# Role of banking system in the Economic Growth and Development

The role of banking system in the economic growth & development can be explained as follows:

1. **Capital Formation:** Economic development requires an increase in the rate of capital formation. For this purpose, it is necessary that the rate of savings increases. Commercial banks can and do serve a very useful purpose in raising the level of aggregate savings. In the first place, commercial banks can provide objective conditions in which people feel that their savings will be secure in the hands of the banks. This sense of security induces people to save and thus, total savings increase. Secondly, for want of proper opportunities, people in low income groups are not able to save. But by operating savings accounts, commercial banks provide an opportunity to small savers to save and invest in productive fields. This is another factor that leads to an increase in total savings. Commercial banks provide a number of attractive schemes offering attractive benefits to the customers. Thus, they are able to mobilize larger amounts of savings.

2. **Provision of finance and credit:** Banks are very important sources of finance and credit for industry and trade. It is observed that credit is the lubricant of all commerce and trade. Hence, banks become nerve centers of all trade activities and therefore commerce and trade could function in the presence of sound banking system.

   The banks cover foreign trade transactions also. Big banks also undertake foreign exchange business. They help in concluding deferred payments, arrangements between the domestic industrial undertakings and foreign firms to enable the former import machinery and other essential equipment.

3. **Monetization of Debts:** Commercial banks serve to increase investable funds by offering to monetize debts if and when required by creditors. Thus, people who have savings may hold back a part of them as a precaution against unforeseen circumstances. But banks offer their services whereby people can hand over their bonds, securities, shares, etc., to the banks against which they (the people) can borrow and meet their needs of cash. This is known as monetization of debts it serves to increase the level of investment; since, with a banking system ready to monetize debts. it is no longer necessary for the people to hold back any cash for unforeseen needs. They can invest all their investable funds.

4. **Regional Balance:** If the banking system in a developing economy has a network of branches, it can help economic development in another way. The banks can transfer surplus funds from regions where they are abundant to those regions which are starved of capital. For example, the branches of a bank in well developed urban centers can collect large amounts of savings because the savings potential of these centers is very high. The same savings through branches in underdeveloped areas can be made available to investors in such areas. This distribution of funds opens up new fields of investment. Thus, the banking system not only

paves the way of economic development between the advanced and the backward regions in a country, but also helps to correct the imbalance in development between the advanced and backward regions of the country.

5. **Consultancy Services:** Besides, commercial banks may also provide financial guidance to entrepreneurs, advise them on the feasibility of their projects and furnish necessary information regarding various sources of finance, technical help, marketing services, etc. These services which are incidental to the usual banking function go a long way in encouraging the development of agriculture, small-scale industries and other types of minor business.

6. **Modernization of Business:** Commercial banks represent the modern organised sector and they are themselves following modern methods of management, accounting, and project-evaluation and so on. When business units from the unorganised sector approach commercial banks for accommodation, they are exposed to these modern business practices. Thus, for example an agriculturist, a minor industrialist or any other small businessman has to submit his project to the bank to forecast the demand for his product and has to prepare his budget. By doing all these things he gets intimation to the modern business practices which he may adopt in the management of his business. This, obviously, has a salutary effect in a developing economy.

7. **Financing agriculture and allied activities:** Agriculture in a developing country like India plays a very important role. The commercial bank helps the farmers in extending credit for agricultural development. Farmers require credit for various purposes like making their produce, for the modernization and mechanization of their agriculture, for providing irrigation facilities and for developing land. The banks also extend their financial assistance in the areas of animal husbanding, dairy farming, sheep breeding, poultry farming and horticulture.

8. **Improves standard of living of the people:** The standard of living of the people is estimated on the basis of the consumption pattern. The banks advance loans to consumers for the purchase of consumer durables and other immovable property, which will raise the standard of living of the people. Stimulating human capital formation, facilitating monetary policy formulation and developing entrepreneurs are some of the other roles played by commercial banks in the economic life of every nation.

9. **Influence on Interest Rates:** As important institutions in the money market, commercial banks can influence the supply of money. By supplying more or less credit, they can exert a significant influence on the market rates of interest. They also thereby influence the choice of the people between holding more or less of liquid assets. This further influences the rates of interest. A cheap money policy with low interest rates stimulates economic development.

10. **Regulation of Economic Activity:** In a developing country, the function of the regulation of the flow of credit by central bank is of the utmost importance. This is especially true when economic development is planned. The plan lays down priorities and on the basis of these priorities, the development of various sectors has to take place. Regulation of credit then becomes an important instrument whereby the central bank prevents credit from flowing into those sectors which are not given priority in the plan and at the same time credit is channelized into the sectors which claim top priority. The effectiveness of the central bank's credit control measures however depends upon the extent to which commercial banks have spread their network in the various sectors of the economy. As well developed commercial banking system; therefore, facilitates the regulation of credit by the central bank and thus aids economic development.

11. **Development of Trade and Commerce:** Development of trade and commerce promotes industrialization by causing the expansion of the market and widening of the remote areas that supply raw materials to industries. Commercial banks provide short-term credit to trade and commerce. They provide remittance facilities. They help the expansion of the bill-market. All these banking services help the expansion of trade and commerce which in turn aids economic development.