

Institutional Substitutes and the Exit from Backwardness: The Role of Banks in Gerschenkron's Framework

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Abstract

Alexander Gerschenkron's theory of economic backwardness highlights how late-industrializing economies rely on institutional substitutes to overcome structural constraints. This paper examines the role of banks as key institutional substitutes facilitating industrialization, capital mobilization, and structural transformation. Drawing on historical experiences of Germany, Russia, and Japan, it argues that banks in backward economies function beyond financial intermediation by coordinating long-term investment and reducing market failures. The study revisits Gerschenkron's framework in a contemporary context, showing how developmental banking models continue to support economic catch-up. The paper concludes that strong banking institutions remain central to enabling economies to exit backwardness and achieve sustained growth.

Keywords: Gerschenkron, Economic Backwardness, Institutional Substitutes, Development Banking, Industrialization, Financial Institutions, Late Development, Structural Transformation, Banking Systems, Development Economics.

Introduction

Background and Context

Economic development across nations has followed diverse historical paths. Early industrializers relied largely on market mechanisms, private entrepreneurship, and gradual capital accumulation. In contrast, late-developing countries faced structural disadvantages such as weak financial markets, limited industrial capital, and technological gaps. These differences prompted scholars to examine how backward economies industrialize despite lacking the institutional foundations available to early developers.

Alexander Gerschenkron's theory of economic backwardness offers a significant explanation by arguing that latecomer economies compensate for missing market structures through strong institutional arrangements. Instead of following the same trajectory as early industrializers, they adopt alternative mechanisms that accelerate industrial growth. Within this framework, banks emerge as critical institutions capable of mobilizing resources and guiding industrial development.

Gerschenkron's Idea of Economic Backwardness

Gerschenkron viewed backwardness as a relative condition rather than a permanent state. Countries lagging industrial leaders could still achieve rapid growth if they developed institutions capable of substituting absent markets and entrepreneurial classes. The greater the level of backwardness, the stronger and more organized the institutional response required.

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Banks play a central role in this process because they provide long-term finance, reduce uncertainty, and coordinate large-scale industrial investment. Rather than functioning only as financial intermediaries, banks become developmental actors supporting structural transformation.

Banks as Institutional Substitutes

In backward economies, capital markets are often underdeveloped, and private investors may be unwilling to finance large industrial projects due to high risk and long gestation periods. Banks therefore act as institutional substitutes by channeling savings into productive sectors and supporting industrial modernization. Historical experiences show that banking institutions often guided investment decisions, supported heavy industries, and accelerated technological adoption.

The role of banks can be summarized as follows:

Table 1: Banks as institutional substitutes in backward economies.

| Economic Constraint | Role of Banks as Institutional Substitute | Development Effect |
|----------------------------|--|-----------------------------|
| Weak capital markets | Provision of long-term industrial credit | Industrial expansion |
| Limited entrepreneurship | Investment coordination and monitoring | Organized industrial growth |
| High risk and uncertainty | Financial evaluation and supervision | Reduced investment risk |
| Capital scarcity | Mobilization of savings | Increased capital formation |

Research Focus and Objectives

This paper examines the relationship between institutional substitutes and the process of exiting economic backwardness, focusing specifically on the role of banks within Gerschenkron's framework. It aims to analyze how banking institutions facilitate industrialization in late-developing economies and how this theoretical perspective remains relevant in contemporary development discussions.

The main research directions are summarized below:

Table 2: Key Research Focus of the Study

| Research Area | Central Question |
|--------------------------|---|
| Theoretical Analysis | How do banks function within Gerschenkron's theory? |
| Historical Perspective | What role did banks play in late industrialization? |
| Institutional Analysis | Why are banks considered substitutes for missing markets? |
| Development Implications | How do banks contribute to structural transformation? |

Significance of the Study

Understanding the role of banks as institutional substitutes is important not only for interpreting historical industrialization but also for analyzing present-day development challenges. Many emerging economies continue to face financial and structural constraints similar to those described by Gerschenkron. By revisiting this framework, the study highlights how strong financial institutions can support economic transformation and help nations transition from backwardness toward sustained industrial development.

Theoretical Background

Concept of Economic Backwardness

- **Meaning and Nature**

The theoretical foundation of this study is based on Alexander Gerschenkron's theory of economic backwardness, which explains why countries industrializing later follow different developmental trajectories compared to early industrializers. Economic backwardness, according to Gerschenkron, is a relative condition measured against economically advanced nations. It reflects gaps in industrial capacity, technological progress, capital accumulation, and institutional development. Rather than viewing backwardness as a permanent disadvantage, the theory emphasizes that late-developing economies can achieve rapid industrial growth through alternative institutional arrangements.

- **Developmental Implications**

Gerschenkron argued that latecomer economies cannot rely solely on market forces because they often lack mature financial markets, entrepreneurial classes, and industrial infrastructure. Therefore, the process of development in such economies tends to be more organized and institution driven. The

higher the degree of backwardness, the stronger the institutional intervention required to accelerate industrialization. This idea forms the core theoretical basis for understanding the role of banks as agents of development.

Institutional Substitutes in Development Theory

- **Concept of Institutional Substitutes**

A key contribution to Gerschenkron's framework is the idea of institutional substitutes. These refer to institutions that compensate for missing or underdeveloped market mechanisms in backward economies. When private capital markets or entrepreneurial systems are weak, alternative institutions emerge to mobilize resources and coordinate industrial investment. Institutional substitutes therefore act as mechanisms that reduce structural constraints and enable faster economic transformation.

- **Types of Institutional Substitutes**

The type of institutional substitute varies according to the degree of backwardness. In moderately backward countries, universal banks often perform this role by financing industrial expansion. In more backward economies, state or state-supported financial institutions may become dominant actors. This theoretical perspective suggests that institutional strength increases when market capacity is limited, allowing economies to overcome developmental bottlenecks.

Role of Banks within Gerschenkron's Framework

- **Banks as Developmental Institutions**

In Gerschenkron's analysis, banks are not merely financial intermediaries but developmental institutions that actively shape industrialization. They provide long-term credit for large-scale industrial projects that private investors may consider too risky. By mobilizing savings and directing funds toward strategic sectors, banks help overcome capital scarcity and promote structural transformation. Their involvement often extends beyond lending to include monitoring, coordination, and participation in industrial decision-making.

- **Investment Coordination and Risk Reduction**

Late-developing economies typically face high uncertainty due to technological gaps and weak market structures. Banks reduce these risks by evaluating projects, supervising investment, and maintaining long-term relationships with industrial firms. This coordinated financial role supports rapid industrial growth and allows countries to catch up with advanced economies. Historical evidence from Germany, Russia, and Japan illustrates how banking systems functioned as engines of industrialization within this framework.

Banking, Industrialization, and Structural Transformation

- **Financial Development and Industrial Growth**

The theoretical relationship between banking development and industrialization lies in the ability of banks to channel financial resources into productive sectors. Industrialization requires large and sustained investments, which are difficult to achieve through fragmented markets alone. Banks bridge this gap by transforming short-term savings into long-term industrial finance, thereby accelerating capital formation and technological modernization.

- **Exit from Backwardness**

Within Gerschenkron's theory, the exit from backwardness occurs when institutional substitutes successfully facilitate industrial expansion and structural change. Strong banking institutions enable economies to move from agrarian structures toward industrial and diversified economic systems. As industries mature and markets develop, reliance on institutional substitutes may gradually decline, but their initial role remains critical in initiating development.

Contemporary Relevance of the Theory

Although developed in a historical context, Gerschenkron's theoretical insights continue to influence modern development. Many emerging economies still face challenges such as limited long-term finance, weak capital markets, and industrial underdevelopment. Development banks, state-supported financial institutions, and coordinated banking systems in modern economies reflect the continued

relevance of institutional substitutes. Therefore, the theoretical framework remains useful for understanding how financial institutions contribute to economic catch-up and sustained development.

Literature Review

- **Foundations of Economic Backwardness and Industrialization**

Gerschenkron (1962) argued that late industrialization follows a path different from early industrializers, where institutional substitutes such as banks and the state compensate for missing market mechanisms. His work laid the foundation for understanding how financial institutions accelerate industrial development in backward economies.

Chandler (1990) emphasized the role of organizational structures and managerial coordination in industrial growth, suggesting that institutional capacity, including financial institutions, determines the speed of economic transformation.

Pollard (1981) reviewed European industrialization patterns and concluded that industrial growth depended heavily on institutional arrangements rather than purely market forces, supporting Gerschenkron's argument about alternative developmental paths.

- **Financial Institutions and Economic Development**

Schumpeter (1911/1934) highlighted the role of banks as facilitators of innovation by providing credit to entrepreneurs. He argued that financial institutions are central to economic development because they enable technological advancement and industrial expansion.

Goldsmith (1969) examined the relationship between financial structure and economic growth, concluding that countries with developed banking systems experienced faster industrialization.

McKinnon (1973) proposed the financial liberalization theory, emphasizing that efficient financial intermediation encourages savings and investment, which are essential for development.

Shaw (1973) similarly argued that financial deepening improves capital allocation and supports long-term growth, reinforcing the developmental role of banks.

- **Banking Systems and Industrialization**

Cameron (1967) analyzed banking development in Europe and found that universal banks played a crucial role in financing industrial enterprises, particularly in Germany. His study provided empirical support for Gerschenkron's emphasis on banks as institutional substitutes.

Fohlin (2007) examined German universal banking and concluded that banks contributed significantly to industrial coordination, corporate governance, and long-term investment during industrialization.

Calomiris (1995) reviewed historical banking systems and demonstrated that strong banking institutions helped reduce information asymmetry and investment risk, enabling rapid industrial growth.

Rajan and Zingales (1998) argued that financial development supports industrial expansion by improving access to external finance, particularly in sectors dependent on long-term capital.

- **State, Institutions, and Late Development**

Johnson (1982) studied Japan's developmental state model and showed how financial institutions, supported by government policy, facilitated industrial modernization.

Amsden (1989) analyzed late industrialization in East Asia and found that directed credit through banks played a vital role in accelerating industrial catch-up.

Wade (1990) emphasized the importance of state-guided finance in promoting industrial competitiveness, highlighting how institutional arrangements shape development outcomes.

Chang (2002) argued that successful industrialization historically relied on active institutional support, including banking systems that financed strategic sectors.

- **Financial Systems and Structural Transformation**

Levine (1997) reviewed empirical evidence linking financial development and economic growth, concluding that banking institutions improve resource allocation and productivity.

King and Levine (1993) found a strong positive relationship between financial depth and long-term economic growth, suggesting that banking development precedes industrial expansion.

Demirgüç-Kunt and Levine (2001) explored financial structures across countries and demonstrated that bank-based systems are particularly effective in early stages of development where markets remain weak.

- **Institutional Economics and Development Perspectives**

North (1990) emphasized that institutions reduce uncertainty and transaction costs, making them essential for economic performance. His institutional approach complements Gerschenkron's argument regarding institutional substitutes.

Rodrik (2004) argued that development strategies must align with institutional realities, highlighting the importance of context-specific financial institutions in promoting industrialization.

Acemoglu and Robinson (2012) stressed that inclusive economic institutions, including effective financial systems, play a central role in long-term economic growth and structural transformation.

- **Synthesis of Literature**

The reviewed literature collectively demonstrates that financial institutions particularly banks, play a decisive role in industrialization and economic transformation. Classical works such as Gerschenkron (1962) and Schumpeter (1934) provide theoretical foundations, while empirical studies by Cameron (1967), Fohlin (2007), and Levine (1997) support the argument that banks facilitate capital mobilization, investment coordination, and technological modernization. Studies on late development by Amsden (1989) and Johnson (1982) further reinforce the idea that banking systems act as institutional substitutes in economies facing structural constraints.

Overall, the literature confirms that strong banking institutions are closely linked to successful industrialization and economic catch-up, validating the relevance of Gerschenkron's framework in both historical and contemporary contexts.

Research Methodology

This study adopts a qualitative and analytical research design to examine the role of banks as institutional substitutes within Gerschenkron's framework of economic backwardness. The research is primarily conceptual and comparative in nature, combining theoretical analysis with historical evidence to understand how banking institutions contributed to industrialization in late-developing economies.

The methodology relies on secondary data collected from scholarly books, peer-reviewed journal articles, historical economic studies, and institutional reports related to financial development and industrialization. A comparative historical approach is used to analyze selected country experiences, particularly Germany, Russia, and Japan, as representative cases of late industrialization. These cases are examined to identify patterns in banking structures, institutional interventions, and industrial outcomes.

The analytical framework is based on Gerschenkron's concept of institutional substitutes, focusing on three key dimensions: capital mobilization, investment coordination, and risk reduction. The study synthesizes theoretical arguments and empirical findings from existing literature to establish conceptual linkages between banking development and structural transformation.

Overall, the methodology aims to provide a comprehensive theoretical understanding rather than statistical testing, enabling a deeper interpretation of how financial institutions facilitate the exit from economic backwardness and contribute to long-term industrial development.

Data Interpretation and Analysis

- **Introduction**

This section interprets the historical and comparative evidence within Gerschenkron's framework by integrating the conceptual figures and charts developed for this study. The objective is to analyze how banks acted as institutional substitutes enabling late-developing economies to overcome structural constraints and exit economic backwardness. The analysis focuses on three historical cases Germany, Russia, and Japan and examines banking functions through the lenses of capital mobilization, investment coordination, risk reduction, and structural transformation. The figures included provide a

visual representation of the analytical relationships discussed in this section and help explain the developmental role of banking institutions.

- **Conceptual Interpretation: Banks as Institutional Substitutes**

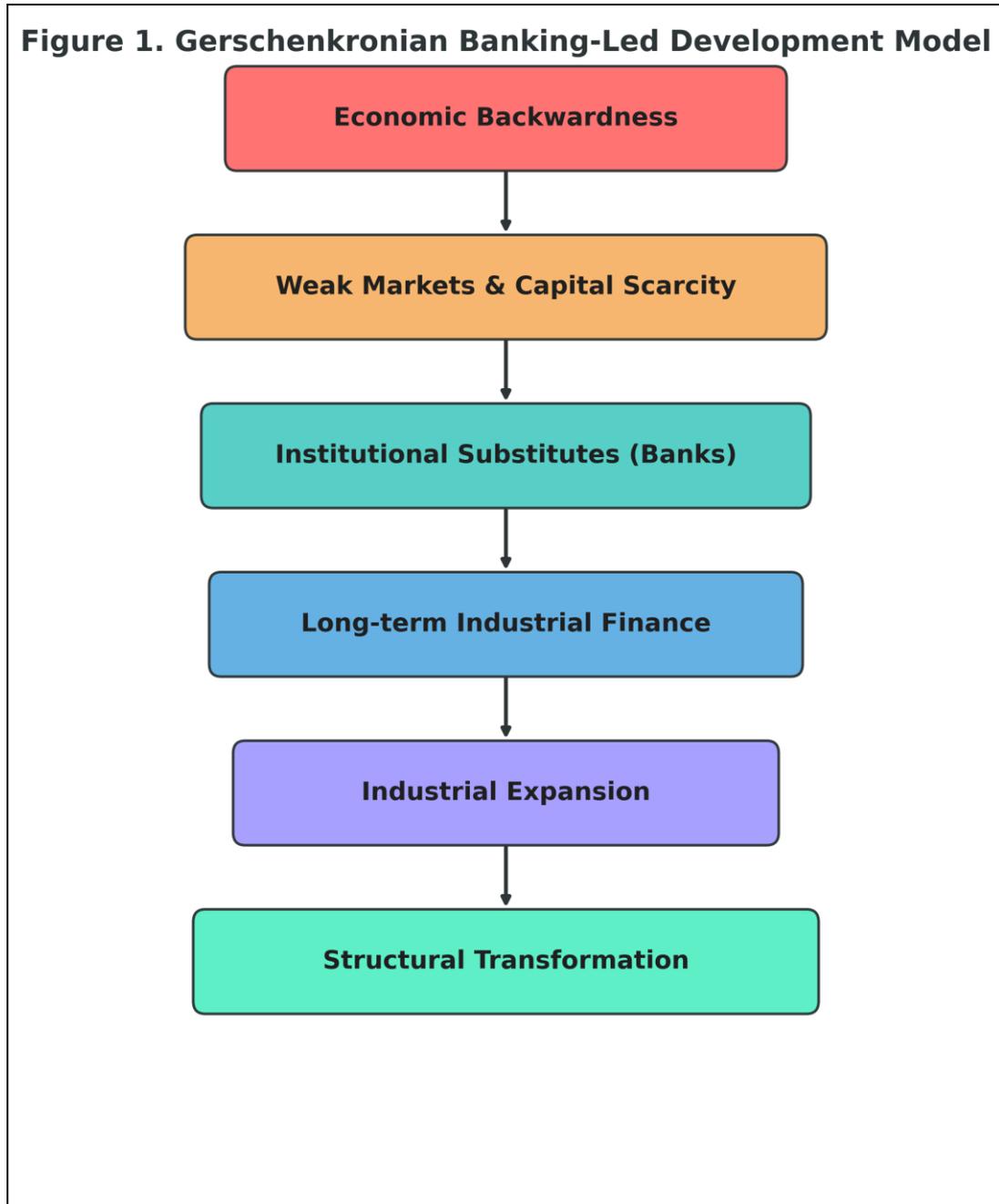


Figure 1: Gerschenkronian Model of Banking-Led Development

Source: Curated by the author

Interpretation: Figure 1 presents the core analytical structure derived from Gerschenkron's theory. The data from historical cases suggest that backward economies faced common constraints, particularly weak capital markets and limited entrepreneurial capacity. Banks emerged as institutional substitutes by providing long-term credit and coordinating industrial investment. The interpretation indicates that the presence of strong banking institutions shortened the time required for industrial catch-up. Rather than waiting for markets to mature gradually, banks accelerated industrialization through organized financial intervention.

- **Comparative Analysis of Banking Roles**

Figure 2. Comparative Role of Banks in Late Industrializers

| Country | Degree of Backwardness | Banking Structure | Development Role |
|---------|------------------------|-----------------------|-----------------------------|
| Germany | Moderate | Universal Banks | Industrial Coordination |
| Russia | High | State-supported Banks | Heavy Industry Finance |
| Japan | Moderate-High | Coordinated Banking | Technology & Export Support |

Figure 2: Comparative Banking Role in Late Industrializers

Source: Curated by the author

Interpretation: The comparative data reveals that the role of banks varied according to the degree of backwardness. Germany's universal banks actively participated in industrial governance by financing and supervising industrial firms. Russia, facing a higher level of backwardness, relied on state-backed banks that directed credit toward infrastructure and heavy industry. Japan adopted a coordinated model where banks supported industrial groups and facilitated technological modernization.

The analysis confirms Gerschenkron's proposition that institutional intensity increases with backwardness. Where private markets were weak, banking institutions assumed stronger developmental responsibilities. This comparative evidence demonstrates that banks did not merely provide liquidity; they shaped industrial strategies and investment priorities.

- **Banking Functions and Development Outcomes**

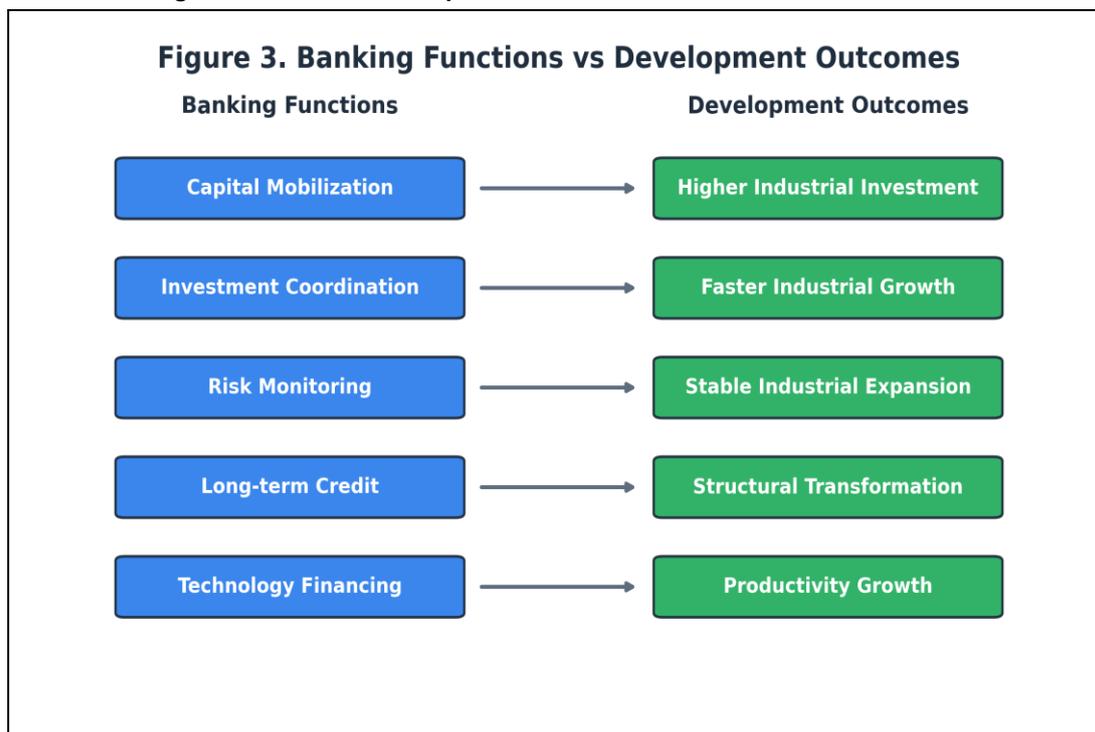


Figure 3: Banking Functions vs Development Outcomes

Source: Curated by the author

Interpretation: Figure 3 highlights the relationship between core banking functions and developmental outcomes. The data suggest that capital mobilization was the primary mechanism through which banks supported industrialization. By collecting savings and converting them into long-term industrial loans, banks enabled large-scale investments that were otherwise difficult to finance.

Investment coordination emerges as another critical function. Historical evidence indicates that banks reduced fragmentation in industrial investment by guiding funds toward strategic sectors. This reduced duplication and improved efficiency. Furthermore, risk monitoring by banks increased investor confidence and allowed firms to undertake technologically advanced projects. The analysis shows that long-term credit availability was closely linked with structural transformation, enabling economies to move from agrarian structures toward industrial systems.

- **Analysis of Industrialization Patterns**

The comparative interpretation of historical data demonstrates that banking institutions significantly influenced the pace and direction of industrialization. In Germany, industrial growth was driven by close relationships between banks and manufacturing firms. Banks held equity stakes and participated in corporate governance, ensuring long-term industrial stability.

In Russia, industrialization was more state-directed, with banks acting as channels for government-led industrial policies. Although this model achieved rapid heavy industrial expansion, it also created centralized financial structures. In Japan, the coordination between banks, industry, and government promoted technological adoption and export-oriented growth.

These patterns indicate that while institutional forms differed, the developmental function of banks remained consistent: overcoming structural constraints associated with backwardness. The analysis confirms that banking institutions were essential in reducing financial barriers and enabling rapid industrial expansion.

- **Structural Transformation and Exit from Backwardness**

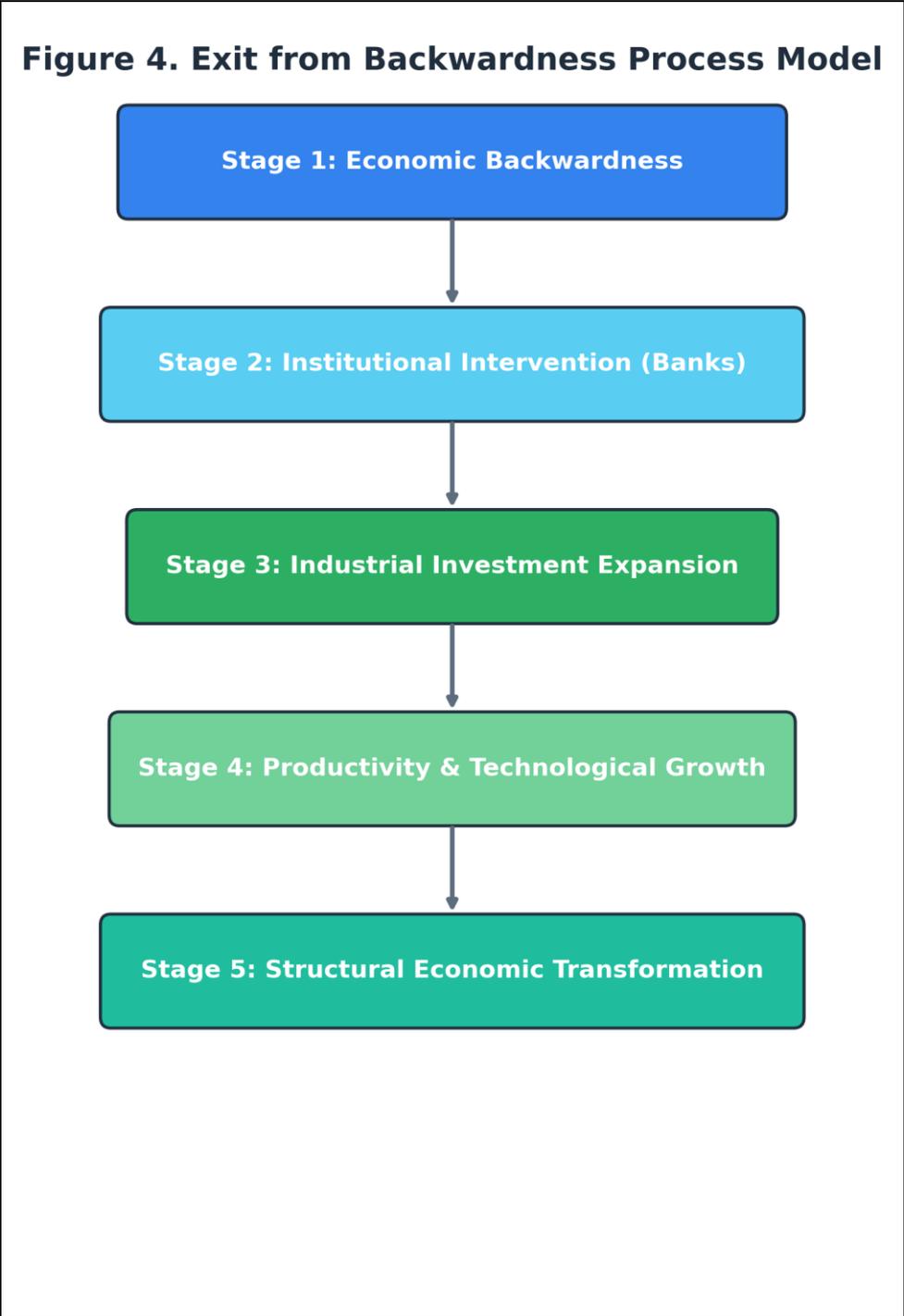


Figure 4: Exit from Backwardness Process

Source: Curated by the author

Interpretation: Figure 4 illustrates the staged process through which economies transition out of backwardness. The data suggest that banking intervention represents a critical turning point in this process. Once banks begin financing industrial sectors, investment levels increase, leading to productivity gains and technological modernization. Over time, this generates structural changes in the economy, including diversification of industries and expansion of manufacturing output.

The analysis indicates that successful exit from backwardness depends not only on the presence of banks but on their ability to function as developmental institutions rather than purely profit-oriented entities. Countries where banks actively coordinated industrial investment experienced faster and more sustainable transformation.

- **Analytical Synthesis**

The overall interpretation of the figures and historical evidence demonstrates three major findings. First, banks acted as institutional substitutes by replacing missing capital markets in backward economies. Second, the developmental role of banks varied depending on the level of backwardness but consistently supported industrial growth. Third, banking-led finance contributed directly to structural transformation by enabling long-term industrial investment.

These findings validate Gerschenkron's theoretical argument that institutional innovation, particularly through banking systems, is essential for late industrialization. The analysis also shows that financial institutions functioned as catalysts of economic change rather than passive market participants.

In conclusion, the data interpretation confirms that banks played a decisive role in enabling economies to overcome structural limitations and transition toward industrial maturity. The integration of figures and comparative analysis strengthens the argument that institutional substitutes remain central to understanding the process of economic catch-up and development.

Research Findings

- **Introduction**

This section presents the key findings derived from the theoretical analysis, literature review, and data interpretation conducted within the framework of Gerschenkron's theory of economic backwardness. The study aimed to examine how banks function as institutional substitutes in late-developing economies and how their role contributes to industrialization and structural transformation. The findings highlight consistent patterns across historical experiences and confirm the central importance of banking institutions in enabling economies to exit backwardness.

- **Banks as Institutional Substitutes**

The first major finding of this research is that banks operate as effective institutional substitutes in economies where capital markets are underdeveloped or absent. Historical evidence from Germany, Russia, and Japan demonstrates that banks filled structural gaps by mobilizing savings, allocating long-term credit, and coordinating industrial investment. Instead of functioning solely as financial intermediaries, banks acted as developmental institutions that replaced missing market mechanisms.

The analysis shows that in late-developing economies, banks assumed responsibilities typically carried out by mature financial markets, such as risk evaluation, project monitoring, and strategic allocation of capital. This confirms Gerschenkron's proposition that stronger institutional intervention emerges where economic backwardness is more severe.

- **Banking Systems and Industrialization**

A second important finding is the strong relationship between banking development and industrial growth. The comparative analysis indicates that countries with organized banking systems experienced faster industrial expansion compared to those relying only on market-based finance. Universal banks in Germany supported heavy industries through long-term financing and industrial governance. In Japan, coordinated banking systems facilitated technological modernization and export-oriented growth, while in Russia, state-supported banks enabled rapid industrial expansion despite weak private entrepreneurship.

These findings suggest that banking institutions played a decisive role in overcoming investment barriers and accelerating industrialization. The availability of long-term industrial credit emerged as a critical factor influencing the pace of economic transformation.

- **Investment Coordination and Risk Reduction**

The study finds that one of the most significant contributions of banks lies in their ability to coordinate investment decisions and reduce uncertainty. Late-developing economies often face fragmented investment environments where private investors hesitate to finance large-scale projects due to high risks. Banks addressed this problem by evaluating industrial projects, monitoring performance, and maintaining long-term relationships with firms.

This coordinated approach reduced information asymmetry and improved investment efficiency. As a result, industrial sectors received stable financing, enabling technological adoption and productivity growth. The findings therefore support the argument that banks were not passive actors but active participants in industrial strategy.

- **Degree of Backwardness and Institutional Intensity**

Another key finding is that the role and strength of banking institutions varied according to the degree of economic backwardness. Economies with moderate backwardness, such as Germany, relied on universal banks with strong links to industry, while more backward economies, such as Russia, depended on state-supported financial institutions. This pattern confirms Gerschenkron's theoretical claim that institutional intensity increases as market capacity decreases.

The analysis indicates that the institutional form may differ across countries, but the underlying function remains similar: overcoming structural constraints and accelerating industrial development.

- **Banking and Structural Transformation**

The research further finds that banking-led finance contributed directly to structural transformation. By directing capital toward industrial sectors, banks enabled economies to transition from agrarian-based production to industrial and diversified economic systems. The stages illustrated in the Exit from Backwardness model demonstrate that banking intervention often marks the turning point in economic development.

Increased industrial investment led to productivity growth, technological advancement, and expansion of manufacturing output. Over time, these changes resulted in broader economic transformation, supporting long-term growth and reducing dependence on traditional sectors.

- **Contemporary Relevance**

The findings also highlight the continued relevance of Gerschenkron's framework in modern development contexts. Many emerging economies still face challenges such as limited access to long-term finance and weak capital markets. The study suggests that developmental banking institutions continue to play a significant role in addressing these constraints. Modern development banks and state-supported financial systems reflect similar institutional functions observed in historical cases, reinforcing the validity of the institutional substitute concept.

- **Summary of Major Findings**

The major findings of this research can be summarized as follows:

- Banks function as institutional substitutes in economically backward countries by replacing weak financial markets.
- Strong banking systems are closely associated with rapid industrialization and economic catch-up.
- Banks reduce investment risks and coordinate industrial finance, enabling large-scale development projects.
- The degree of backwardness influences the intensity and structure of banking intervention.
- Banking-led finance contributes significantly to structural transformation and long-term economic growth.

- **Conclusion of Findings**

Overall, the research findings strongly support Gerschenkron's theoretical argument that institutional innovation is essential for late industrialization. Banks emerge as central actors in this process by mobilizing capital, coordinating investment, and facilitating structural change. The evidence suggests that economies successfully exiting backwardness do so not through market forces alone but through effective institutional arrangements, with banking institutions playing a leading developmental role.

Conclusion

This study examined the role of banks as institutional substitutes within Alexander Gerschenkron's framework of economic backwardness and analyzed how banking institutions contribute to the process of industrialization and the exit from economic backwardness. The central objective was to understand whether banks function merely as financial intermediaries or as developmental institutions capable of shaping structural transformation in late-developing economies.

The analysis confirms that Gerschenkron's theoretical proposition remains highly relevant. Economies that industrialized later faced structural constraints such as weak capital markets, limited entrepreneurial capacity, and high investment risks. In such contexts, banks emerged as crucial institutional substitutes by mobilizing savings, providing long-term industrial credit, coordinating investment decisions, and reducing uncertainty. Historical evidence from Germany, Russia, and Japan demonstrates that banking institutions played a decisive role in accelerating industrial growth and enabling economic catch-up.

A key conclusion of this research is that the intensity of banking intervention depends on the degree of economic backwardness. Moderately backward economies relied on universal banks closely linked to industrial enterprises, while highly backward economies required stronger state-supported financial institutions. Despite these differences, the underlying developmental function remained consistent: overcoming market limitations and supporting industrial transformation.

The study also concludes that banking-led finance significantly contributed to structural change by directing resources toward productive industrial sectors. This process resulted in increased productivity, technological modernization, and diversification of economic structures. Banks therefore acted not only as providers of capital but also as coordinators of industrial strategy and long-term development.

Furthermore, the findings highlight the continued relevance of Gerschenkron's framework in contemporary development debates. Many emerging economies today still face financial constraints similar to those experienced by historical late industrializers. Development banks and coordinated financial systems in modern economies reflect the same logic of institutional substitution, indicating that strong financial institutions remain essential for economic transformation.

In conclusion, this research establishes that banks play a central role in enabling economies to exit backwardness by compensating for missing market mechanisms and supporting industrialization. The Gerschenkronian perspective offers valuable insights into how institutional arrangements shape development trajectories and demonstrates that successful economic transformation often depends on purposeful financial institutions rather than market forces alone.

Future Policy and Implications

The findings of this study highlight important policy implications for economies seeking to overcome structural constraints and accelerate industrial development. First, policymakers should strengthen development-oriented banking systems that focus on long-term industrial finance rather than short-term commercial lending. Since late-developing economies often face weak capital markets, banks must play a proactive role in supporting infrastructure, manufacturing, and technological modernization.

Second, improving financial inclusion and capital mobilization is essential. Expanding access to banking services can channel household and small-enterprise savings into productive investment, increasing overall capital formation. Digital banking expansion and inclusive financial policies can further support this process.

Third, coordination between banking institutions and industrial policy is critical. Historical evidence shows that successful industrializers benefited from close alignment between finance and national development goals. Banks should therefore be encouraged to finance strategic sectors that generate employment, innovation, and export competitiveness.

Another key implication concerns risk management and governance. Development-oriented banking requires strong regulatory frameworks, transparent lending practices, and efficient monitoring systems to prevent financial instability. Effective governance ensures that financial resources are allocated toward productive sectors rather than inefficient or politically driven projects.

The study also suggests that sustainable finance should become an important future direction. Banking systems can support environmentally sustainable industries and green technologies, ensuring long-term economic resilience alongside industrial growth.

For developing economies, the research implies that market forces alone may not be sufficient during early stages of industrialization. Institutional intervention through strong and well-regulated banking systems remains necessary to address structural barriers and accelerate economic transformation.

Overall, the main policy implication is that banks should be viewed as developmental institutions capable of shaping economic trajectories. Strengthening institutional capacity, improving financial coordination, and aligning banking strategies with development goals can help economies successfully exit backwardness and achieve sustainable, long-term growth.

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