-
-	-	-	-
Total	5000	1000	4000

This process repeats itself until the first primary deposit of Rs. 1,000 and the initial extra reserves of Rs. 800 results in additional or derivative deposits of Rs. 4,000 (800+640+512+...)

When we add the initial deposits together, we receive a total of Rs. 5,000 in deposits. The credit multiplier in this situation is 5 (reverse of the CRR), and the credit generation is five times the initial surplus reserves of Rs. 800.

Example 2: Multiple credit creation by a banking system

The financial system is made up of many banks, and it is unable to grant loans in excess of the money it generates. A bank loses money when it makes a derivative deposit because it loses money to other banks.

The loss of one bank's deposit is the gain of another bank's deposit. This cash transfer within the banking system establishes primary deposits and expands the potential for derivative deposits to be created.
An illustration for better understanding:

Banks	**Primary Deposits**	**Cash Reserves (r = 20%)**	**Credit Creation or Derivative Deposits (ΔD)**
A	Rs. 1000 (Initial primary deposits)	Rs. 200	Rs. 800 (Initial excess reserves ΔR)
B	800	160	640
C	640	128	512
D	512	102	410
-	-	-	-
-	-	-	-
Total	5000	1000	4000

As previously stated, a onetime deposit of Rs. 1,000 with bank A results in a total deposit of Rs. 5,000.

Factors Affecting Credit Creation

- The demand for credit in the market
- The desire for banks to create credits
- The ability of banks to create credit, which is determined by the availability of cash deposits in banks. In addition, the ability to produce credit is influenced by the elements that influence their cash deposit ratio.

IMPORTANCE OF BANKS IN THE DEVELOPMENT OF INDIA

Monetary Policy

Monetary policy is the process by which the monetary authority of a country, generally the central bank, controls the supply of money in the economy by its control over interest rates in order to maintain price stability and achieve high economic growth. This is applied to curb the problem of inflation and deflation. In India, the Reserve Bank of India carries this out.

Increased Employment Opportunities

As banks promote industry and investment, it automatically generates job opportunities. Therefore, banks allow the economy to generate employment opportunities.

Promotion of Saving Habits of the People

Banks provide different kinds of deposit schemes and provide rewards and returns in the form of interest. This is attractive to depositors. This encourages people to create saving and banking habits.

Support Agricultural Development

Since the main source of the Indian economy is agriculture, banks promote the agricultural sector by providing loans and advances with low rate of interest compared to other loans and advance schemes.

Balanced Development

Some banks play a crucial role in the socio-economic development of India i.e. they help to spread banking activities in rural and semi-urban areas. A well-developed banking system allows the country to develop in a balanced way without especially considering rich and poor, cities and rural areas, etc.

FUNCTIONS OF COMMERCIAL BANKS

A commercial bank is a type of financial institution that performs all operations related to the deposit and withdrawal of money for the general public, granting credit for investments and other similar activities. These banks are profitable institutions and only operate for the purpose of making a profit. The two main characteristics of a commercial bank are lending and borrowing. The bank takes the deposits and gives money to various projects to earn interest (profit). The interest that a bank offers to depositors is called the interest rate, while the interest at which a bank lends money is called the interest rate.

Primary functions

Accepts deposits: Commercial banks accept deposits from their customers in the form of saving, fixed, and current deposits.

Savings account- Savings allow a customer to credit their account up to a certain limit. These deposits are preferred by fixed income people that are used to generate savings over time.

Fixed account- This is the type of account in which money is deposited for a fixed period of time. The rate of interest depends on the time period of deposit.

Current account-This is the type of account in which the customer can withdraw money from at any given time. There is no fixed period of deposit.

Provide loans and advances: Banks grant loans to organizations and individuals and benefit from accrued interest. Banks generally keep a small reserve for their expenses while offering the balance to clients as various types of short-term and long-term loans.

Credit cash: When a customer wants a loan, they are not provided with liquid cash. First, a bank account is opened for them. After this, the money is then transferred to their account. This allows the bank to create more money.

Secondary functions

Agency services: The customers give instructions to the banks to make/ accept payments on their behalf. The banks and customers have a relationship of a principal and agent. The bankers provide the following agency services:

1) Purchase of foreign exchange
2) Collection of interest and dividends
3) Transfer of funds via demand drafts and mail transfer
4) Payment of insurance premium, interest and instalments
5) Purchasing and selling of securities

General Utility Services: Commercial banks also offer various general public services to their clients. Some of these services are explained below:

1) Safety locker facility- The custody of important documents, valuables such as jewellery is one of the oldest services provided by commercial banks. The bank only provides lockers and keys, but valuables are always under the control of its users. Only locker customers can enter the safe after entering their name and account number.
2) Credit cards- Credit cards are another important means of payment. Visa and Master cards are operated by commercial banks. A person can use a credit card to withdraw cash from ATMs and make payments in commercial establishments.

3) Money Transfer- The transfer of funds is one of the most important functions of commercial banks. Checks and credit cards are two important payment mechanisms used by banks. Despite the increase in financial transactions, banks are managing the money transfer process very efficiently.
4) Foreign exchange- Commercial banks help individuals and organizations that export or import products from abroad to provide foreign exchange. However, only certain banks that have a license to trade forex are eligible for such transactions.
5) Automatic Teller Machines (ATM)- These are machines which serve in the quick withdrawal of cash. This gets withdrawn from the person's bank account via a credit/ debit card.

ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT

Commercial banks are a source of finance for small businesses. The role of commercial banks in economic development is based primarily on their role as financial intermediaries. In this role, commercial banks help promote the flow of investment capital in the market. The main mechanism of this capital allocation in the economy is the loan process, which helps commercial banks.

1) Government spending- Commercial banks also support the role of the federal government as an agent of economic development. In general, commercial banks help finance government spending by purchasing bonds issued by the Ministry of Finance. Both long- and short-term Treasury bills help finance operations, government programs, and support deficit spending.
2) Favourable schemes for small businesses- Commercial banks also finance business loans in various ways. An entrepreneur can apply for a loan to finance the costs of starting a small business. Once funded, small businesses can start operations and initiate growth plans. The aggregate effect of small business activity generates the bulk of employment across the country.
3) Wealth- Commercial banks also offer types of accounts for storing or generating individual wealth. In turn, deposits withdrawn by commercial banks with account services are used for loans and investments. For example, commercial banks typically attract deposits by offering traditional savings and checking accounts menus for businesses and individuals. Similarly, banks offer other types of time deposit accounts, such as money market accounts and certificates of deposit.
4) Risk- One of the most significant roles of commercial banks in economic development is as a risk arbiter. This is especially the case when banks provide loans to companies or individuals. For example, when people want to borrow money from a bank, the bank reviews the borrower's finances, including income, creditworthiness, and debt levels, among other things. The result of this analysis helps the bank estimate the probability of default for the borrower. By eliminating risky borrowers, commercial banks reduce the risk of financial losses.

STATISTICS

Sector wise loan of commercial banks in 2020. (Rs in million)

BFI Name	Janata	Mega	CBL	Century	Sanima
Sector Wise					
Agricultural and Forest Related	3,369.62	1,931.00	2,631.35	1,739.52	1,660.20
Fishery Related	79.85	23.78	53.28	34.26	23.54
Mining Related	9.79	130.20	27.97	460.41	894.91
Manufacturing (Producing) Related	14,792.44	11,655.30	**9,977.64**	**15,078.55**	11,420.09
Construction	5,277.12	3,209.64	2,891.34	5,645.89	7,420.87
Electricity,Gas and Water	3,282.79	1,870.54	2,550.30	2,444.07	3,801.68
Metal Products, Mach. & Ele. Eqp.	370.75	619.46	456.34	1,008.23	1,340.41
Tras., Com. and Public Utilities	852.18	1,059.06	1,355.39	624.84	4,676.73
Wholesaler & Retailer	**15,538.19**	**18,080.96**	9,255.36	11,252.99	16,177.18
Finance, Insurance and Real Estate	2,670.86	9,796.57	4,970.96	6,825.56	3,136.05
Hotel or Restaurant	2,257.60	3,651.08	1,416.89	2,390.80	2,426.49
Other Services	3,139.32	1,472.82	1,840.64	1,897.71	2,797.89
Consumption Loans	3,470.15	4,006.52	3,477.84	4,059.09	2,422.16
Local Government					
Others	9,916.90	10,606.53	3,027.25	6,184.29	**20,558.34**
TOTAL sectorwise	**65,027.57**	**68,113.45**	**43,932.54**	**59,646.20**	**78,756.54**

CONCLUSION

Countries have started a development process over a very long period of time. The mixed capitalist economies framework has sought to use the evolving banking function embedded in existing or specially created institutions to further its development objectives. The role of these institutions in the development of late industrializing developing countries cannot be emphasized enough. However, as mentioned above, neoliberal financial liberalization is changing financial structures; some countries are abolishing specialized development banks on the grounds that equity and bond markets would do the job. This inevitably leads to funding bottlenecks for long-term investments, especially for small and medium-sized companies. Fortunately, there are some countries like Brazil that have not yet taken this route.

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