

THE ROLE OF COMMERCIAL BANKS IN ECONOMIC DEVELOPMENT

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ABSTRACT

Commercial banks play a central role in economic development by mobilizing savings, allocating capital, facilitating payments, and supporting investment across all sectors of the economy. As financial intermediaries, they channel surplus funds from savers to borrowers, thereby promoting entrepreneurship, industrial expansion, job creation, and technological innovation. In developing economies, commercial banks are particularly important because they provide credit to small and medium-sized enterprises (SMEs), agricultural producers, and households that often lack direct access to capital markets. This article examines the contribution of commercial banks to economic development through a qualitative review of recent academic literature. The study finds that well-functioning banking systems stimulate economic growth by increasing financial inclusion, improving resource allocation, and enhancing monetary policy transmission. At the same time, weak governance, non-performing loans, and inadequate regulation can limit the developmental impact of banks. The findings suggest that commercial banks remain indispensable institutions in both advanced and emerging economies. The article concludes with recommendations aimed at strengthening banking efficiency, promoting responsible lending, and expanding access to financial services to support sustainable economic development.

Keywords. *Commercial Banks; Economic Development; Financial Intermediation; Credit Allocation; Financial Inclusion; Banking Sector*

INTRODUCTION

Commercial banks are among the most influential institutions in modern economies. Their primary function is to accept deposits and extend loans to individuals, businesses, and governments. By performing this intermediation role, banks connect those who have excess funds with those who need capital for

productive activities. This process facilitates investment, increases production, and contributes to long-term economic growth.

The relationship between banking development and economic growth has been widely studied in economic literature. Financial systems that efficiently mobilize savings and allocate credit tend to foster higher levels of investment and productivity (Beck & Levine, 2018). Commercial banks also support economic stability by providing payment services, managing liquidity, and transmitting central bank policies to the broader economy.

In developing countries, commercial banks are particularly important because capital markets are often underdeveloped. Businesses, especially SMEs, depend heavily on bank financing to purchase equipment, expand operations, and hire workers. Access to banking services also promotes financial inclusion by enabling households to save securely and obtain credit for education, housing, and entrepreneurship (Demirgüç-Kunt et al., 2022).

This article explores the role of commercial banks in economic development by reviewing recent scholarly research and analyzing the mechanisms through which banks contribute to growth, employment, and financial stability.

Literature Review

The theoretical foundation for the role of banks in development is based on the financial intermediation theory. According to this perspective, banks reduce transaction costs, screen borrowers, monitor investments, and diversify risks, thereby improving capital allocation.

Financial Economics scholars have consistently found a positive relationship between banking sector development and economic growth. Beck and Levine (2018) argue that banks accelerate economic progress by identifying productive investment opportunities and monitoring borrowers. Their findings suggest that stronger banking systems are associated with higher productivity and income growth.

More recent studies emphasize the role of financial inclusion. World Bank Group data analyzed by Demirgüç-Kunt et al. (2022) show that broader access to banking services increases household resilience, encourages entrepreneurship, and reduces poverty. Commercial banks contribute by expanding deposit accounts, digital payments, and microcredit services.

Commercial banks are also essential for SME financing. According to OECD (2023), SMEs account for a large share of employment worldwide but frequently face credit constraints. Banks help overcome these constraints by providing working capital and long-term loans.

Recent research highlights how technological innovation has enhanced banks' developmental impact. Digital banking and financial technologies reduce costs and expand services to underserved populations (Ozili, 2021). However, poor governance, excessive risk-taking, and weak regulation can lead to banking crises that hinder economic growth.

METHODOLOGY

This study uses a qualitative literature review methodology. Academic journal articles, policy reports, and institutional studies published primarily between 2018 and 2025 were examined to assess the role of commercial banks in economic development.

The literature selection focused on five themes:

1. Savings mobilization
2. Credit allocation and investment financing
3. Financial inclusion
4. SME and household lending
5. Banking stability and regulation

Sources were selected based on academic rigor, citation frequency, and relevance to contemporary banking systems. The findings were synthesized to identify recurring patterns and practical implications for policymakers and banking institutions.

ANALYSIS AND RESULTS

Commercial banks encourage individuals and businesses to deposit funds securely. These deposits become a major source of loanable funds. By transforming short-term deposits into long-term loans, banks support capital formation and productive investment.

The most significant contribution of commercial banks is the extension of credit. Loans finance machinery, infrastructure, inventory, and innovation. Efficient credit allocation increases productivity and supports structural transformation from low-value to higher-value economic activities.

SMEs are often referred to as the backbone of the economy. Commercial banks provide working capital, trade finance, and investment loans that enable SMEs to grow and create jobs. Improved access to bank credit is strongly associated with higher business survival and expansion rates (OECD, 2023).

Commercial banks promote inclusive development by offering savings accounts, mobile banking, and consumer credit. Greater financial inclusion enables households to manage risk, smooth consumption, and invest in education and business opportunities (Demirgüç-Kunt et al., 2022).

Banks serve as the primary channel through which central bank policies affect the real economy. Changes in interest rates influence lending behavior, investment, and consumption. Stable and well-capitalized banks strengthen this transmission mechanism and improve macroeconomic management.

Despite their importance, commercial banks face several obstacles. High non-performing loans, weak corporate governance, and limited competition can reduce lending efficiency. In some developing countries, banks may prefer low-risk government securities rather than productive private-sector lending. Strong supervision and prudent regulation are therefore essential.

Overall, the analysis confirms that commercial banks are key institutions for mobilizing resources, financing productive activities, and supporting inclusive and sustainable economic growth.

Conclusion and Recommendations.

Commercial banks play a fundamental role in economic development. They mobilize savings, provide credit, facilitate payments, support SMEs, and promote financial inclusion. Through these functions, banks stimulate investment, job creation, and productivity growth.

The literature demonstrates that countries with efficient and stable banking systems tend to experience stronger and more sustainable economic performance. Nevertheless, the developmental impact of banks depends on sound governance, prudent risk management, and effective regulation.

The following recommendations are proposed:

1. Expand access to banking services in rural and underserved areas.
2. Increase lending to SMEs and innovative enterprises.
3. Strengthen credit risk assessment and reduce non-performing loans.
4. Promote digital banking and financial technology adoption.
5. Enhance regulatory oversight and corporate governance.
6. Encourage financial literacy to improve responsible use of banking services.

In conclusion, commercial banks remain indispensable to economic development. When properly regulated and efficiently managed, they serve as engines of investment, inclusion, and long-term prosperity.

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