Role of Banks in the Development of Indian Economy

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Abstract: Without a sound and effective banking system, no country can ever have a healthy economy. In the modern’s economic system, banks play a very important role in economic development of country. They collect the surplus savings of the people and make them available for investment. They also create new demand deposits in the process of granting loans and purchasing investment securities. They facilitate trade both inside and outside the country. Commercial banks, which is an important part of the financial system of the country. As per the Reserve Bank of India (RBI), India’s banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are far superior to any other country in the world. Indian banking industry has recently witnessed the roll out of innovative banking models like payments and small finance banks. The central bank granted in-principle approval to 11 payments banks and 10 small finance banks in FY 2015-16. RBI’s new measures may go a long way in helping the restructuring of the domestic banking industry. This research paper relates to the study of banks role in the economic development of country. India’s Banking System has no longer confined to only the metros, but has reached even to the backward corners of the country.

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

INTRODUCTION

Bank is a financial institution that performs several functions like accepting deposits, lending loans thus helps in agriculture and rural development etc. Bank plays an important role in the economic development of the country. Without a sound and effective banking system, no country can have a healthy economy. 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. The most important role of a bank is to connect those who have capital with those who need capital. India is not only the world’s largest independent democracy, but also an emerging economic giant. For the past three decades, India’s banking system has several outstanding achievements. This is one of the reasons of India’s growth process. According to joint report prepared by KPMG-Confederation of Indian Industry (CII), Indian banking sector is poised to become fifth largest by 2020. The report also states that bank credit is expected to grow at a compound annual growth rate of 17 per cent in coming years. After post economic liberalization and globalization, there has been a significant impact on the banking industry. The concept of Banking in India dates back to the first half of 18th century. The first bank that was established in the country was The General Bank of India founded in 1786. 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 in 1935. The Indian banking system consists of 26 public sector banks, 25 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. Public-sector banks control nearly 80 percent of the market, thereby leaving comparatively much smaller shares for its private peers. Banks are also encouraging their customers to manage their finances using mobile phones. Standard & Poor’s estimates that credit growth in India’s banking sector would improve to 11-13 per cent in FY17 from less than 10 per cent in the second half of CY14.

Today, banks have diversified their activities and are getting into new schemes and services that include opportunities in credit cards, consumer finance, life and general insurance, investment banking, mutual funds, pension fund regulation services, etc. Today, the banking sector is one of the biggest service sectors in India. The focus of banks has shifted from customer acquisition to customer retention by providing various products like internet banking, ATM services, telebanking and electronic payment etc. The facility of internet banking enables a consumer to access and operate his bank account without actually visiting the bank premises. The facility of ATMs and credit/debit cards has also helped a lot. Banks can contribute to a country’s economic development in the following ways:
1. Removing the deficiency of capital formation

In any economy, economic development is not possible unless there is an adequate amount of capital formation. The serious capital deficiency in developing countries is removed by banks. A sound banking system mobilizes small savings of the community and makes them available for investment in productive enterprises. Banks mobilize deposits by offering attractive rates of interest and thus convert savings into active capital. Otherwise, that amount would have remained idle. Banks distribute these savings through loans among productive enterprises which are helpful in nation building. It facilitates the optimum utilization of the financial resources of the community.

2. Helps in generating employment opportunity

Banks help in providing financial resources to industries and that helps in automatically generate employment opportunities. Especially employment generated by banking sector every year runs in millions. Equally revenue generation through tax and dividend collection by the government invested every year. While revenue and employment generation are two very important contributions, successfully maintaining healthy credit line to industrial sector as well as to overall economy is another important contribution of the financial sector.

3. Financial assistance to Industries

The commercial banks finance the industrial sector in a number of ways. They provide short-term, medium-term and long-term loans to industry. The Industrial Development Bank of India is the main institution in India providing financial assistance to the industrial sector. It provides direct financial assistance to the industrial enterprises in the form of granting loans and advances, and purchasing or underwriting the issues of stocks, bonds or debentures. The creation of the Development Assistance Fund is the special of the IDBI. The Fund is used to provide assistance to those industries which are not able to obtain funds mainly because of heavy investment involved or low expected rate of returns. IDBI gives guidance to start a business. To facilitate an easy access to finance by Micro and Small Enterprises, the Government/RBI has launched Credit Guarantee Fund Scheme to provide guarantee cover for collateral-free credit facilities extended to MSEs up to Rs 1 crore. Moreover, Micro Units Development & Refinance Agency (MUDRA) Ltd. was also established to refinance all Micro-finance Institutions (MFIs), which are in the business of lending to micro / small business entities engaged in manufacturing, trading and services activities up to Rs 10 lakh.

4. Promote saving Habits of the people

Bank attracts depositors by introducing attractive deposit schemes and providing higher rates of interest. Banks providing different kinds of deposit schemes to its customers. It enables to create saving habits among people. Bank open different accounts to attract customer. These accounts are opened as per the requirements of customers such as current account, fixed deposit account, saving account and recurring account etc.

5. Financial assistance to Consumer Activities

People in underdeveloped countries being poor and having low incomes do not have sufficient financial resources to buy durable consumer goods. The commercial banks advance loans to consumers for the purchase of such items as houses, furniture, refrigerators, etc. In this way, they also help in raising the standard of living of the people in developing countries by providing loans for consumption activities.

6. Helps in implementing Monetary Policy

The commercial banks help the economic development of a country by implementing the monetary policy of the RBI. RBI depends upon the commercial banks for the success of its policy of monetary management in keeping with requirements of a developing economy. Thus the commercial banks contribute much to the growth of a developing economy by granting loans to agriculture, trade and industry, by helping in capital formation and by following the monetary policy of the country.

7. Financial facilities for Trade

The commercial banks help in financing both internal and external trade. The banks provide loans to retailers and wholesalers to purchase goods in which they deal. They also help in the movement of goods from one place to another. Banks provide all types of facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc. for promoting the trade. Moreover, they finance both exports and imports of developing countries by providing foreign exchange facilities to importers and exporters of goods. Exim Bank of India and the Government of Andhra Pradesh has signed a Memorandum of Understanding (MoU) to promote exports in the state.
8. Foreign Currency Loans

Foreign currency loans are meant for setting up of new industrial projects. Banks also helps in providing loans for expansion, diversification, modernization or renovation of existing units. Banks also helps in financing import of equipment from abroad and/or technical knowhow.

9. Promotion of New Entrepreneurs

Development banks in India have also achieved a success in creating a new class of entrepreneurs and spreading the industrial culture. Special capital and seed Capital schemes have been introduced to provide equity type of assistance to new and technically skilled entrepreneurs who lack financial resources of their own. Development banks have been actively involved in the entrepreneurship development programmes. Innovations are an essential prerequisite for economic development. These innovations are mostly financed by bank credit in the developed countries. But in underdeveloped countries, entrepreneurs hesitate to invest in new ventures and undertake innovations largely due to lack of funds and high chances of risk. Facilities of bank loans enable the entrepreneurs to step up their investment on innovational activities, adopt new methods of production and increase productive capacity of the economy.

10. Balanced Development

Modern banks spreading its operations throughout the world. We can see number of big banks like citi bank, SBI, PNB, Baroda bank etc. It helps a country to spread banking activities in rural and semi-urban areas. With the spreading of banking operations all over the country, helps to attain balanced regional development by promoting rural areas. The Reserve Bank of India (RBI) has granted in-principle licenses to 10 applicants to open small finance banks, which will help expanding access to financial services in rural and semi-urban areas. IDFC Bank has become the latest new bank to start operations with 23 branches, including 15 branches in rural areas of Madhya Pradesh. Modern bank plays important role in the 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. They transfer surplus capital from the developed regions to the less developed regions, where it is scarce and most needed. This reallocation of funds between different regions will promote economic development in underdeveloped areas of the country.

11. Financial assistance to agriculture sector

Agriculture is the backbone of economy of any country like India. The commercial banks help the large agricultural sector in developing countries. They provide loans to traders in agricultural commodities. They open a number of branches in rural areas to provide agricultural credit. They provide finance directly to agriculturists for the marketing of their produce, for the modernisation and mechanisation of their farms, for providing irrigation facilities, for developing land, etc. The share of commercial banks in total institutional credit to agriculture is almost 48 percent followed by co-operative banks with a share of 46 percent and RRBs about 6 percent. Most of the credit-related schemes of the government to uplift the poorer and the under-privileged sections have been implemented through the banking sector. They also provide financial resources for animal husbandry, dairy farming, sheep breeding, poultry farming, and horticulture. The small and marginal farmers and landless agricultural workers, artisans and petty shopkeepers in rural areas are provided financial assistance through the regional rural banks in India. There are various studies which show that in India 40% farmers are committing suicide because of not able to fulfill the loan amount of banks. Commercial banks are providing credit to the poor farmers but this is not free from the other problems.

12. Government Spending

Commercial banks also support the role of the federal government as an agent of economic. 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.

Recent important reforms

Over past few years government has taken many steps to make banking sector even more robust, although it will take quite a few years to see positive impact of these reforms. Moreover, these reforms will open new stream of revenue and employment generation for the economy.

Following are some of these reforms

- Last year in 2015, RBI took unprecedented step by opening up the much anticipated ‘payment bank’ sector. It
 awarded payment bank licenses to 11 entities, these 11 payment banks are expected to give further boost to growth of financial sector as well as to overall Indian economy.

• To reduce the burden of loan repayment on farmers, a provision of Rs 15,000 crore has been made in the Union Budget 2016-17 towards interest subvention.

• Under Pradhan Mantri Jan Dhan Yojna (PMJDY), 250.5 million accounts! have been opened and 192.2 million RuPay debit cards have been issued as of October 12, 2016. These new accounts have mustered deposits worth almost Rs 44,480 crore.

• The Reserve Bank of India (RBI) has issued guidelines for priority sector lending certificates (PSLCs), according to which banks can issue four different kinds of PSLCs— those for the shortfall in agriculture lending, lending to small and marginal farmers, lending to micro enterprises and for overall lending targets — to meet their priority sector lending targets.

• To make banks more ‘credit friendly’, RBI has allowed banks to raise funds via long-term bonds for financing the critical infrastructure sector. This means banks no longer have to meet cash reserve ratio, statutory liquidity ratio or priority sector norms to disburse credit for big infrastructure projects.

• In July 2016, the government allocated Rs 22,915 crore as capital infusion in 13 public sector banks, which is expected to improve their liquidity and lending operations, and shore up economic growth in the country.

• Indian government started Mudra Scheme, under which Indian banks will be providing cheap and affordable credit to new & small entrepreneurs.

CONCLUSION

From the above study we conclude that Banks should invest more in infrastructure facilities like irrigation facilities, processing, storage and marketing activities. Such agricultural infrastructure can be improved by banks, as there are abundance prospects for banks to invest in the above activities. Thus, the banks have come to play a useful role in promoting economic development by mobilising the financial resources of the community and by making them flow into the productive channels. The Indian banks are now playing a very active role in fostering economic development of the country. The above study reveals that how commercial banks are helpful in development of country. If we make the comparison between rural area and urban area then it is clear that urban areas are more developed. This is because of low credit flow and less contribution of agriculture sector in GDP of India. If agriculture sector grow then only economic development is possible in India. To conclude, we can say that the modern economies of the world have developed primarily by making best use of the credit availability in their systems. India. The role of banks has been important, but it is going to be even more important in the future. In spite of all these bright projection, there is a growing concern about increasing NPAs in banking sector. Many analysts, however, feel that some tough steps by RBI coupled with ‘special financial stimulus’ to banks is necessary to overcome the incremental issue of NPAs.

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