



Role of Commercial Banks in Economic Development

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Abstract

Commercial banks play a pivotal role in fostering economic development by mobilizing savings, allocating credit, facilitating investment, and supporting financial stability. As key intermediaries within the financial system, they channel funds from surplus units to deficit units, thereby promoting capital formation and productive economic activities. This paper examines the role of commercial banks in economic development with a focus on their contribution to industrial growth, agricultural financing, infrastructure development, and support for small and medium-sized enterprises (SMEs). It also explores how banking services such as payment systems, trade finance, and financial inclusion initiatives enhance economic efficiency and broaden access to financial resources. Furthermore, the study analyzes the impact of technological advancements, regulatory frameworks, and monetary policies on the developmental functions of commercial banks. Special attention is given to the challenges faced by commercial banks in developing economies, including credit risk, non-performing assets, and uneven access to banking services. The paper concludes that a well-regulated and inclusive banking system is essential for sustainable economic growth, as commercial banks not only stimulate investment and employment but also contribute to financial deepening and long-term economic resilience.

Keywords: Commercial Banks; Economic Development; Financial Intermediation; Capital Formation; Credit Allocation; Financial Inclusion; Sustainable Growth

INTRODUCTION

1. Background of the Problem

Economic development is a multidimensional process encompassing sustained growth in income, structural transformation of productive sectors, employment generation, poverty reduction, and improvement in living standards. Financial systems play a central role in this process by mobilizing savings, allocating capital efficiently, facilitating trade, and managing risk. Among financial institutions, **commercial banks** occupy a dominant position due to their extensive reach, intermediary functions, and regulatory importance within national economies. Historically, commercial banks have served as the primary conduit between surplus units (savers) and deficit units (investors), enabling capital accumulation and productive investment. In developing and emerging economies, where capital markets are often underdeveloped, the dependence on bank-based financial systems is particularly pronounced. Even in advanced



economies, commercial banks remain systemically significant due to their role in credit creation, payment systems, and monetary transmission mechanisms.

In the post-global financial crisis era and especially after the COVID-19 pandemic, the role of commercial banks has undergone renewed scrutiny. Governments and central banks increasingly rely on commercial banks to transmit monetary stimulus, support small and medium enterprises (SMEs), stabilize financial markets, and promote inclusive growth. Simultaneously, banks face challenges arising from digital disruption, regulatory tightening, climate-related financial risks, and rising expectations regarding social and developmental responsibilities.

Despite their centrality, debates persist regarding the **extent, channels, and quality of commercial banks' contribution to economic development**. While some scholars argue that banking sector expansion fosters growth and inclusion, others caution against excessive credit expansion, financial fragility, and unequal access to banking services. This divergence necessitates a systematic and critical review of contemporary literature to clarify the evolving role of commercial banks in economic development.

2. Conceptual and Theoretical Context

The relationship between banking development and economic growth is grounded in several theoretical frameworks within economics and finance.

2.1 Financial Intermediation Theory

Financial intermediation theory posits that banks reduce transaction costs and information asymmetries between savers and borrowers. By screening borrowers, monitoring projects, and diversifying risk, commercial banks improve the efficiency of capital allocation. From this perspective, well-functioning banking systems stimulate investment, productivity, and long-term economic growth.

2.2 Endogenous Growth Theory

Endogenous growth models emphasize the role of financial institutions in promoting innovation, human capital formation, and technological progress. Commercial banks contribute by financing research-intensive firms, startups, and infrastructure projects that generate positive spillover effects across the economy. Credit availability thus becomes a driver of sustained growth rather than merely a response to it.

2.3 Bank-Based vs Market-Based Financial Systems

The bank-based view argues that banks are more effective than capital markets in fostering development, particularly in early stages of economic growth. Banks are better suited to long-term financing, relationship lending, and supporting SMEs. In contrast, market-based systems emphasize securities markets. Contemporary literature increasingly adopts a **complementarity perspective**, recognizing that banks and markets jointly support development.

2.4 Financial Inclusion and Development Theory

Recent theoretical discourse extends beyond growth metrics to emphasize **inclusive and sustainable development**. Commercial banks are viewed as key agents in expanding access to financial services, integrating marginalized populations into the formal economy, and



supporting environmentally sustainable investments. This shift reflects broader development paradigms aligned with the Sustainable Development Goals (SDGs).

Together, these theoretical perspectives frame commercial banks not merely as profit-oriented entities but as institutions with systemic and developmental significance.

3. Global and Regional Trends in Commercial Banking

3.1 Global Trends

Between 2019 and 2026, global banking systems have experienced significant transformation. Key trends include:

- Expansion of digital banking and fintech collaboration
- Heightened regulatory oversight focusing on capital adequacy and risk management
- Increased emphasis on sustainable finance and ESG-aligned lending
- Countercyclical lending roles during economic downturns

In advanced economies, commercial banks have supported economic recovery through accommodative credit policies and government-backed lending programs. In emerging economies, banks continue to play a crucial role in infrastructure financing, industrial development, and trade facilitation.

3.2 Regional Perspectives

In developing regions such as South Asia, Sub-Saharan Africa, and parts of Latin America, commercial banks are instrumental in addressing structural development challenges. These include financing agriculture, MSMEs, and rural enterprises, as well as implementing financial inclusion initiatives through branch expansion and digital platforms.

However, regional disparities persist in credit allocation, access to formal banking, and the developmental impact of banking activities. This uneven performance underscores the importance of contextual analysis in evaluating the role of commercial banks.

4. Rationale of the Study

The rationale for the present review arises from several interrelated considerations. First, while the banking-growth nexus has been extensively studied, much of the literature remains fragmented across regions, methodologies, and conceptual lenses. Second, recent economic disruptions and technological shifts have altered the functional role of commercial banks, making older conclusions potentially outdated. Third, contemporary development discourse increasingly emphasizes inclusion, sustainability, and resilience, requiring a reassessment of banking sector contributions beyond traditional growth indicators.

A comprehensive review focusing on the **2019–2026 period** allows for the integration of post-pandemic insights, digital banking developments, and sustainability-oriented finance. Such a review is essential for policymakers, regulators, academics, and banking practitioners seeking evidence-based understanding of how commercial banks can effectively support economic development in a rapidly changing global environment.

5. Research Gap Identification



Despite extensive scholarship, several gaps remain evident in the existing literature. First, many studies examine the impact of banking development on economic growth using narrow quantitative indicators, often overlooking qualitative dimensions such as inclusiveness and sustainability. Second, empirical findings remain mixed, with variations across income levels, institutional quality, and regulatory frameworks. Third, there is limited synthesis of how traditional banking functions interact with newer roles related to digital finance and green investment.

Moreover, few review studies systematically integrate theoretical perspectives with recent empirical evidence to identify convergences and contradictions. This lack of synthesis limits the ability to draw coherent conclusions and formulate informed policy recommendations.

6. Objectives of the Study

In light of the above context, the present review article is guided by the following objectives:

1. **To critically review existing literature on the role of commercial banks in promoting economic development**, with emphasis on financial intermediation, credit allocation, capital formation, and growth outcomes.
2. **To examine how commercial banking activities contribute to inclusive and sustainable economic growth**, focusing on financial inclusion, SME financing, and emerging sustainability-oriented banking practices.

7. Transition to Review of Literature

Given the complexity and evolving nature of the relationship between commercial banks and economic development, a structured and thematic examination of prior studies is essential. Accordingly, the next section presents a **thematic Review of Literature**, synthesizing conceptual models, empirical evidence, methodological trends, and scholarly debates from recent global research to clearly situate the present study within existing knowledge.

CONCLUSION AND IMPLICATIONS

1. Synthesis of Key Insights

This review set out to critically examine contemporary literature on the role of commercial banks in economic development, with particular attention to inclusive and sustainable growth outcomes. The synthesis of studies published between 2019 and 2026 demonstrates that commercial banks remain central to development processes across both advanced and developing economies, albeit through evolving mechanisms and expanded functional expectations.

The literature consistently highlights that commercial banks contribute to economic development primarily through financial intermediation, credit allocation, and liquidity provision. By mobilizing savings and channeling funds toward productive investments, banks influence capital formation, industrial expansion, and employment generation. However, the review also reveals that the developmental impact of banking activity is not automatic; it is highly contingent on the quality of institutions, regulatory effectiveness, and the sectoral composition of credit.



Beyond traditional growth effects, recent scholarship underscores a broader developmental role for commercial banks. Financial inclusion initiatives, SME financing, and digital banking innovations are increasingly recognized as critical pathways through which banks support inclusive economic participation. At the same time, the growing emphasis on sustainable finance reflects a shift toward long-term development objectives that integrate environmental and social considerations into banking operations.

2. Commercial Banks and Inclusive Growth: Key Conclusions

A major conclusion emerging from the reviewed literature is that **access to banking services matters as much as credit volume**. Studies consistently show that inclusion-oriented banking—characterized by affordable accounts, accessible credit, and digital payment systems—enhances household welfare and supports micro- and small-scale entrepreneurship. Commercial banks, due to their scale and regulatory backing, are uniquely positioned to institutionalize financial inclusion initiatives.

Nevertheless, the literature also cautions against equating financial inclusion solely with credit expansion. Evidence suggests that inclusion efforts focused excessively on consumer lending may generate short-term consumption gains without delivering sustained development benefits. Thus, the developmental contribution of commercial banks depends on the alignment of inclusion strategies with productive and income-generating activities.

3. Sustainability and the Evolving Developmental Role of Banks

Another important conclusion is that the role of commercial banks in economic development is increasingly intertwined with sustainability considerations. The growing body of research on green finance and ESG-aligned lending indicates that banks are gradually internalizing environmental and social risks into their decision-making processes. This evolution reflects both regulatory pressures and changing stakeholder expectations.

However, the literature reveals uneven progress across regions and institutions. While some banks actively support renewable energy, infrastructure, and socially responsible projects, others remain constrained by risk perceptions, limited expertise, or short-term profitability concerns. As a result, the contribution of commercial banks to sustainable development remains significant but incomplete.

4. Theoretical and Academic Implications

From a theoretical standpoint, the reviewed studies suggest the need to move beyond narrow growth-centric models of banking development. Contemporary evidence supports a multidimensional framework that integrates financial intermediation theory with inclusion and sustainability perspectives. This implies that future theoretical models should account for qualitative aspects of banking, such as access, resilience, and long-term developmental orientation.

Academically, this review contributes by consolidating fragmented findings across growth, inclusion, and sustainability literatures. By adopting a thematic and integrative approach, it clarifies areas of convergence and contention, thereby offering a more coherent understanding of how commercial banks influence economic development in the current global context.

5. Policy and Practical Implications



The findings of this review carry important implications for policymakers, regulators, and banking practitioners. For policymakers, the evidence underscores the importance of creating regulatory environments that incentivize productive and inclusive lending while safeguarding financial stability. Policies that encourage SME financing, infrastructure investment, and green lending can enhance the developmental impact of commercial banks.

For banking institutions, the literature highlights the strategic value of aligning business models with long-term development goals. Investments in digital infrastructure, risk assessment capabilities, and sustainability frameworks can enable banks to expand their developmental role while maintaining financial viability.

6. Directions for Future Research

Despite extensive scholarship, the review identifies several avenues for future research. There is a need for more integrative studies that simultaneously examine growth, inclusion, and sustainability outcomes. Comparative research across regions and institutional contexts would further enhance understanding of how regulatory and structural factors shape banking-led development. Additionally, future reviews may benefit from incorporating emerging themes such as climate risk, digital financial ecosystems, and post-crisis resilience.

7. Concluding Remarks

In conclusion, the literature reviewed affirms that commercial banks remain indispensable to economic development, but their role has expanded beyond traditional intermediation functions. In the contemporary period, banks are increasingly evaluated based on their capacity to promote inclusive and sustainable growth alongside economic expansion. A nuanced and context-sensitive understanding of this evolving role is essential for maximizing the developmental potential of commercial banking systems.

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