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A Study on impact of Scheduled Commercial Banks on Economic Growth in India

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Abstract

Commercial banks place an important role in the socio-economic development of any region. The economic and financial system that India inherited at the time Independence was not at all suitable for the settlement of the socio-economic problems, which generally the financial sector should achieve. As per the Indian economy, Commercial banks comprises of State Bank of India and its associates, all nationalized banks, foreign banks, other scheduled commercial banks, regional rural banks and non scheduled commercial banks. The Indian banking system comprises of 27 public sector banks, 21 private sector banks, 49 foreign banks, 56 regional rural banks, 1562 urban cooperative banks and 94384 rural cooperative banks. As on the study period the demand for both corporate and retail loans and the sectors that have seen demand include services, real estate, consumer durables and agriculture. The SCBs help in mobilize savings and channelize them into productive investments and thereby helping in capital formation and thus increase the GDP growth rate of the county. The study covers the period of 7 years (from 2013-2014 to 2019-2020). The data collected for the study is from secondary sources. The period of study is taken for the year 2011-12 to 2017-18. The study is restricted to only schedule commercial banks and the data is collected accordingly. The study examines the impact of SCBs in economic growth of India by using the tools such as Mean, Standard Deviation and trend analysis. The simple regression model is most appropriate for the study to examine the relationship between selected indicators of SCBs and growth of the GDP.

Keywords: GDP, SCBs, Capital Formation, Commercial Banks, Economic Growth.

Introduction

Banks have an important role in the overall growth and development of any country. They play a vital role in the growth any sector in the economy. The entire trade and commerce sector is dependent on the banking industry and thus the banks are considered has the backbone of any economy. Commercial banks place an important role in the socio-economic development of any region. The economic and financial system that India inherited at the time Independence was not at all suitable for the settlement of the socio-economic problems, which generally the financial sector should achieve. Thus immediate necessity was the political movement for the nationalization of Reserve Bank of India which was completed in the year 1949 with the goal that the central banking institution of the country would have the commitment to serve the social and economic objectives laid down by it. At the same time, the Imperial Bank of India, the premier banking institution was nationalized in 1955 for the extension of banking facilities on a large scale, more particularly in the rural and semi-urban areas, and renamed as State Bank of India (SBI). The structure of public sector banking was strengthened further in 1959 through the establishment of subsidiaries of State Bank of India. The banking sector is divided into Commercial banks and Co-operative banks. The Reserve Bank of India, Act 1934 has classified the banks as scheduled banks and non-scheduled banks. The scheduled banks are those, which have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakh and which satisfy Reserve Bank of India, that their affairs are carried out in the interest of the depositors. All commercial banks are scheduled banks. Commercial Banks comprises the State Bank of India and its subsidiaries, nationalized banks, foreign banks and other scheduled commercial banks, regional rural banks and non-scheduled commercial banks. The total number of branches of commercial banks is more than fifty thousand and the regional rural banks are about eight thousand covering 280 districts in the country.

Classification of Commercial Banks

- **Scheduled Banks:** Banks which have been included in the Second Schedule of Reserve Bank of India act 1934 and they are categorized as follows:
- **Public Sector Banks:** These banks are those which have their majority of the share with the government. Example: State Bank of India, Punjab National Bank, Syndicate Bank, Union Bank of India, etc.
- **Private Sector Banks:** These banks are those which held their majority of share with the private individuals. Example: ICICI Bank, IDBI Bank, HDFC Bank, AXIS Bank, etc.
- **Foreign Banks:** These banks have their Head Office outside the country in which they are located. Example: Citi Bank, Standard Chartered Bank, Bank of Tokyo, etc.
- **Non Scheduled Commercial Banks:** Those banks which are not added in the Second Schedule of Reserve Bank of India act 1934.

Functions of Commercial Banks

Primary Functions

- **Accepting Deposits:** the commercial banks accept the savings of the public in the form of deposits such as Fixed term deposits, Current account deposits, Recurring deposits, Saving account deposits, Tax saving deposits, deposits for NRIs.
- **Lending Loans:** The commercial banks lend loans and advances and thereby earn interest on it. This function is the main source of income of the banks.
  - **Overdraft Facility:** The current account holder has the rights to withdraw more than to what they deposited in their account.
  - **Loans to person or to a firm against some collateral security**
  - **Cash credit** loan in installments against certain security
  - **Loans by discounting bills of exchange.**

Secondary Functions

Agency Functions:

- Payment of taxes, bills
- Collection of funds through bills, cheques
- Transfer of funds
- Sale-purchase of shares and debentures
- Collection and payment of dividend or interest
- Acts as trustee and executor of properties
- Foreign exchange transactions

Credit Creation: The bank creates credit on the basis of its primary deposits. It further lends the money to common borrowers, corporate, investors. This landed money is deposited by those people to have excess money and want to earn a fix return on their money. Commercial banks charges more rate of interests from borrowers as compared to given to the depositors of the money.

Scheduled Commercial Banks in the Development of India

Scheduled Commercial banks support in mobilizing savings through branch banking. The bank mobilizes savings and channelizes them to productive investments in capital formation. Capital is one of the most important part of any business or industry. Banks increase capital formation by collecting deposits from depositors and convert these deposits into loans and advances to industries. The SCBs also underwrite the equity and debt to large companies thereby taking part in helping develop the capital market. SCBs support the role of federal government as an agent of economic development. 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.

Objectives of the study

- To examine the challenges associated with economic growth.
- To analyze the performance of Scheduled Commercial banks and its impact in GDP

Research Methodology

The Scheduled commercial banks play a vital role in financing small businesses in India. The role of scheduled commercial banks in economic development rests chiefly on their role as financial intermediaries. In this background the scheduled commercial banks support to flow the investment throughout the marketplace. The chief mechanism of investment allocation in the economy is through the lending process which helps the Scheduled commercial banks. The study covers the period of 7 years (from 2013-2014 to 2019-2020). The data collected for the study is from secondary sources. The period of study is taken for the year 2011-12 to 2017-18. The study is restricted to only schedule commercial banks and the data is collected accordingly. The study examines the impact of SCBs in economic growth of India by using the tools such as Mean, Standard Deviation and trend analysis. The simple regression model is most appropriate for the study to examine the relationship between selected indicators of SCBs and growth of the GDP. This relationship is stated as

$$\mathbf{Y = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3 + u}$$

Where Y = GDP, X_1 – Deposits, X_2 –Investments, X_3 – Credits, u – error term

Hypothesis

H_0 = Selected Indicators of Commercial banks has no significant impact on the GDP

H_1 = Selected Indicators of Commercial banks has significant impact on the GDP

Table 1: Trend analysis on Deposits of Scheduled Commercial Banks in India

(INR in Crores)

Year	**Actual**	**Trend**
2013-2014	7705560	7580280
2014-2015	8533285	8571191
2015-2016	9327290	9562103
2016-2017	10757656	10553015
2017-2018	11406049	11543927
2018-2019	12573772	12534839
2019-2020	13567492	13525751
Mean		10553015
Standard Deviation		2145918.1

Source: Handbook of Statistics of Indian Economy, RBI

The table represents the annual growth of deposits of Scheduled Commercial Banks in India during the period 2013-2014 to 2019-2020. The trend reflects contribution of deposits is increasing from year to year. This indicates that both the time deposits and demand deposits were increasing continuously. The increase in deposits has an upward trend. An equation of the form Y=a + bt has been fit to the data. With the values of 'a' and 'b' to be 10553015 and 990912 the trend line has been fit and the trend values for the study period has been obtained. On the overall deposit share is increasing in the Indian Scheduled Commercial banks.

Table 2: Trend analysis on Investments of Scheduled Commercial Banks in India

(INR in Crores)

Year	Actual	Trend
2013-2014	2212821	2214533
2014-2015	2491825	2467212
2015-2016	2625509	2719890
2016-2017	3030963	2972568
2017-2018	3318454	3225246
2018-2019	3381056	3477924
2019-2020	3747349	3730602
Mean		2972568.1
Standard Deviation		550601.86

Source: Handbook of Statistics of Indian Economy, RBI

The table reveals that there is a moderate increase in the investment of SCBs for the study period 2013-2014 to 2019-2020. An equation of the form Y = a + bt has been fit to the data. With the values of 'a' to be 2972568 and 'b' to be 252678 the trend value has been obtained. The investment in government security was INR 2214533 crores in 2013-2014 which increased to INR 3730602 crore in the year 2019-2020. Overall during the study period the investment in government security by SCBs was increasing in moderate rate.

Table 3: Trend analysis on Credits of Scheduled Commercial Banks in India

(INR in Crores)

Year	Actual	Trend
2013-2014	5994096	5808153
2014-2015	6536420	6557322
2015-2016	7249615	7306490
2016-2017	7841466	8055658
2017-2018	8625425	8804826
2018-2019	9771722	9553994
2019-2020	10370861	10303162
Mean		8055657.9
Standard Deviation		1627031.1

Source: Handbook of Statistics of Indian Economy, RBI

The above table reveals the credit of Scheduled Commercial Banks during 2013-2014 to 2019-2020. In the beginning year of the study it was revealed that INR 5808153 crores has increased to INR 10303162 crores in 2019-2020. The growth rate was significantly increasing throughout the period. An equation of the form Y = a + bt has been fit to the data. With the values 'a' to be 8055658 and 'b' to be 749168 the trend values has been obtained. The credit of SCBs has been increasing in a increasing rate throughout the study period.

Table: 5 Regression Model between Selected Indicators of SCBs and GDP

$$\mathbf{Y = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3 + u}$$

Y = GDP, X_1 – Deposits, X_2 –Investments, X_3 – Credits, u – error term

Summary of GDP and Related Independent Variables

Model	R	R^2	Adjusted R Square	Std. Error
1	0.99	0.99	0.99	73660.54

Coefficients of Selected Indicators of Scheduled Commercial Banks

Variables	Coefficients	Std. error	t-value	p-value
Y	1547790	211024.4	7.33	0.00*
X_1	0.039	0.22	0.17	0.87
X_2	1.554	0.47	3.26	0.04**
X_3	1.504	0.18	7.99	0.00*

***Significant at 1% level **Significant at 5% level.**

The table shows that if the regression coefficient of 1.554 units would mean that by holding all the other variables constant, an increase in investments by an extent of one unit would be accompanied by an increase in the GDP growth rate by an amount of 1.554 units. Similarly, holding all other variables constant, if credit increases by one unit each, the GDP would increase by 1.504 units. At p = 0.01 the results for credit indicator of SCBs rejected the null hypothesis and shows that there is a significant impact on dependent variable. Further at p = 0.05 the result shows the Investments are statistically significant. The result of regression analysis is that R^2 is 0.99 which implies that there is 99 percent correlation and is statistically significant at 1% and 5% level. The table: 5 also shows that at a given p-value of 0.00 for the t-statistic value of 7.33 there is a statistically significant positive relationship at the level of 5% as well as 1% between selected indicators of Scheduled Commercial Banks (SCBs) and GDP. Hence the null hypothesis stands rejected that as H_0 is rejected and H_1 is accepted.

Conclusion

Scheduled Commercial Banks play a significant role in the economic development of the country. The major function of Scheduled commercial banks is to provide maximum financial convenience to the public. This is indicated in the study that during the study period credit has been increasing at an increasing rate. There are three major responsibilities for the SCBs to focus on the economic growth of the country. The first responsibility is to promote overall savings by making SCBs more accessible to the public. Next distribute the savings in a efficient manner to the public through mobilizing investments from economic and social perspective. Finally the SCBs are responsible for creating credit and facilitating the transaction of business and trade which ultimately impact the growth of the economy. From the study it can be concluded that Scheduled Commercial Banks have significant impact in economic growth of India, particularly by significant growth in investment and credit.

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