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Role of banks in rural development: A review of literature

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Abstract
Banks not only provide finance but also influence the utilisation of the country's resources. In a modern economy, banks are not merely dealers in money and credit but leaders in the process of economic growth. The business of banking entails the collection and transmission of funds from the saving surplus to the saving deficit economic units. Commercial banks are playing very important role in providing credit to rural industries, which increases the production, employment and consumer spending, thereby boosting the economy. Thus, banks act as the mobilizer of funds to all sectors of the economy.

Keywords: Capital formation, commercial banks, financial inclusion, investment, rural development

Introduction

A well developed banking system is essential for the economic development of any country. Banks not only provide finance but also influence the utilisation of the country's resources. In a modern economy, banks are not merely dealers in money and credit but leaders in the process of economic growth.

The business of banking entails the collection and transmission of funds from the saving surplus to the saving deficit economic units. Thus, banks act as the mobilizer of funds to all sectors of the economy. Commercial banks have grown from 92,117 in 2011 to 154,485 branch network by 2021. But, the industry has continuously been under attack by main observers especially marketing critics for failure to utilize fully the advantages of modern marketing principles in operating their banking business for better achievement of co-operate objectives and goals. Unfortunately, product management is the most criticized of all banking practices. Thus, the poor product management practices of the banks have resulted into sense of complaints of dissatisfaction among customers about the quality of services offered. To them services are inadequate and poorly rendered. Beside most customers and potential customers are not fully aware of the bank services.

With the introduction of liberalization, privatization and globalization the role of banking sector changed dramatically. Credit is one of the critical inputs for agricultural development. It capitalizes farmers to undertake new investments and/or adopt new technologies. The importance of agricultural credit is further reinforced by the unique role of Indian agriculture in the macroeconomic framework along with its significant role in poverty alleviation. Realizing the importance of agricultural credit in fostering agricultural growth and development, the emphasis on the institutional framework for agricultural credit is being emphasized since the beginning of planned development era in India. India is home to 22 per cent of the world's poor. Such a high incidence of poverty is a matter of concern in view of the fact that poverty eradication has been one of the major objectives of the development planning process. Indeed, poverty is a global issue. Its eradication is considered integral to humanity's quest for sustainable development. Reduction of poverty in India is, therefore, vital for the attainment of international goals.

India is a developing country and the problem of economic development is at the core of all its economic policy. Issue of economic development is a multi faceted issue, requiring simultaneous focus on a number of different variables. One of the major issues involved is ensuring and balancing the economic growth of both urban and rural sectors simultaneously. In India, it has been observed that the urban sector has grown at a much faster rate than the rural area. As result of this, there has been movement of population from rural areas to urban causing stress to the economy of both areas. The problems faced by Indian rural sector are:

1. Low level of Income
2. Low level of saving
3. Low level of Capital formation
4. Low level of infrastructural development
5. Low educational level
6. Low level of economic equality among different sections of populace especially for the marginalised sections such as SC, ST and women.
7. Excessive reliance on agricultural production and low level of industrial development.
8. Low level of existence of financial institutional structure.
9. High rate of unemployment and under employment.

To this effect Indian policy makers since Independence have launched a number of schemes to arrest and stop the mass exodus of rural populace. Their chief instrument in this process is development of adequate banking and financing facilities in rural areas and implementation of various supportive schemes through them.

Role of Banks in Rural Development: Review of Literature

Commercial banks are playing very important role in providing credit to rural industries, which increases the production, employment and consumer spending, thereby boosting the economy. These banks are heavily regulated by the Central Bank of that country, the RBI, in India. For example, central banks impose reserve requirements on commercial banks, which means that the commercial banks would need to hold a certain percentage of their consumer deposits at the central bank in case of a rush to withdraw funds from the general public. These entities help markets thrive and, if their influence is used well, can positively foster development so that more people can access essential services and consumer goods.

Commercial banks are classified into two categories, i.e., scheduled commercial banks and non-scheduled commercial banks. Furthermore, scheduled commercial banks are classified into three types: private banks, public banks and foreign banks.

A few research studies are referred hereunder to understand the role of banks for developing rural economy. Many studies have been conducted to test if the growth of macro socio-economic variables depends on monetary or banking data in an economy. Bhatia (1978) attempted to analyse the economic performance of Indian Banking system as reflected in its output, price and profitability over the period 1950-68. The main findings of this study are: i) the profit performance of Indian Banking System during the period 1950-68 has been satisfactory; (ii) the structure of banking system (represented by the number of bank offices and the deposit concentration ratio) during the period has an insignificant effect on its performance. Evolution of an effective institutional credit structure, which can meet the credit needs of the rural economy, has been one of the basic objectives of credit policy in India. The reserve bank of India has policy of institutionalization of rural credit in India.

All India Rural Credit Survey report recommended the three tier cooperative credit system, viz. state cooperative bank, district central cooperative bank, and primary cooperative societies, at state, district, and village level respectively. The adoption of financial liberalization reforms has been a very laudable initiative given the extent of financial repression that was prevalent prior to these reforms and the stifling effects of repression on both the financial sector itself and on the economy as a whole. The rural population in India suffers from a great deal of indebtedness and is subject to exploitation in the credit market due to high interest rates and the lack of convenient access to credit.

Rose (1986) sees the importance of savings beyond capital formation. To her, savings are a catalyst for capital formation but equally, a major determinant of the cost of credits based on the law of scarcity, which holds that ‘when the former is low and scarce, it becomes more costly to obtain’. The classics 5 as well as modern growth models hold that savings constitute the principal parameter, and determinant of economic growth.

Empirical evidence time and again emphasizes the relationship between finance and growth. According to the works of King and Levine (1993) and Levine and Zervos (1998), at the cross-country level, evidence indicates that various measures of financial development (including assets of the financial intermediaries, liquid liabilities of financial institutions, domestic credit to private sector, stock and bond market capitalization) are robustly and positively related to economic growth. Other studies also establish a positive relationship between financial development and growth at the industry level, like the one by Rajan and Zingales (1998). The topical endogenous growth literature structured on ‘learning by doing’ processes, allocates a special role to finance (Aghion and Hewitt, 1998). The researchers so far have not only looked at how finance facilitates economic activity, but also social aspects like poverty, hunger, etc. The consensus is that finance promotes economic growth, but the magnitude of impact differs.

Deshpande (1998) conducted a case study of two commercial bank branches in Maharashtra command area for evaluating performance of commercial banks in financing agriculture. In this studied the non interest cost incurred by the sample beneficiaries revealed that in almost all kinds of loans cost of records shared was the maximum in rural branch. With regard to cost towards trips to bank, beneficiaries in rural branch did not incur any cost because of proximity of bank.

Lawrence (2001) analyzed the process of financial reforms in India and China and concluded that new banks entry (followed in China) into banking system rather than the rehabilitation approach (followed in India) was more efficient in reducing the NPAs. However, they explain the approach of both the countries in following their paths to reduce NPAs. Kaminsky and Schmukler (2002) opined that currently, there are opposing views concerning the most preferable coordination mechanism. According to the development and political view of state involvement in banking, a government is through either direct ownership of banks or restrictions on the operations of banks better suited than market forces alone to ensure that the banking sector performs its functions. The argument is essentially that the government can ensure a better economic outcome by for example channeling savings to strategic projects that would otherwise not receive funding or by creating a branch infrastructure in rural areas that would not be built by profit-maximizing private banks. The active involvement of government thus ensures a better functioning of the banking sector. Thillairajah (1994) and Padmanabhan (1988) sharing the same opinion, explain the high marginal propensity to save by the unstable economic conditions that generally prevails in these areas (unstable incomes, fluctuations in harvest etc).

Mathur (2002) examined the arguments extended to a case for the privatization of public sector evidence that state ownership banks lower the probability of banking crisis. Private and foreign banks stimulate efficiency, innovation and economic growth. It is held that the Arguments which are put forward for the privatization of PSBs are not strong. Private ownership may lead to crisis if the regulatory system is unable to control the adverse extraneous pressures.

Ramachandran (2004) studied the relationship between money, output and prices and found evidence that growth in money is an indicator of future movement in prices and output. He further concludes that an economy like India must have moderate monetary policy rather than aggressive one as it may amplify price fluctuations in the long run. Burgess, Pande and Wong (2005) stated the importance of public sector banks and mention that expansion of nationalized banks into rural unbanked areas have led to reduction in poverty by increasing lending amongst low caste and tribal groups.

As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy. In India the focus of financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account. The international definitions of financial inclusion have been viewed in much wider perspective (Leeladhar, 2005).

Issues related to banking development in India have been discussed thoroughly in Indian defence (Economist, 2005). The article discusses the viewpoints of RBI for keeping away competition from private and foreign sector banks and slowly opening the banking sector. It mentions that 20 public sector banks control three quarters of banking assets and have more than 51% government ownership, thus these banks can be forced to offer credit at subvention rates: a cause for poor society like India. However, the banking sector was opened in 1991 for private banks which have proved their mettle yet the social cause still rests with the public sector banks. The entry of foreign sector banks have induced competition in the Indian banking sector and has made its mark in technology up gradation and swiftness of transactions, thus bridging gap between the credit seeker and credit giver. However, the significance of public sector banks still cannot be refuted by any factor. The article clearly mentions "For a country as big as India, and as much in need of basic development finance, financial-sector liberalization presents a dilemma." Since the 26% poor, more than 70% of country living in villages needs to be cared and supported: a venture which rational business men may not find worthy and safe.

Berger *et al*. (2008) have conducted research on role of bank ownership type in banking relationship with the customer. They have concluded that the companies which have targets to diversify and have multiple banking relationships tend to become foreign banking customers and customers of state owned banks are usually unlikely to diversify and have multiple banking relationships.

Commercial Banking Report (2008) states that India's high savings rate and RBI's regulatory norms have brought stability in banking system however it also mentions that politics has complicated policy making and that about half of government's revenues are spent on interest, salaries and pension of public sector employees. Acharya *et al*. (2009) investigated the relationship between financial development: credit growth and economic growth: per capita income growth in 14 Indian states, using panel co-integration and modified ordinary regression analysis. The panel co integration results confirmed existence of relationship between the two variables under study. Regarding entry of foreign banks in India, Clifford (2009) states that many European and U.S. banks have made India their beehive and are spreading their retail operations in the country.

Vijayalakshmi (2009) conducted the study on Role of Financial Inclusion for Inclusive Growth in India - Issues & Challenges and concluded that Financial Inclusion has far reaching consequences, which can help many people come out of abject poverty conditions. Financial inclusion provides formal identity, access to payments system & deposit insurance. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty.

An article in Emerging Markets Monitor (2010), reveals the fact that commercial credit growth will increase with increase in growth in infrastructure, capital expenditure loans and consumer lending. It goes on to say that job security offered by urban regions and enhanced rural purchasing power will also contribute in this growth. However, it cites the risk in terms increasing non-performing assets is a cause of concern. Vijay Kelkar (2010) analysed in his article Financial Inclusion for Inclusive Growth that enhanced financial inclusion will drastically reduce the farmers' indebtedness, which is one of the main causes of farmers' suicides. The second important benefit is that it will lead to more rapid modernization of Indian agriculture.

Chattopadhyay, Sadhan Kumar (2011) conducted a study titled Financial Inclusion in India: A Case-study of West Bengal. An index of financial inclusion (IFI) has been developed in the study using data on three dimensions of financial inclusion. It is revealed from the index that Kolkata district leads with the highest value of IFI, while rest of the districts show a very low level of financial inclusion. A survey was also conducted in the state in order to gauge the financial inclusion in rural Bengal and the results reveal that around 38 per cent of the respondents do not have sufficient income to open a savings account in the bank.

Reddy K. Sriharsha (2011) studied the flow of credit to small borrowers with the objective to evaluate the extent of financial Inclusion based on credit to small borrowers with special reference to agricultural credit in Andhra Pradesh. This paper attempted to fill this gap by evaluating the extent of financial inclusion in Andhra Pradesh based on the penetration of credit to small borrowers.

Roshny Unnikrishnan et. al (2012) affirmed to the importance of financial inclusion in economic empowerment. This study identified the variables in enabling financial inclusion, analyzed the barriers to effective financial inclusion and the prerogative steps to be taken to overcome the barriers and enable inclusive growth. The study concluded by identifying the variables that empower the masses financially and stating the importance of social inclusion in relation to financial inclusion and also by reinforcing the importance of self-sustenance at the bottom of the economic pyramid. Ramasubbian and Duraiswamy (2012) suggested that though over the past six years the FI strategy had improved the life style of BPL, but missing focus on savings and credit improvement strategies degrades the benefits of FI. This paper surveys and analyzes the issues pertaining to implementation of financial inclusion in economically down trodden districts of Tamil Nadu, India.

Rama Pal and Rupayan Pal (2012) analyzed the aspects related to income related inequality in financial inclusion in India using a representative household level survey data, linked to State-level factors. This paper also provides estimates of the effects of various socio, economic and demographic characteristics of households on propensity of a household to use formal financial services, and compare that for rural and urban sectors. A notable result is that greater availability of banking services fosters financial inclusion, particularly among the poor.

Swamy and Mithra (2017) stressed that there is an urgent need to promote rural artisans, village crafts and cottage industries as they are contributing substantially towards economic and social upliftment of the large chunk of our population in rural areas. He observed that for the exploitation of full potential of the village industries an integrated approach is necessary since these traditional skills have been retained by the craftsmen of different regions face various problems that need to be solved in a coordinated manner. It was, therefore, suggested that a detailed analysis be carried out relating to their performance over the past ten years so as to identify their specific problems and to take suitable measures to remove them. Attention should be drawn towards the need to bring about the suitable technological changes, which lead to production of better-quality goods thereby increasing the income level of workers. He has felt that the various organizations have to play a positive role towards this end and the financial institutions should come forward with easy credit facilities.

Gangadhara Rao (2018) had made a detailed and an indepth study of the Rural Industries located in the industrial estates of Coastal Andhra Pradesh and attempted to evaluate the impact of the programme of industrial estate on the emergence of entrepreneurship in the MSME sector. The study found that the educational and income levels are important factors motivating entrepreneurship of all the ambitions. Money making is the major ambition of the entrepreneurs.

Dubey and Gupta (2018) suggested that the commercial banks restrategiez their policy and direct their efforts towards the opening of more branches, creation of more credit accounts and focussed dispersal to areas with low priority funding in the study period. Only by redesigning their strategies in this manner would they achieve their socio economic objectives of helping with the growth of agriculture, industry, trade, finance, professional and other services sectors etc in rural areas. Presently the data do not support the efficient performance by banks in this regard.

Raghavendra N R (2019) said that the Micro, Small and Medium Enterprises (MSME) play a dominant role in the generation of employment opportunities in rural areas of the country. But, these MSMEs are suffering from lack of financial resources. Among the sources of finance available to MSMEs, the major source is loans from banks. Especially commercial banks are concentrating more on large scale and profitable industries that is why MSMEs are not in a position to get adequate loan from these banks. Central Government has recently announced that merging of syndicate bank with Canara Bank in the coming days. A case study of these two banks is taken into consideration to know the role of these banks in the development of MSME sector in the country. An attempt has been made to know the difference in lending by commercial banks towards MSME sector. t-test is used to know the difference between Loan disbursed by Canara bank and Syndicate Bank towards MSME sector.

Chandra and B. Ramji (2020) have studied that the Indian commercial banks are expected to act as an instrument in fostering growth at rural areas by promoting activities like development of entrepreneurship, Commercial Banks have undertaken specific activities and launched special schemes to develop entrepreneurship at rural levels. The purpose is to encourage small scale entrepreneurship to set up business at rural areas and thereby generate income and increase employment levels of rural community in general.

B.Patras Verma and V. Chendu Goyal (2021) made it clear in their research paper that the Commercial Banks provide much needed financial assistance to the various essential but fund starved rural industries. They identify industries which are of essential nature but lack proper funds and raise funds from sectors which have surplus funds to direct the funds to these industries. Commercial Banks have devised schemes with low interest and zero interest loan facility for various marginal communities, Self-Help Groups and less developed rural industrial sectors. Banks have also acted as facilitator of smooth flow of goods and services from the producer to consumer.

The Commercial banks are playing an important role in the development of rural industries in India. 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. The banking sector's role in deposit mobilization and extending credit is of much importance. The commercial banks have extended loans at concessional rates to rural industries. The functioning of banks through financial inclusion and social banking is also worthy of note. Commercial banks have to concentrate more and more lending to the rural industries. Otherwise, Rural Industries will suffer from shortage of money. The role of Commercial banks should be increased further in lending to the rural Industries (Eswaraih and Sivasankar, 2022).

Summing up

The role of the bank in rural development is manifold. Banks are functional in the processes of savings, capital formation, investment, production in the rural economy. The role of banks in rural development may be understood by comprehending the below mentioned points:

- Banks motivate the people for savings through various programs and collect the dispersed savings of the people. Further, the bank invests it in the rural economy.
- Banks provide the rural small businessmen with loans from deposited money which plays a crucial role in rural development. Especially, the micro-credit programs of different banks made the rural landless people bankable and provided them with the required capital for business and other economic activities.
- Banks play a crucial role in rural capital formation, Banks collect the dispersed savings of rural people through different deposit schemes. Then distribute loans to them for starting a productive as well as any other self-sufficient economic activity.
- Commercial and specialized banks, specially State-Owned Commercial Banks (NCBs) distribute agricultural loans to rural people which make them able to invest in their firms or lands. As most of our farmers are poor they cannot invest enough to increase the production, bank loans help them to increase their production through proper irrigation, fertilization and so on.
- Banks play a crucial role in sustaining and developing our small and cottage industries. Because most of our small and cottage industries are being closed due to lack of enough capital.
- Banks can provide our unemployed youths with training and loan to start a business or to invest in a farm. Such training and income- generating projects can make our youths self-reliant, lessen the intricate problem of unemployment and improve the standard of living in our rural areas.
- Banks play a crucial role in mentioning the disadvantaged groups in the community under some special programs. Even, through making the disadvantaged people economically self-sufficient, banks play important role to empower them and lessen social inequality thereby.

Finally, we may opine that banks in India have come to be recognized as vital catalytic agent engaged in the herculean task of stoking the engine of economic development and uplifting the teeming helpless and neglected masses of the country. Post nationalization period has witnessed unparalleled expansion of branch network, growth in deposits and dimensional, functional and geographical increase in lending operations of the commercial banks. Now-a-days, they constitute one of the pillars of the economy and control the commanding heights. To ensure the uninterrupted growth at a rapid pace, it is necessary that these banks function efficiently.

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