International Journal of Global Research Innovations & Technology (IJGRIT)
ISSN : 2583-8717, Impact Factor: 6.972, Volume 03, No. 02(II), April-June, 2025, pp 143-152

Catalysts of Growth: The Role of Commercial Banks in India's Economic Development

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DOI: 10.62823/IJGRIT/03.2(II).7732

ABSTRACT

Commercial banks are the backbone of a nation's financial architecture, and their role in promoting economic development is both foundational and evolving. In the context of India, a rapidly growing and diversifying economy, the role of commercial banks extends far beyond traditional deposit-taking and lending. This paper examines how commercial banks in India contribute to key dimensions of economic development such as credit expansion, financial inclusion, infrastructure financing, and support for micro, small, and medium enterprises (MSMEs). Employing a secondary research methodology, the paper draws on data from RBI reports, government publications, and empirical research to provide a comprehensive overview of the sector's performance. It traces the historical evolution of commercial banking in India and evaluates how various initiatives such as the Pradhan Mantri Jan Dhan Yojana, MUDRA scheme, and digital banking reforms have enabled broader participation in the financial system. The study also discusses emerging challenges including rising non-performing assets (NPAs), competition from fintech firms, and regulatory compliance burdens. Key findings reveal that while commercial banks have made notable strides in financial outreach and credit delivery, structural reforms are still required to make banking more inclusive, resilient, and responsive to the demands of a digital-first economy. The paper concludes with policy recommendations aimed at leveraging banking capabilities for long-term sustainable growth, especially in underbanked and rural regions. This work contributes to the discourse on banking reforms and their alignment with India's broader development goals.

***Keywords**: Commercial Banks, RBI, Indian Economy, Financial Outreach.*

Introduction

Commercial banks play a pivotal role in shaping a country's economic trajectory. As financial intermediaries, they facilitate the mobilization of savings and direct them toward productive investments, thereby accelerating capital formation and economic growth. In a developing economy like India, where financial inclusion and equitable distribution of credit are critical developmental goals, commercial banks serve not only as profit-making institutions but also as key agents of socio-economic transformation.

The roots of India's modern banking system date back to the establishment of the Imperial Bank of India in 1921, which later became the State Bank of India (SBI) in 1955. Post-independence, the nationalization of banks in 1969 and 1980 was a turning point in aligning banking operations with national development goals. The creation of priority sector lending norms, expansion of rural branches, and establishment of institutions like NABARD were aimed at democratizing access to credit and supporting agriculture and small-scale industries. In the post-liberalization era, the introduction of private and foreign banks brought about competition, efficiency, and technological innovation in the sector.

Over the last two decades, the Indian banking system has undergone a digital revolution with transformative policies like Pradhan Mantri Jan Dhan Yojana (PMJDY), Unified Payments Interface (UPI), and Direct Benefit Transfers (DBT). These initiatives have made banking more accessible, especially for rural and marginalized populations. According to the World Bank (2022), over 80% of Indian adults now own a bank account, a stark contrast to less than 40% a decade ago.

Despite this progress, several challenges persist. Rising non-performing assets (NPAs), regulatory compliance pressures, lack of financial literacy, and the growing dominance of fintech and non-banking financial companies (NBFCs) pose serious questions about the long-term sustainability of the banking model. The COVID-19 pandemic further exacerbated issues related to loan defaults, digital divide, and financial vulnerability, prompting a re-evaluation of banks' roles in crisis response and recovery.

This study aims to explore the multifaceted contributions of commercial banks to India's economic development. It will analyze how banks support various sectors including agriculture, MSMEs, infrastructure, and housing, while also examining their role in promoting financial inclusion, employment generation, and digital innovation. The research will utilize secondary data from RBI, NABARD, World Bank, and peer-reviewed literature to assess both the achievements and shortcomings of commercial banks in the Indian context.

By presenting a comprehensive overview supported by visual data and scholarly insights, this paper contributes to the ongoing policy dialogue on making commercial banking more inclusive, efficient, and aligned with India's long-term development vision.

Literature Review

The role of commercial banks in facilitating economic development has been widely acknowledged in economic literature. Classical economists like Schumpeter emphasized the importance of financial institutions in enabling innovation by reallocating financial resources toward productive investments. Schumpeter (1934) argued that banks serve as agents of economic change by extending credit to entrepreneurs, thus accelerating industrial progress. Later, McKinnon and Shaw (1973) proposed that financial liberalization enhances savings and investment, strengthening the foundation for economic growth, especially in developing economies like India.

- **International Perspectives**

Globally, empirical research suggests a strong correlation between financial development and economic growth. Levine (1997) highlighted how well-functioning financial institutions improve resource allocation and facilitate capital accumulation. King and Levine (1993) conducted cross-country regressions that demonstrated the positive impact of bank development on GDP growth, capital accumulation, and productivity improvement. These foundational studies laid the groundwork for evaluating financial intermediation's role in developing economies.

- **Indian Context**

In the Indian scenario, commercial banks have played a central role in bridging the financial divide. Post-independence, especially after the nationalization of banks in 1969 and 1980, the Indian government utilized the banking sector to expand credit to underserved areas. Bandlamudi and Taidala (2017) emphasized that this expansion helped in rural development, agricultural financing, and supporting priority sectors. Similarly, Dube and Gupta (2018) highlighted that commercial banks were instrumental in reaching the unbanked population and supporting the government's inclusive growth agenda.

Vashisht (2019) noted that banks not only facilitated capital mobilization but also played a catalytic role in industrial development by financing MSMEs and infrastructure. Meanwhile, Srinivas (2022) used IHDS panel data to investigate financial inclusion patterns in India and found that access to banking has a positive impact on household income and stability.

- **Financial Inclusion and Social Development**

Financial inclusion has been a central focus of Indian economic policy, with commercial banks being its primary drivers. The launch of Pradhan Mantri Jan Dhan Yojana (PMJDY) in 2014 significantly increased account ownership, particularly among women and rural households. According to the World Bank (2022), over 80% of Indian adults now own a bank account, which is a sharp rise from just 35% in 2011. Meghana (2020) conducted a comparative study on Canara and Corporation Bank and found that bank-led financial inclusion significantly improved savings habits and credit access in low-income households.

Moreover, Subbareddy (2020) highlighted how commercial banks' loan portfolios for agriculture, housing, and education supported long-term developmental goals. Similarly, the Reserve Bank of India's reports (2023) emphasize the role of priority sector lending norms in guiding banks to serve social objectives alongside profitability.

- **Technological Innovation and Digital Banking**

The last decade has witnessed a digital transformation in the Indian banking sector. The adoption of UPI, digital wallets, mobile banking, and AI-based credit scoring tools has revolutionized the way commercial banks interact with customers. IMF (2023) notes that India has become a global model for digital financial services. Gatla (2025) emphasized that this digital wave has allowed banks to scale operations efficiently, reduce transaction costs, and expand financial access even in remote areas.

However, challenges such as digital illiteracy, cybersecurity risks, and regulatory compliance remain. Despite these, the trend points toward greater integration of technology in banking operations, with FinTechs increasingly collaborating with traditional banks to reach new customer segments.

- **Identified Gaps in Literature**

While numerous studies have acknowledged the contributions of commercial banks to financial inclusion and sectoral development, fewer have explored the dynamic impact of digital banking, post-pandemic recovery, and sectoral credit quality trends using recent data. Additionally, there is limited analysis comparing the performance of public vs. private commercial banks in driving inclusive growth. This paper aims to fill these gaps by offering an updated and data-driven analysis of how commercial banks continue to shape India’s economic landscape in the evolving financial ecosystem.

Research Methodology

Research Design

This study adopts a descriptive and analytical research design, primarily relying on secondary data sources to evaluate the role of commercial banks in India's economic development. The research aims to assess and interpret how commercial banking activities have contributed to key areas such as credit disbursement, financial inclusion, sectoral development (e.g., agriculture, MSMEs), and technological innovation.

Data Sources

The data used in this study are secondary and have been extracted from the following reputable sources:

- Reserve Bank of India (RBI) bulletins and annual reports
- Ministry of Finance, Government of India
- Reports from NABARD and SIDBI
- World Bank and IMF databases
- Peer-reviewed journal articles and case studies
- Bank-specific disclosures and performance reports
- Financial sector databases (e.g., Statista, IndiaStat)

These sources provide both quantitative data (deposits, NPAs, credit growth, inclusion metrics) and qualitative insights (policy evaluations, expert commentary).

Data Collection and Analysis

Relevant data spanning the last 10 to 15 years have been compiled and analyzed using:

- **Descriptive statistics**: to observe trends in deposit growth, credit allocation, NPA levels, and financial outreach.
- **Comparative analysis**: between public and private sector commercial banks in terms of performance and developmental impact.
- **Graphical representation**: including bar charts, pie charts, and line graphs to visually interpret patterns and trends.
- **Thematic content analysis**: of government policy reports and financial inclusion initiatives to extract developmental themes.

Research Objectives

- To examine the contribution of commercial banks to India’s economic development through credit, inclusion, and sectoral support.

- To analyze recent trends in banking innovations and digital finance and their impact on accessibility and efficiency.
- To identify the key challenges faced by commercial banks in supporting inclusive and sustainable growth.

Limitations

- The study relies solely on secondary data, limiting primary insights from consumers, bankers, or policymakers.
- The rapidly evolving banking environment may cause some data (especially pre-pandemic) to become quickly outdated.
- Sector-specific deep dives (e.g., agriculture or MSMEs) are constrained by the availability of disaggregated data.

Ethical Considerations

As the research uses publicly available data from authentic institutions, no personal or confidential information is involved. Ethical standards concerning citation and data representation have been strictly maintained.

Here is a visual representation of the **Credit and Deposit Share by Bank Type in India (2023 Estimates)**. This stacked bar chart illustrates the relative contributions of public, private, and foreign banks in India's banking sector:

- **Public Sector Banks** dominate both credit and deposit markets with 60–65% share.
- **Private Sector Banks** follow with approximately 30–35% share.
- **Foreign Banks** contribute around 5% to both.

Overview of the Commercial Banking Sector in India

India's commercial banking sector is the backbone of its financial system and plays a critical role in mobilizing savings, distributing credit, and driving economic development. The sector is primarily composed of:

- **Public Sector Banks (PSBs)**: State-owned institutions that form the majority of the sector's market share.
- **Private Sector Banks**: Agile players that have grown rapidly in the last two decades with customer-centric innovations.
- **Foreign Banks**: Limited in number but influential in niche sectors such as corporate finance and international trade.
- **Structural Composition**

  As of 2023, India has:
  - **12 Public Sector Banks**
  - **21 Private Sector Banks**
  - **45 Foreign Banks (with branches or subsidiaries)**
  - Over **60 Regional Rural Banks (RRBs)** and thousands of **Urban Cooperative Banks**
- **Key Indicators**

  According to the RBI Financial Stability Report and other public domain sources:
  - Total **aggregate deposits** crossed ₹180 lakh crore in 2023.
  - **Gross Bank Credit** stood at ₹155 lakh crore.
  - Non-Performing Assets (NPAs) for scheduled commercial banks declined from 9.1% in 2018 to **5.3% in 2023**, indicating improved asset quality.
  - Credit to **MSMEs** and **agriculture** has seen consistent growth, bolstered by government schemes like MUDRA and Kisan Credit Card.
- **Technological Advancements**

  Indian banks are increasingly leveraging digital technologies:
  - **Core Banking Solutions (CBS)** adoption is near-universal.

- Platforms like **Unified Payments Interface (UPI)** have revolutionized retail payments.
- Digital banking through apps and AI chatbots is now mainstream, especially among private banks.

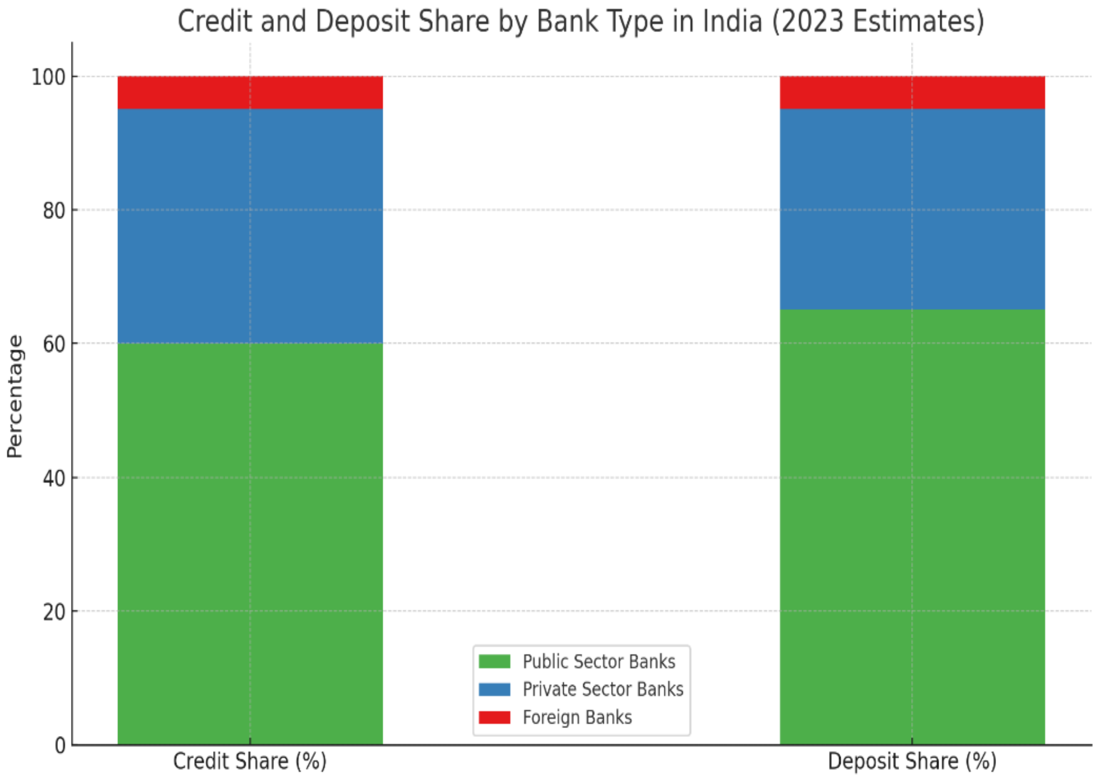

Figure 1: Credit and Deposit Share by Bank Type in India

Source: Compiled and visualized by the author using data from RBI Reports, NASSCOM AI Trends (2024)

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Analysis and Discussion

- **Financial Intermediation and Capital Mobilization**

Commercial banks act as vital financial intermediaries, channeling household savings into productive investments. Through deposit mobilization, they provide accessible credit to individuals, businesses, and governments. In FY 2022–23, **aggregate deposits** with scheduled commercial banks exceeded ₹180 lakh crore, with **gross credit** around ₹155 lakh crore (RBI, 2023). This indicates robust intermediation efficiency.

Banks support **productive capital formation** by:

- Offering working capital loans to enterprises
- Financing infrastructure through long-term loans
- Supporting housing and real estate through retail lending

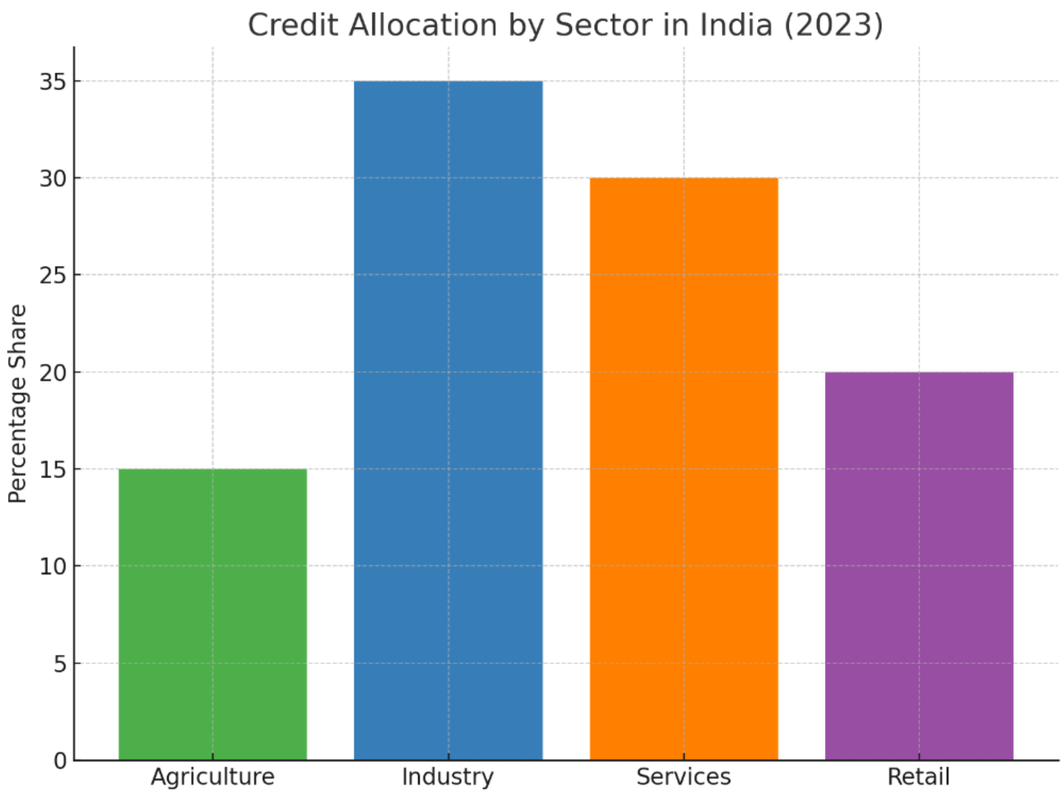

Figure 2: Credit Allocation by Sector in India

Source: RBI Reports (2023), Ministry of Finance (GOI), Jan Dhan Dashboard, NPCI UPI Statistics

- **Sectoral Contributions to Economic Development**
  - **Agriculture and Rural Development**

Banks provide essential credit to agriculture via schemes like **Kisan Credit Card** and **Priority Sector Lending**. As of March 2023, agriculture credit crossed ₹18 lakh crore, impacting over 12 crore farmers. Regional Rural Banks and cooperative banks play a vital role in rural credit expansion.

  - **MSME Support**

Micro, Small, and Medium Enterprises (MSMEs) contribute over **30% of India's GDP** and are major employment generators. Banks disbursed over ₹20 lakh crore to MSMEs in 2023 under various schemes, including **MUDRA loans**, **CGTMSE**, and **Stand-Up India**. This improves employment and entrepreneurship across India.

  - **Infrastructure Development**

Long-term credit is extended to sectors like roads, power, telecom, and logistics. Public sector banks particularly support large infrastructure projects aligned with the **NationalInfrastructure Pipeline (NIP).**

- **Financial Inclusion and Social Impact**

The financial inclusion drive has been transformative:

  - **Jan Dhan Yojana**: Over **49 crore bank accounts** with ₹1.9 lakh crore balance as of March 2024
  - **Direct Benefit Transfer (DBT)**: Seamless government subsidy delivery to over 100 crore beneficiaries
  - **Digital Banking**: Rise in mobile and internet banking with over **11 billion UPItransactions per month (2024)**

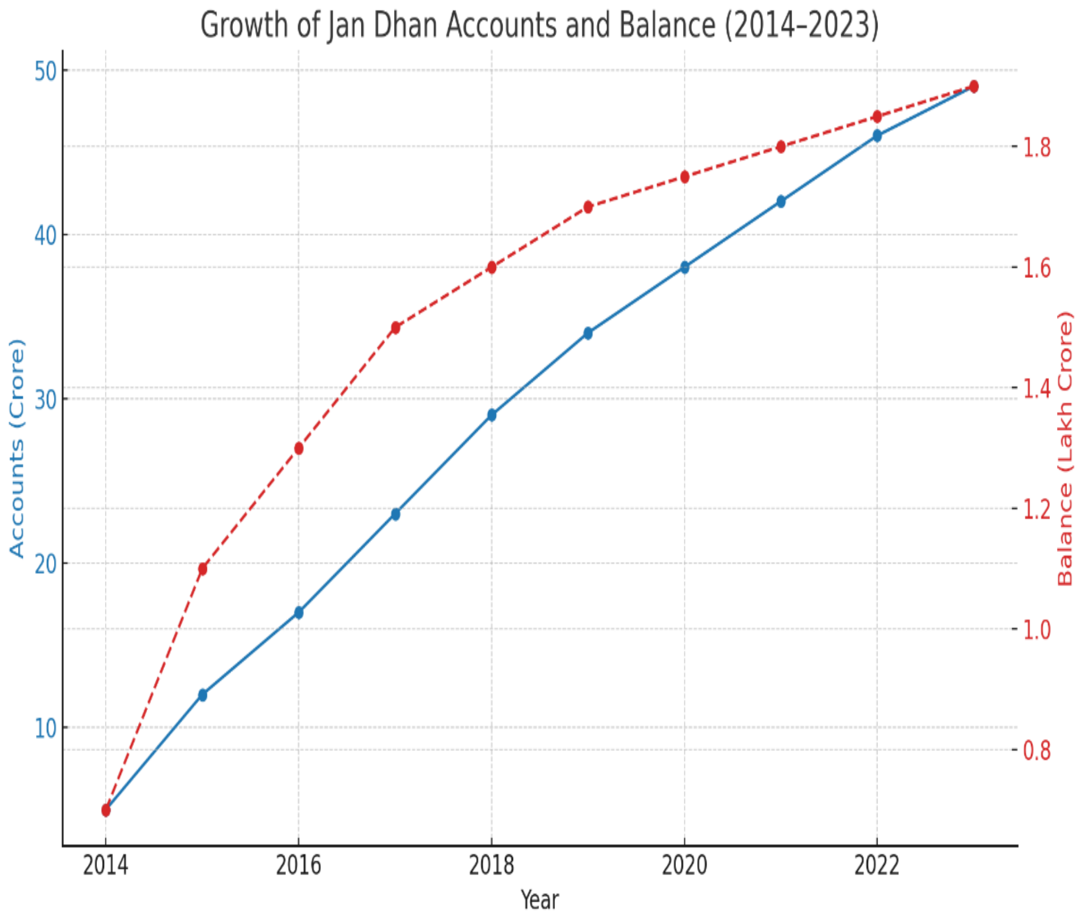

Figure 3: Growth of Jan Dhan Accounts

Source: RBI Reports (2023), Ministry of Finance (GOI), Jan Dhan Dashboard, NPCI UPI Statistics.

- **Role in Employment and Entrepreneurship**

Commercial banks directly employ lakhs of individuals and indirectly support millions of jobs by financing entrepreneurs and businesses. As of 2023:

- Over **12 lakh people** are employed in banking services
- Over **3 crore jobs** are estimated to be indirectly created through banking-led credit to MSMEs, agri-businesses, and start-ups

Banks also support **women entrepreneurs**, **youth start-ups**and **rural artisans**, thereby reinforcing the socio-economic fabric of the country.

- **Digital Innovation and Financial Technology**

Banks have partnered with FinTechs to drive innovation:

- AI/ML-based **loan underwriting**
- **Chatbots** for customer service
- **Credit scoring using alternate data**
- Blockchain-based **cross-border remittances**

Private sector banks lead in adopting such technologies, creating a digitally enabled, secure, and scalable ecosystem for credit delivery and financial management.

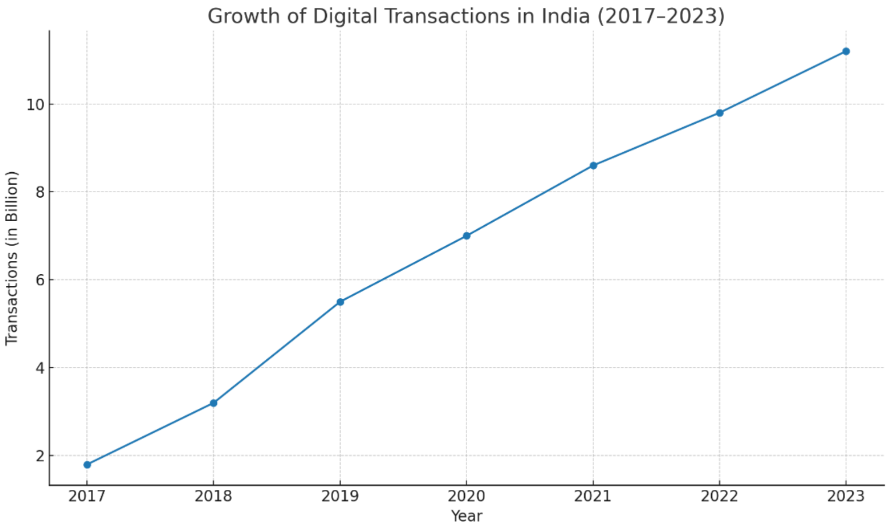

Figure 4: Growth of Digital Transactions in India

Source: RBI Reports (2023), Ministry of Finance (GOI), Jan Dhan Dashboard, NPCI UPI Statistics

Findings and Policy Recommendations

Key Findings

Based on the secondary data, literature analysis, and sectoral observations, the following major findings emerge regarding the role of commercial banks in India's economic development:

- **Strategic Role in Financial Intermediation**

Commercial banks play a pivotal role in mobilizing savings and directing them towards productive investments. Over the past two decades, there has been a steady rise in credit-to-GDP ratio, indicating deepening of financial services. The share of credit extended to MSMEs, agriculture, and retail sectors has grown.

- **Inclusive Banking and Social Impact**

Schemes such as the Pradhan Mantri Jan Dhan Yojana (PMJDY) have expanded access to formal banking, especially in rural and semi-urban areas. Over 49 crore Jan Dhan accounts have been opened (see Figure 3), contributing to financial empowerment, especially among women and low-income groups.

- **Sectoral Credit Allocation Reflects Policy Priorities**

The sectoral distribution of credit by banks (Figure 2) suggests a policy-induced tilt toward industrial and service sectors. However, agriculture still receives only around 15% of total institutional credit despite employing over 40% of the workforce—revealing a critical gap in credit equity.

- **Digital Transformation and Innovation**

Commercial banks have increasingly embraced digital platforms, including UPI, IMPS, and mobile banking. With over 11 billion digital transactions recorded in 2023, the ecosystem is witnessing improved efficiency and reduced cost of service delivery. Private banks are ahead in adopting AI/ML for credit scoring and fraud detection.

- **Challenges of Non-Performing Assets (NPAs) Persist**

Despite progress in recapitalization and resolution mechanisms (e.g., IBC, NARCL), high NPAs in public sector banks (PSBs), especially in sectors like infrastructure and real estate, continue to burden profitability and investor confidence.

- **Limited Financial Literacy and Awareness**

Even with broader outreach, financial inclusion does not always translate to financial empowerment. Many Jan Dhan accounts remain inactive or underutilized due to lack of awareness, digital literacy, and trust in formal systems.

Policy Recommendations

To maximize the contribution of commercial banks to inclusive and sustainable economic development, the following multi-pronged policy suggestions are proposed:

- **Strengthen Sector-Specific Credit Frameworks**
  - **Agricultural Credit:** Design region-specific credit plans for agri-allied sectors and promote interest subvention on short-term loans.
  - **MSME Lending:** Introduce flexible loan assessment models based on cash flow rather than traditional collateral models. Leverage platforms like TReDS to ease invoice financing.
  - **Green Finance:** Offer preferential interest rates for green energy, EV adoption, and sustainable farming practices in line with India's Net Zero goals.
- **Address NPAs through Early Warning and AI**
  - Improve risk prediction using AI-based credit scoring models.
  - Mandate banks to report early signs of stress through centralised dashboards.
  - Encourage faster settlement of bad loans through expansion of DRTs and NCLTs.
- **Foster Public-Private Digital Collaboration**
  - Promote innovation sandboxes for FinTech–bank partnerships under RBI.
  - Enhance cybersecurity infrastructure and digital grievance redressal in rural branches.
  - Launch incentive-based campaigns for digital literacy in Tier-2/3 towns.
- **Strengthen Financial Literacy and Behavioural Interventions**
  - Integrate banking literacy modules in school and college curricula.
  - Collaborate with SHGs, NGOs, and Panchayats for training programs in regional languages.
  - Use behavioral nudges (SMS alerts, gamified apps) to increase active usage of accounts.
- **Regional and Gender-Inclusive Banking**
  - Expand the network of all-women bank branches and women-centric credit schemes (like Mahila Udyam Nidhi).
  - Use data analytics to identify and target underbanked districts, especially in North-East India and tribal belts.
- **Regulatory Reforms and Simplification**
  - Reduce compliance burden on small borrowers through rationalization of KYC norms.
  - Simplify credit appraisal process and documentation, particularly for informal sector entrepreneurs.
- **Integrate ESG and SDG Alignment into Banking**
  - Encourage banks to adopt ESG (Environmental, Social, and Governance) frameworks in lending.
  - Link lending incentives to SDG goals such as zero poverty, gender equality, and climate action.

Conclusion

Commercial banks have long stood as the backbone of India's economic machinery, playing an instrumental role in channeling funds, supporting industries, enabling rural development, and promoting financial inclusion. Through this study, it is evident that the transformation of India's banking system from a colonial relic to a robust, diversified, and digitized engine of growth has been monumental.

The expansion of credit to underserved sectors like MSMEs and agriculture, implementation of flagship schemes such as Jan Dhan Yojana, Mudra Loans, and DBT, and the surge in digital banking adoption, all underscore the vital function of commercial banks in democratizing access to finance. The analysis also highlighted how commercial banks are no longer just financial institutions but also instruments of social change, promoting gender inclusion, rural penetration, and entrepreneurship.

However, challenges persist in the form of non-performing assets, regulatory burdens, credit delivery gaps, and limited financial literacy among the masses. The dominance of PSBs in rural India often contrasts with operational inefficiencies, while private banks lead in innovation but remain urban-centric. As India aspires to become a $5 trillion economy, the evolution of commercial banking must be guided by inclusive policies, strong risk frameworks, and digital empowerment.

Future Scope of Research

This research opens several avenues for future academic and policy-oriented studies:

- **Comparative Study of Public vs. Private Banks:** Investigating the performance, risk-taking behavior, and customer satisfaction levels across public and private commercial banks in India.
- **Role of Banks in Sustainable Finance:** Future research can explore how Indian banks are aligning with ESG (Environmental, Social, Governance) goals and financing green transitions.
- **Regional Banking Penetration and Development:** A state-wise analysis can identify how differential banking density and outreach affect regional economic disparities.
- **Digital Divide in Banking Services:** As digital banking grows, studies can assess accessibility and user behavior across gender, age, and urban-rural divides.
- **Impact of FinTech and Neobanks**: Understanding the competitive or collaborative dynamics between traditional commercial banks and emerging fintech players.
- **Banking Reforms and Financial Literacy Outcomes**: Evaluating the link between financial awareness campaigns and behavioral change in rural/urban populations regarding savings, credit, and digital usage.

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