

Role of Banks in Economic Development-An Appraisal

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Abstract

A nation's economic development largely depends on the banking sector. The banking sector acts as the backbone of any country. They are operating not just as custodians of the nation's wealth but also as its resources, which are needed for the economic growth of the country. Banks are essential to the economic development of a nation as they offer financial services to the general public and businesses, which ensures economic and social stability and sustainable growth of the economy. Hence, the performance of banks is directly correlated with the overall status of the economic growth of the country. The main purpose of this article is to understand how banks contribute to the economic growth of the country and also to study the problems of the banking sector that affect economic growth, like fast-changing markets, technology, and customer preferences, which are followed by suggestions for achieving a better economic growth rate.

Keywords: *Economic growth, Banking sector, Economic, County, national resources.*

Introduction

Economic development is one of the most important aspects of any country. The banking industry is an essential component of the economy. As a result, this sector is vital to the economy's health. Furthermore, the banking sector continues to be at the forefront of contributing to the economy through its ability to collect and attract saver deposits, provide loans to encourage investment and production, and create economic expansion in the majority of economic sectors, such as agriculture, industry, and trade. Finally, it serves as a link between savers and borrowers. In this study, the important role of the banking sector and its major functions will be explained using variables that represent the key businesses of banks that contribute to the country's economic growth.

This study aims to determine the relationship between the banking sector and economic growth via major variables that have a significant impact on overall economic growth. The goal of this paper is to provide evidence by investigating the relationship between banking sector growth and Indian economic growth. Furthermore, it examines the effects of credit facilities, banking deposits, credit interest rates, and branch count on gross domestic product (GDP) as a proxy for economic growth rate.

Review of Literature

A review of some important research studies in the field of Banking conducted by different scholars at various points of time has been made.

Ghosal S.N. and Sharma, M.D. (1965) have made an attempt to analyze the role of commercial Banks in the economic growth of developing economy like India. They have identified various stages of economic growth and established that Commercial Banks have a greater role to play in different stages of economic growth

Nigam, B.M.L. (1967) has evaluated the significance of banking system in the process of economic development since 1951. His observations revealed that non-availability of timely and adequate credit has been one of the important reasons for slow growth rate in various sectors of the economy.

Goyal, S.K. (1967) has pointed out that Banking institution acts as a catalytic agent for reduction of disparities in the level of income and wealth which is sine-qua-non for economic development of developing countries like India.

Hukku, V.N. (1968) has highlighted the need of finance in a developing economy and the role of Commercial Banks in financing agriculture, industry and export finance which would accelerate the pace of economic development.

Prasad Kamita (1970) , John, C. (1970) and Bhardacharya,T.R. (1970) have established that nationalization of Bank is an opportune step in the light of certain economic and financial trends Can contribute to the growth of national income so also to the economic development of developing countries like India

Varde, S.D. (1973) in an empirical study has observed that rural branches act as an active catalyst in the integrated socio economic development of the area served by them.

Sharma, B.P. (1974) has made an attempt to assess the functional and developmental activities of Indian Commercial Banking during 1951-74. By showing the flow of Bank finance to different sectors of the economy he has highlighted the crucial role played by Banks in accelerating the tempo of growth in a developing economy like India.

Statement of Problem

The banking sector contributes significantly to the economic growth of any country because banks' primary role is to mobilize financial resources to meet the financial demands of various productive sectors of the economy. Although it faces some challenges in performing at its best, such as NPAs, losses in rural branches and over-dues, and competition from non-banking financial institutions, among others. The main goal of this paper is to understand the significant impact of banks' performance parameters, such as deposits, credits, number of operating branches, and profitable growth of the banking sector, on the country's economic growth. And also this paper followed by conclusion which highlights impact of banking sector contribution towards economic growth.

Significance of the Study

Achieving greater economic growth is highly dependent on the banking sector performance of any country. The banking sector plays a significant role through its performing tools such as deposits, lending,

and expansion of its operations and profitability, which will definitely pump the economic growth of the country. It has become important to know how the banking sector impacts on the economic growth of the country as well as the barriers of the banking sector which are dragging behind economic growth. This paper tries to conclude the points which can improve the performance of the banking sector and also eradicate the challenges of the banking sector in economic development.

Research Methodology

The purpose of this research paper is to look into the impact of the Indian banking sector on economic growth as measured by GDP from 2017 to 2021/2022. The researcher selected the bank's performance parameters, which are measured by independent variables such as deposits, credits, profits, and performing branches. These variables are indicators of the banking sector and have an impact on economic growth. Regression analysis has been used in this paper for analyzing the impact of banking parameters on GDP

Objectives

1. To analyze the role of banks in economic development.
2. To study the different facilities of banks and their contribution towards economic development
3. To examine the problems being faced by banks to contribute fully through economic development
4. To suggest suggestion in the light of the findings of the study

Role of Banking in Economic Development

Banks play an important and necessary role in every nation's economic growth. Banks primarily manage withdrawals, deposits, lend short-term loans, home loans, mortgage loans, underwrite, assist governments and corporations in investments, and raise large amounts of funds. They control a large portion of the money supply in circulation and can influence the nature and character of production in any country. To investigate the economic significance of banks we must analyze the general and essential functions of banks.

1) Accepting Deposits: Banks accept deposits by mobilizing people's savings.

Savings deposits are a type of safe deposit account for people who have savings and placed in a savings account. Deposits in this account earn nominal interest, and banks have the authority to release funds on demand by the depositor. Deposits in this account earn nominal interest, and banks have the authority to release funds on demand by the depositor.

- Demand deposits: are held in the current account. On demand, the depositor can withdraw the funds. The account holder, however, must specify the amount and number of withdrawals.
- Fixed deposits: These are also referred to as time deposits. The amount deposited cannot be withdrawn before the maturity period agreed upon.

2) Granting of Loan: Banks grant loans and advances in a variety of ways. These operations take various forms.

- Cash credit: In exchange for collateral, the bank makes loans to individuals or businesses. The loan money is credited to the borrower's account, and he can withdraw it whenever he wants.
- Overdraft facilities are available: These facilities are enjoyed by respectable and dependable customers. In times of need, the customer can write checks and overdraw his account, even if there is insufficient money in it. The customer will pay the bank interest on the amount overdrawn.
- Bills of exchange discounting: These operations are carried out by discounting commercial papers, promissory notes, and bills of exchange for a period of three months. The balance amount is given to the customer after the banks deduct interest and collection charges from the face value of the bills. The banks collect the payment from the party when the exchange bill matures.

3) Credit Creation: Every loan approved by a banker generates a deposit. Because when a bank approves a loan for a customer, an account in his name is opened, and the loan amount is credited to his account. When the borrower needs money, he or she withdraws it. The creation of such deposits increases the economy's money stock and creates new money through its circulation.

4) Increase in Market Size: Commerce and industry can expand their fields of operation with the help of strong banking system. Commercial banks act as a bridge between buyers and sellers. Goods are delivered with bank guarantees, allowing industry and commerce to cultivate and locate markets for their products. The risks are assumed by the bank. When the banks have released the risks, the industry can look forward to reaping the benefits of the market's size.

5) Serve as a Catalyst for Balanced Regional Development: Banks assist in the proper allocation of funds among the various sectors of the economy. Banks' primary motto is to make a profit. Bank profits are maximized when funds are lent for more productive purposes. With the introduction of branch banking, customers can now choose between different regions. More bank funds are drawn to a region with high growth potential. Banks contribute to the development of infrastructure, which is necessary for economic development. As a result, banks serve as engines of balanced regional development in the country.

6) Agriculture and Related Activities Financing: Farmers benefit from the bank's support in obtaining credit for agricultural development. Farmers require credit for a variety of reasons, including production; the modernization and mechanization of their agriculture; the provision of irrigation facilities; and the development of land. Banks also provide financial assistance in animal husbandry, dairy farming, sheep breeding, poultry farming, and horticulture.

7) To Improve People's Standard of Living: The consumption pattern is used to estimate a person's standard of living. Banks make loans to consumers for the purchase of consumer durables and other immovable property, which raises the people's standard of living.

Facilities of Banks and Their Contribution towards Economic Development

This study includes banking performing parameters such as deposits, credits, profits, and performing branches of banks as variables indicators of the banking sector and GDP indicates the growth of economy.

Banking deposits

Deposits play an important role in the development of the economic system; banks usually obtain those amounts from depositors and lend them to needy units and investors, resulting in the creation of new investment projects, an increase in the number of working units within society, which impact on economic growth.

Table 1 Bank Deposits and GDP

Year	Deposits (in cr)	GDP (billion \$)
2017	1,07,30,029	2,651.47
2018	1,14,34,451	2,702.93
2019	1,26,39,009	2,831.55
2020	1,37,48,655	2,667.69
2021	1,54,43,510	3,173.40

Source: Economic Survey 2021-22 Statistical

Banking Credits

Bank credit is the amount available to a business or person from a banking institution in the form of loans; it is the total amount of money that a person or business can borrow from a bank. Bank credit enables the money flow in the economy, which impacts economic growth.

Table 2 Bank Credit and GDP

Year	Credits (in cr)	GDP (billion \$)
2017	79,17,868	2,651.47
2018	87,66,973	2,702.93
2019	98,97,595	2,831.55
2020	1,05,18,812	2,667.69
2021	1,10,78,050	3,173.40

Source: Economic Survey 2021-22 Statistical

Banking sector profit

Bank profitability is a measure used to assess a bank's performance. Banks make money by generating more money than they spend on expenses. The majority of a bank's profit comes from service fees

charged for its services and interest earned on its investments. Bank profitability is a major factor which affects the economic growth of the country.

Table 3 Banking sector profit and GDP

Year	Banking sector profit (US billion \$)	GDP (US billion \$)
2020	153.15	2,702.93
2021	153.70	2,831.55
2022	156.11	2,667.69

Source: <https://www.moneycontrol.com>

Bank performing branches

The bank establishes its branch for convenience, performance, and easy reach of its customers. The increasing number of branches indicates the operational growth and market share growth which impact on economic growth.

Table 4 Bank branches and GDP

Year	branches	GDP (billion \$)
2018	1,42,467	2,702.93
2019	1,46,192	2,831.55
2020	1,50,043	2,667.69
2021	1,50,590	3,173.40
2022	1,51,250	3,469.00

Source: RBI website

Regression Analysis and Hypothesis

This study aims at finding relationship between banking sector growth and economic growth with the help of data available from 2017 to 2021.

In the light of study objectives following hypotheses are tested.

H1: There is a significant correlation between the Bank Deposits and GDP

H2: There is a significant correlation between the Bank Credits and GDP

H3: There is a significant correlation between Bank Profit and GDP

H4: There is a significant correlation between Performing Branches and GDP

Linear regression examines the strength of the relationship between independent variables and dependent variable

Table 5: linear regression matrixes

Variable	Co-efficient	Std.error	t-statistic	p-value
Bank's Deposits	0.246	0.000	0.358	0.754
Bank's Credits	0.897	0.000	1.636	0.200
Bank's Profits	0.913	0.006	3.158	0.087
Bank's Branches	0.638	0.041	1.435	0.247

Relation between the Bank Deposits and GDP

Table 5 shows that there is a positive relationship between Banks deposits and GDP. The elasticity between the Deposits and GDP equal to (0.246) and it's positively affected GDP which means if deposit increase by 1%, the GDP will increase by 0.246 %. Looking at the probability of the variable >5%, therefore, we can't reject the null hypothesis.

- H0: There is a no significant correlation between the Bank Deposits and GDP (Accept)
- H1: There is a significant correlation between the Bank Deposits and GDP (Reject)

Relation between the Bank Credit and GDP

Table 5 shows that there is a positive relationship between Banks credit and GDP. The elasticity between the credit and GDP equal to (0.897) and it's positively affected GDP which means if credit increase by 1%, the GDP will increase by 0.897% Looking at the probability of the variable >5%, therefore, we can't reject the null hypothesis.

- H0: There is a no significant correlation between the Bank Credit and GDP (Accept)
- H1: There is a significant correlation between the Bank Credit and GDP (Reject)

Relation between the Bank profit and GDP

Table 5 shows that there is a positive relationship between Banks profit and GDP. The elasticity between the banks profit and GDP equal to (0.913) and it's positively affected GDP which means if deposit increase by 1%, the GDP will increase by 0.913 %. Looking at the probability of the variable >5%, therefore, we can't reject the null hypothesis.

- H0: There is a no significant correlation between the Bank Profit and GDP (Accept)
- H1: There is a significant correlation between the Bank Profit and GDP (Reject)

Relation between the Bank branches and GDP

Table 5 shows that there is a positive relationship between bank branches and GDP. The elasticity between the bank branches and GDP equal to (0.638) and it's positively affected GDP which means if branches increase by 1%, the GDP will increase by 0.638 %. Looking at the probability of the variable >5%, therefore, we can't reject the null hypothesis.

- H0: There is a no significant correlation between the Bank branches and GDP (Accept)
- H1: There is a significant correlation between the Bank branches and GDP (Reject)

Problems Faced by Banks to Contribute Fully Through Economic Development

Banking sector development will impact positively on countries economic development, although it has some challenges which is negatively affecting the banking sector in contributing towards the economic development such as

Public sector banks' NPAs

The problem of high loan write-offs and NPAs will result in low asset growth and it is more severe for public sector banks (PSBs) than private banks. However, most of the larger NPAs get resolved as per the Insolvency and Bankruptcy Code or other mechanisms. This is becoming a problem for economic growth

Banks subject to prompt Corrective Action (PCA)

RBI has placed 11 PSBs under the PCA framework due to factors such as insufficient capital and high NPAs. In these banks, lending and deposit-taking capabilities are limited. Despite the imposition of PCA, recoveries in these banks have been stagnant.

Losses in Rural Branches

Due to high overheads and the prevalence of the barter system in most parts of rural India, most rural branches are losing money.

Large Over dues

Small commercial bank branches are now dealing with a new problem of large amount of overdue advances to farmers. The former National Front Government's decision to waive all loans to farmers up to Rs. 10,000 crores has worsened the situation for such banks.

Gap between promises and performance

Banks' failure to fulfill the needs of other sectors through undesired credit patterns thus creates the gap between promise and performance. Despite the fact that banks' objectives have been redefined, the bank staff has remained static, and old procedures continue to be followed.

Competition by foreign banks

The Indian banking sector is facing tough competition from foreign banks where foreign banks' performance and services attract customers of national banks towards them and make Indian banks underperform.

Political pressures

Growing political pressures from the Centre and the States have also affected the smooth operation of nationalized banks. Nationalized banks frequently face numerous challenges as a result of various political pressures. Such pressures are created in personnel selection and the granting of loans to specific parties without regard to their creditworthiness.

Conclusion

The country's banking sector's performance has an impact on economic growth both directly and indirectly. The banking sector will work in many dimensions, and each dimension will impact on economic growth. The banking parameters like deposits, credit facilities, operational expansion, and profitability highlighted in the hypothesis will impact the Indian economy. Furthermore, the banking sector is facing many problems such as political pressure, inadequate lending, inefficient operational strategies, high over dues, and failure to make a profit in rural branches, as well as strategies to give higher customer satisfaction to serve and retain customers, which can help in achieving the higher performance of banks, resulting in desirable economic growth for the country.

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