Bridging the Credit Gap: Examining Banking Behavior, Credit Access, and Economic Growth in India

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Abstract

This paper explores the shifting dynamics of India's credit market and its critical role in stimulating economic growth, especially banking behavior and its implications for productivity. Despite a strong slew of reforms that began with the enactment of the Insolvency and Bankruptcy Code, India's population and businesses still have a large portion that remains underserved by formal credit systems. By analyzing district-level data and banking trends, we identify a marked shift in risk aversion among banks post-IBC, leading to an increased preference for consumer loans over industrial credit. This shift has broader implications for economic productivity, as evidenced by the declining impact of credit-deposit ratios on per capita income over the past decade.

Additionally, the paper explores alternative sources of credit: the corporate bond market and private credit funds, their limits, and the potential they can generate in bridging India's credit gap. The research points toward a comprehensive reform approach that has to reduce risk aversion and improve market inclusivity. The recommendations suggest relaxing the regulatory constraints and promoting diversification in credit options through incentive schemes as well as developing market infrastructure to ensure liquidity. This study brings urgency to the need for sorting out structural challenges in the credit market of India and ensuring sustainable and inclusive growth.

1 Introduction

Economies, especially developing ones, need the presence of substantial credit for economic growth. In most economies, the major channels of credit include banks and financial institutions, the corporate bond market, private credit including AIFs and the newly developed fintech lending system. In essence, businesses need a quick and low-cost access to credit to finance their growth and expansion and individuals need the same for investment and consumption. When aggregated at a national level, this eventually leads to the growth of the economy. Now, in the case of developing countries like India, low interest rates and the ready availability of credit from multiple sources are key catalysts for existing businesses to expand rapidly and for entrepreneurship to spur in the economy.

India's credit market is essential in allocating financial resources to stimulate economic growth and progress. Throughout the years, the market has developed in reaction to economic reforms, regulatory changes, and changes in credit demand and supply across different sectors. Although credit in India has seen many changes in this century, the vast majority of businesses and individuals still lack access to formal credit, underscoring the need for national-level changes to reform this system.

This paper seeks to understand and model a change in banking behaviour towards credit seekers, and also understand the impact of said behaviour on growth. After evaluating such a scenario in the banking sector, this paper also covers other sources of credit in India, exploring their shortcomings and recommending an overall policy direction. We start with an overview of India's credit market, and then move on to the focal point of our paper that helps understand changed bank behaviour in terms of risk-aversion. We chose the enactment of the Insolvency and Bankruptcy Code as the intervention to differentiate between credit dynamics in banks. After we notice a change in risk-aversion of banks, we try to understand the implications on growth for which we look at district specific data. The paper's theme throughout stands to be an under-served credit market in India, be it from banks, bonds or other sources.

1.1 Overview of India's Credit Market

India's credit market is more than just a collection of institutions or tools; it is a dynamic environment through which money flows into various sectors of the economy. The banking sector—dominated by state-owned institutions and augmented by private players—has been central to this system. Banks remain a central channel, directing funds to both established corporate borrowers and individual consumers. Beyond them, Non-Banking Financial Companies (NBFCs) have carved out their own space, often reaching those the banks miss: smaller firms, entrepreneurs, and certain types of consumers who may lack the ideal profile for traditional lenders. Over time, NBFCs have emerged as key partners in expanding the reach of formal credit, helping bridge gaps that might have otherwise slowed economic progress.

If we look at key metrics like private credit-to-GDP ratios, it becomes clear that India still lags behind several other emerging economies. Many nations in Asia and Eastern Europe, for instance, report far higher figures, signaling that their private sectors enjoy broader and more varied channels of credit access. India's lower ratio suggests that significant parts of its economy—particularly MSMEs, infrastructure projects, and growing entrepreneurial ventures—could benefit from better credit availability. By diversifying its sources of credit, India could drive more balanced and sustainable growth.

Beyond traditional banking and NBFCs, Alternative Investment Funds (AIFs) and other private credit providers are emerging as important players in India's credit ecosystem. AIFs, regulated by SEBI, focus on providing debt to businesses that may not meet the stringent credit requirements of banks. These funds

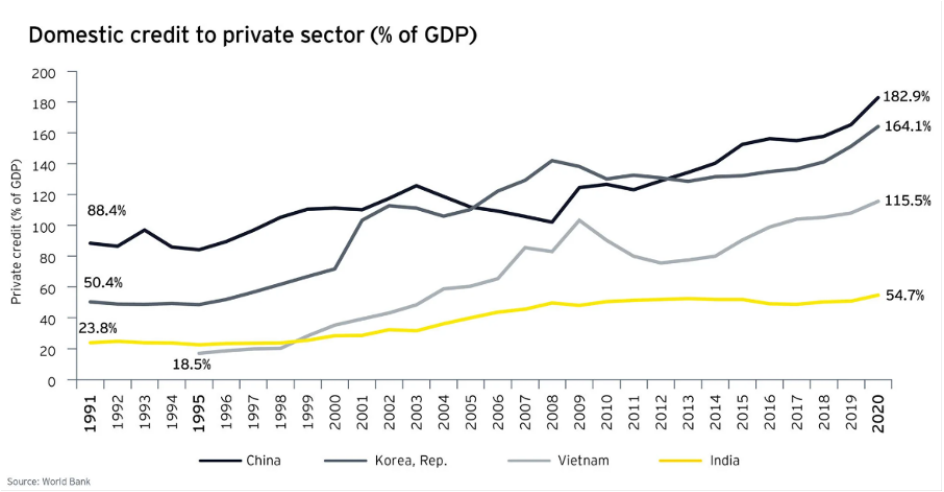

Figure 1: Domestic Credit to Private Sector

are particularly active in high-yield debt, special situation financing, and distressed assets. Categories such as Category II AIFs include private equity-style funds that invest in infrastructure projects, real estate ventures, and growth-stage companies, offering much needed capital to sectors underserved by traditional channels (Tiwari, 2024).

Another emerging alternative is fintech-driven lending platforms, which leverage technology to provide quick and accessible credit to individuals and small businesses. Companies like Vayana Networks serve an important purpose by providing financing for every step of the supply chain, mainly targeting MSMEs who are typically credit restraint. These firms play a valuable role in helping credit reach the furthest corners of the economy, bringing more businesses and individuals into the formal credit system. Additionally, as an alternative to traditional sources of credit, the corporate bond market has emerged as an avenue to access credit for major and large players in the industry. However, this is alo plagued with a severe lack of penetration into the overall industry. Currently contributing only 16% of GDP, the market lags significantly behind developed economies like the US, where corporate bonds represent over 100% of GDP (Patil and Das, 2024). Limited issuer diversity, low liquidity, and a preference for bank loans have restricted the growth of this market. Initiatives by regulators, including the RBI and SEBI, aim to deepen the corporate bond market through measures such as improved transparency, mandatory credit ratings, and secondary market development. Strengthening this segment is critical for reducing the economy's reliance on traditional banking channels.

Finally, even with a financial heavyweight like HDFC Bank—widely regarded as one of India's premier private lenders—at the forefront, the country's credit ecosystem still struggles to reach the level of sophistication seen in more mature markets. HDFC's growth and customer reach demonstrate just how far a single institution can go regarding efficiency and trust. Yet, despite its prominence, the broader credit landscape in India remains comparatively shallow, with many borrowers unable to access the full spectrum of financial products they need. In other countries, businesses and consumers benefit from a richer mix of lending options, vibrant bond markets, and innovative credit channels that cater to diverse risk profiles and sectors. In contrast, the Indian market's dependence on a handful of established players and traditional lending practices has limited its capacity for broad-based financial inclusion and flexibility. The presence of a top-tier bank like HDFC shows what can be achieved, but it also underscores what remains to be done. To truly evolve, India's credit market must broaden its horizons, encouraging new participants, deeper

liquidity, and more tailored financing solutions that meet the needs of all borrowers, not just those at the safest end of the spectrum.

While the overview of India's credit market highlights its evolving dynamics and the persistent challenges of access and inclusivity, a deeper understanding of how bellwether financial institutions i.e; banks allocate credit is crucial to addressing these gaps. Section 2 delves into the behavioral tendencies of banks, particularly their risk aversion, and examines how these tendencies have shifted following major regulatory interventions like the Insolvency and Bankruptcy Code. By analyzing these changes, we aim to uncover their implications for credit allocation across sectors and their broader impact on economic growth.

2 Risk Aversion and Growth in Banking

2.1 Empirical Framework and Results

2.1.1 Understanding Behaviour through Risk Aversion

In this section, we have two themes to explore in banking behaviour. We mainly understand banking behaviour as risk aversion towards particular segments of the economy (agriculture, industry and personal loans). The topics covered are: (a) risk aversion of banks to particular segments of the economy, and (ii) how the said risk aversion impacts growth.

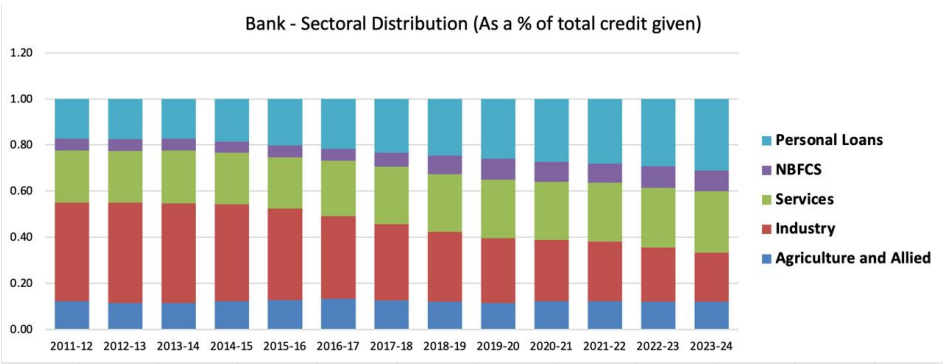

Figure 2: RBI data

In Figure 2, we see the credit disbursed towards industry fell as a share of total credit advances, however, this trend alone isn't a testament to capture risk aversion by banks. To achieve this, we compare the sensitivity of credit disbursed to industry (and consumer loans) as a percentage of total credit advances to the ratio of Net NPA to Net Advances. The regression we use to capture this is given by:

$$Credit\_To\_Industry_{Pre-IBC} = \beta_0 + \beta_{1,Pre-IBC,Ind} * NetNPA\_to\_NetAdv \ + \beta_{2,Pre-IBC} * CDR$$

We do such a regression for two periods for 21 private banks. The first period is pre-IBC, and the second period is post-IBC. The years in concern are 2012,2013 and 2014 for the former period and 2017,2018 and 2022 for the latter period. The reason we do not include 2019 or 2020 is because we want to minimize any COVID related impacts. Also, we include Net NPA to Net Advances and not the absolute amount to control bank-size effects. CDR is used as a control for indicating overall bank risk- a higher CDR would mean a more lax bank in terms of advancing credit. We also look at the same equation post IBC for the same set of banks, given by the equation:

$$Credit\_To\_Industry_{Post-IBC} = \beta_0 + \beta_{1,Post-IBC,Ind} * NetNPA\_to\_NetAdv \ + \beta_{2,Post-IBC} * CDR$$

These two regressions, in isolation, will tell us how the sensitivity of credit lending towards industry has changed over time; we look at the difference between $\beta_{1,Post-IBC,Ind}$ and $\beta_{1,Pre-IBC,Ind}$. The data will show a negative coefficient on Net NPA to Net Advances, but an increase in the absolute value from pre to post IBC (i.e; becoming more negative) would indicate a relative increase in sensitivity towards industry. We indicate this delta given by: $|\beta_{1,Post-IBC,Ind}| - |\beta_{1,Pre-IBC,Ind}|$ as the **change in industry lending sensitivity**. We take absolute amounts as it helps us understand the change in magnitude, as the coefficients are negative. In order to better understand bank behaviour we also look at sensitivity of lending towards consumers. This allows us to isolate the question of which segments of credit seekers (industry, consumers or others) see banks being more risk averse towards them. We compare with personal loans and not other sectors as credit advancements have seen the lion's share of credit being lent towards industry about a decade ago to majority of credit being lent to consumers. The regressions will be given as:

$$Credit\_To\_Consumer_{Pre-IBC} = \beta_0 + \beta_{1,Pre-IBC,Cons} * NetNPA\_to\_NetAdv \ + \beta_{2,Pre-IBC} * CDR$$

$$Credit\_To\_Consumer_{Post-IBC} = \beta_0 + \beta_{1,Post-IBC,Cons} * NetNPA\_to\_NetAdv \ + \beta_{2,Post-IBC} * CDR$$

In order to gauge whether the sensitivity to consumer lending has changed over time or not, we look at the difference between $\beta_{1,Pre-IBC,Cons}$ and $\beta_{1,Post-IBC,Cons}$. **Change in consumer lending sensitivity** is given by $|\beta_{1,Post-IBC,Cons}| - |\beta_{1,Pre-IBC,Cons}|$. After establishing this, we move on to understanding the question of the impact on credit lending and dynamics towards productivity. Has such a change actually impacted productivity or not?

2.1.2 Results

Table 1: Resgression Results for Credit to Industry: Post IBC

Advances to Industry/Total Advances	**Coefficient**	**Std. Err.**	**t**	$P > \|t\|$
NetNPA_to_NetAdv	-0.0082593	0.0060909	-1.356	0.180
CDR	-0.0002932	0.0001724	-1.7	0.09
_cons	0.3145338	0.0413752	7.60	0.000
Model Statistics				
R-squared	0.0145			
Root MSE	0.14274			

Table 2: Regression Results for Credit to Consumers: Post IBC

Advances to Consumers/Total Advances	**Coefficient**	**Std. Err.**	**t**	$P > \|t\|$
NetNPA_to_NetAdv_n	0.0195638	0.0104679	1.87	0.067
CDR	0.0006137	0.0004054	1.51	0.136
_cons	0.1298457	0.0353462	3.67	0.001
Model Statistics				
Number of obs	58			
R-squared	0.0925			
Adj R-squared	0.0595			
Root MSE	0.12178			

Table 1 Let's first start with the coefficient on Net NPA to Advances for the regression on credit to industry that was given by $\beta_{1,Post-IBC,Ind}$ in the empirical framework: a percentage increase in Net NPA to Net Advances is associated with a 0.8% decrease in credit towards industry (as a percentage of total credit). Note that this data is time static and only looks at variations in bank behaviour amongst different banks. Although, the data is statistically insignificant at the 10% confidence interval, adding data for smaller finance banks and public banks will make the claim more robust. Such data, however, remains incredibly disaggregated for public banks.

Table 2 The coefficient on Net NPA to Net Advances when it is regressed on advances to consumer loans, previously denoted as $\beta_{1,Post-IBC,Cons}$ shows an incredibly interesting narrative. Contrary to industry, a percentage point increase in Net NPA to Net Advances is actually associated with 1.9% increase in credit towards consumers (again as a share of total credit). Surprisingly, more risk averse banks, given by a higher ratio of Net NPA and advances are associated with higher lending towards unproductive consumer loans and lesser lending towards industry. Evidently, post IBC the sensitivity of banks towards industry is heightened compared to personal and consumer loans. This statistic becomes even more interesting when we perform the same regression for the period before IBC- 2012, 2013 and 2014.

Table 3: Regression Results for Credit to Industry: Pre IBC

Advances to Industry/Total Advances	**Coefficient**	**Std. Err.**	**t**	$P > \|t\|$
NetNPA_to_NetAdv	0.000178	0.000094	1.89	0.08
CDR	0.0001562	0.000041	3.74	0.00
_cons	0.478345	0.051494	9.02	0.000
Model Statistics				
Number of obs	59			
R-squared	0.0234			
Root MSE	0.18482			

Table 3 Before IBC, for the same banks, the negative relation between net NPA to net advances and credit to industry is flipped and is positive. A percentage increase in Net NPA/Net Advances leads to an *increase* in credit towards industry. This is also significant at 10% confidence level. We would like to also look at such a relation with credit towards consumers, however, sector wise advances were not required to be published by banks to non priority sectors before 2015.

Such a relation indicated the MSME sector, which is a mjor constituent to industry lending, is severely credit restraint, and supports the claim of an underserved credit market in the introduction. Larger firms have more dimensions to access credit- through AIFs, Banks and NBFC, however, MSMEs which have the potential to boost productivity lack the capital support they need. Credit lending towards industry has fallen by around half when we look at it as a share of total advances by banks; and the above regression helps us isolate this statistic to conclusively show it's due to a heightened risk aversion towards industry, and not because of lackluster credit demand.

Data Collection We primarily relied on Indiastat.com for bank ratios (private sector banks). Credit towards industry was calculated by looking at financial statements under the section *Gross Advances and NPA*. We summed up both priority and non-priority lending to industry for all values. Private sector banks had more aggregated data, hence we looked at those and not public sector banks. Throughout the comparison we looked at 21 banks over three years in each pre and post IBC period. The banks include- ICICI, HDFC, Federal, IDFC, IndusInd, Karnataka Bank, Karur Vyasa, Kotak, Lakshmi Vilas, Nainital, RBL, South Indian, Tamilnad Mercentile, Dhanalakshmi, Yes Bank, Axis, Bandhan, City Union, DCB

Bank and SBI.

2.1.3 Credit Dynamics and Productivity

In this section, the question we're trying to understand if this risk aversion as seen by banks impact productivity. Again, we look at time specific data regarding per capita income and credit deposit ratios. Higher credit deposit ratios proxy for increased credit lending, and since it's a ratio of deposits it looks at relative increases rather than absolute. As we've seen because of the risk aversion displayed by banks, credit has moved away from industry towards consumer loans. An implication of the same on growth would mean that credit towards consumers is, or not, as productive as credit towards industry. If credit towards consumers *is* truly less productive, we will see it impact per capita income and growth.

The data we've used is district level GDP and per capita income, and also credit and deposits per district. The relation we're trying to establish is productivity of a particular district and the credit deposit ratio (CDR)- a proxy for productivity is per capita income and the CDR indicates higher credit roll out. The reason we took CDR and not just total credit outstanding is because that will be highly correlated with larger districts by population. The regressions in concern are:

$$Dist\_PCI_{Real,2012} = \beta_0 + \beta_{1,2012} * CDR + \beta_{2,2012} * Urban\_Binary$$

$$Dist\_PCI_{Real,2022} = \beta_0 + \beta_{1,2022} * CDR + \beta_{2,2022} * Urban\_Binary$$

The question we're trying to ask here is, has the productivity of credit changed over time, and if so why. If we compare the coefficients on CDR over time, we want to look at the difference between $\beta_{1,2022}$ and $\beta_{1,2012}$. Over these two periods, the change that took place in credit is the shift from industry lending to consumer lending. Hence, if the coefficient on CDR has reduced in 2022, it could imply that credit, in general, has become more unproductive in the hands of consumers rather than producers.

Ideally, we would have wanted to have district specific credit advanced by sector, but such data isn't recorded in a micro level. Hence, we're resorting to a generalized assumption backed by a macro fact- credit has moved away from industry in 2012 to consumers in 2022. The reason why we include the urban binary is to control for any agglomeration-related effects on district PCI- urban areas have higher incomes. The urban binary also controls for predominant income sources- urban areas are less agrarian than rural ones.

2.1.4 Results

Table 4: Regression Results 2013

PCI_Dist in Rs 1000s	**Coefficient**	**Std. Err.**	**t**	$P > \|t\|$
TOT_P	4.53e-06	1.85e-06	2.45	0.014
Urban_binary	4.425441	3.885801	1.14	0.255
CDR_n	0.1601601	0.0466448	3.43	0.001
_cons	53.78019	4.792055	11.22	0.000
Model Statistics				
Number of obs	694			
R-squared	0.0295			
Adj R-squared	0.0253			
Root MSE	45.333			

Coefficient on CDR: A percentage increase in CDR is associated with Rs. 160 increase in per capita income of a particular district- significant at 1% confidence level.

Table 5: Regression Results 2022

PCI_Dist in 1000s	**Coefficient**	**Std. Err.**	**t**	$P > \|t\|$
Urban_binary	5.67483	1.757382	3.21	0.0012
CDR_n	0.089145	0.023457	3.82	0.001
_cons	112.78019	8.569856	13.16	0.000
Model Statistics				
Number of obs	736			
R-squared	0.0367			
Adj R-squared	0.0125			
Root MSE	49.344			

Coefficient on CDR: A percentage increase in CDR is associated with Rs. 80 increase in per capita income of a particular district- significant at 1% confidence level

Sources: Reserve Bank of India (RBI). Spatial Distribution of Deposits and Credit (Annual) — Database on Indian Economy (DBIE)- Statement 4A and and International Crops Research Institute for the Semi-Arid Tropics (ICRISAT). Data and Analytics Platform (DAP): GDP Dataset

The reason we cannot use population data in 2022 is because of the latest census currently being carried out. For district wise credit and deposits, the RBI publishes quarterly district-wise statistics for Schedules Commercial Banks. We merged this data with district level GDP data from ICRISAT and census data from 2011 for district characteristics

Conclusion The data shows that the coefficient on CDR (credit to deposit ratio) has an economically significant impact in 2013- by increasing the CDR by say 10%, the associated increase in per capita income is Rs. 1600. But, as we can see the impact of CDR on per capita income has reduced by half from 2013 to 2022. This shows the reduction in productivity of credit. It's a strong data point to support the claim that shifting credit from industry to personal loans has negatively impacted district specific productivity.

3 Problems in India's Credit Ecosystem and how it affects growth

As seen in the previous section, it's only a matter of time until we realise whether this aversion to productive loans in industry is temporary or not. The current trend is dominated by loans that reach the hands of consumers, pumping demand to fuel the economy even further. If this is met with an unsatisfactory increase in output capacity, we could see inflationary pressures persist. Now that we've established a clear trend of behaviour in the behemoth of Indian banking, and also notice its impact on growth, we now move on to understand other forms of availing credit in India and their dynamics. We further break it up into the corporate bond market and the private credit market.

While the cost of borrowing money is very important, what's more critical for sustaining long-term economic growth is the wider accessibility of credit. As Adam Smith famously said, "Money says the proverb makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that little." India's credit market has generally favoured the safer and high certainty businesses and individuals,

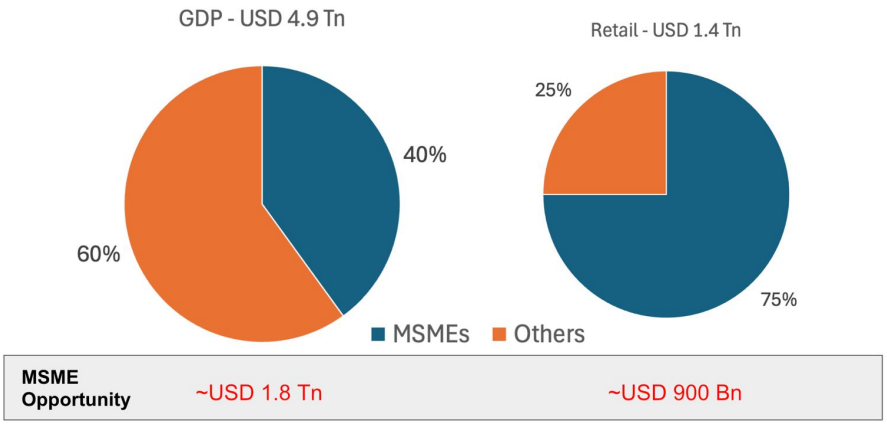

Figure 3: MSME Opportunity: FY27e, USD, Share of GDP and Retail

leaving most of the market un-served. We will look at this from two different lenses, one from the corporate bond market and the other from the emerging private credit market in India.

3.1 Corporate Bond Market

The corporate bond market in India has traditionally been heavily skewed towards larger corporations with high credit ratings and towards the financial services sector in particular. While this segment was just about 16% of the GDP in 2024, 97% of corporate bond issuance were concentrated in the top 3 rating categories (AAA, AA+, and AA), where BFSI raised 77% of the bonds (Bhan, 2024). Issuers who are unable to get these ratings cannot access the bond market. This would explain why most of the issuers are either non-banking financial corporations (NBFCs) or public sector undertakings (PSUs). Manufacturing firms accessing the bond market is a rarity, and the situation is worse in infrastructure projects. Despite being best suited for market-based financing due to their long gestation period, these projects are unable to raise funds through bonds, primarily due to their typically low BBB ratings in the initial phase of their life-cycle (Bhan, 2024). While India is trying to drive growth through manufacturing and infrastructure, such a handicap presents significant roadblocks towards achieving this necessary growth.

What about the MSMEs now, which account for about 30% of our GDP and 48% of our exports? As previously observed, where 90% of individuals have bank accounts, only 14% of MSMEs have access to formal credit, which compels them to access the informal credit system, where interest rates are 2.5x more on average (Goswami, 2024). This presents a huge problem for the economy, where by employing a huge chunk of the population, these institutions drive growth at the grassroots level, translating to economy-wide growth and development. These gains are then passed on to other allied industries, creating a wonderful domino effect.

Another significant shortcoming of this market is that more than 90% of the issuance of these bonds is through private placements and the secondary market for such securities is quite illiquid. In India, pension funds and insurance companies who majorly invest in corporate bonds rely on liquidity in these markets for safety of their investments, disincentivizing them from investing in lower rated securities. These players are typically 'buy and hold' investors who don't frequently trade bonds and as such contribute to this illiquidity in the bond markets. One of the major impediments is a longstanding rule from authorities that makes it hard for long-term investors like insurers and pension funds to go big on infrastructure. The

regulation bars them from investing in notes rated below AA, which in India are deemed risky because they're hard to offload in a smaller market during times of stress (Patil and Das, 2024). A lack of a well-developed secondary market for these bonds, presents challenges for fundraising if conditions did improve allowing firms with lower ratings to issue bonds. Given this current situation, the corporate bond market lacks both the depth and liquidity to provide funding to key sectors including manufacturing, infrastructure and MSMEs, which are critical for the growth of the Indian economy.

The corporate bond market (total bonds outstanding) at 16% of GDP (2021) is an opportunity that remains sub-optimally utilized as compared to Asian peers – South Korea (87%), Malaysia (57%), and China (36%). India's corporate bond market needs greater breadth with focus on all categories of investment grade bonds.

3.2 Private Credit Market

The private credit market has made significant progress in the last couple of years and is poised to reach about $18 billion in AUM at the end of 2024 (India's Private Debt Market to Top US$ 18 Billion in 2024, 2024). It has generally served as an alternative to bank financing, taking on riskier projects with uncertain cash flows, stimulating growth across sectors. Targeted credit funds have also been on the rise in recent years, pooling both domestic and international capital, funding projects from infrastructure and manufacturing to small startups seeking growth funding. These funds have therefore played a pivotal role in deepening the credit ecosystem in India. Private credit has bridged a large gap in the Indian credit market, and is well-positioned to see continued demand and supply-side growth. However, in comparison to the total funding requirements, this private credit industry represents a small portion of the total demand for credit. A recent wave of regulations has now made it easier for new AIFs to set up credit funds focusing on key growth sectors in India, especially infrastructure. A growth in this market as well as loosening up of further regulations would allow the wider spread of credit in the Indian market.

We can conclude that significant strides have to be made in the credit industry in India to address most of the unmet demand for capital. Given the pivotal role of MSMEs in fostering wealth creation at a grassroots level and advancing India's trajectory towards global prominence, there is a dire need for the financial services sector, in collaboration with governmental and regulatory entities, to expedite efforts addressing MSME funding challenges (Choksi, 2024).

4 Conclusion

The data conclusively proves that banks *are* risk-averse to more productive lending that is lending towards industry. And by moving away, its gone to consumer loans which have impacted productivity as well. This amplifies the gap that remains- disruptive industries and firms that can spurt growth do need to be met with a more risk-loving approach which banks currently aren't willing to satisfy. India has set very ambitious goals for itself, aiming to become a developed economy by 2047. But to reach this, several intermediate milestones have to be achieved, with the nearest one being the expansion of India to a $5 trillion economy within the next 3 years, overtaking both Japan and Germany. To achieve its ambitious economic goals, India must address the foundational issues in its credit ecosystem. While strides have been made, challenges persist in ensuring equitable access to credit across all sectors, especially for MSMEs, infrastructure projects, and underserved segments. The shift in banking behavior post-IBC has illuminated systemic risk aversion, with significant implications for productivity and growth. Simultaneously, the underdevelopment of alternative credit sources like corporate bonds and private credit markets limits the economy's potential. Addressing these challenges through targeted reforms is essential for sustainable and

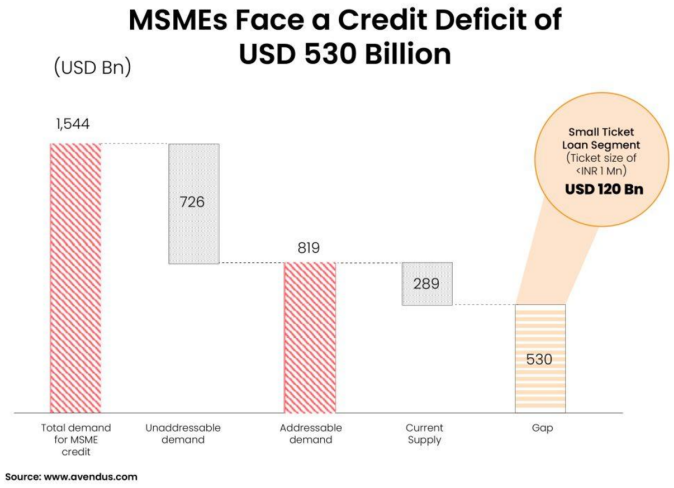

Figure 4: MSME Credit Gap

inclusive growth. By fostering a dynamic, responsive, and inclusive credit system, India can effectively fuel the engines of innovation, entrepreneurship, and industrial expansion, charting a clear path toward its development aspirations. In a world, where the future is non-bank credit India has a long way to go.

4.1 Reforms in Credit

To address the structural challenges in India's credit market and unlock its full potential, a multi-pronged reform strategy is essential. Firstly, regulatory barriers such as the stringent Alternative Investment Fund (AIF) regulations need to be eased to promote private credit. Unlike global peers, India lacks a thriving private credit ecosystem, largely due to risk-averse lending practices and limited regulatory support. Currently, these regulations restrict the flow of institutional funds into alternative credit markets, leaving many businesses without access to the funding they need (Doshi, 2024). Encouraging private equity and venture debt players to participate in credit markets through tax incentives and co-lending programs can bridge this gap. By allowing greater participation from pension funds and insurance companies, India can channel long-term capital into private credit, enabling businesses to access diversified financing options.

Secondly, India's corporate bond market must be made more inclusive and liquid. Presently, it is heavily skewed towards large, well-rated issuers, leaving mid-sized and smaller companies underserved. Policies should incentivize the issuance of bonds by a broader range of issuers, perhaps through credit enhancement mechanisms or partial government guarantees. At the same time, improving market infrastructure—such as introducing a robust secondary market for corporate bonds—will ensure greater liquidity, attract institutional and retail investors, and align India with global practices (Roy, 2024).By implementing these measures, India can reduce risk aversion in its credit markets, foster financial inclusivity, and stimulate economic activity. Thus, to conclude, we can see that a flow of capital from these different providers to priority sectors and businesses will act as a fuel to push India towards becoming a developed economy.

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