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## Financial Structure of India: A Comprehensive Research Analysis

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### ABSTRACT

India's financial system is among the most intricate and swiftly changing frameworks in emerging market economies. This paper offers an in-depth analysis of India's financial infrastructure, covering its banking industry, capital markets, monetary policy framework, fiscal system, non-banking financial entities, insurance sector, and efforts towards financial inclusion. The study evaluates the institutional framework managed by the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), and other regulatory authorities. We examine the transformative effects of significant reforms such as the 2016 demonetization, the Insolvency and Bankruptcy Code of 2016, the Goods and Services Tax (GST) introduced in 2017, and the Jan Dhan Yojana initiative on the nation's financial deepening. The paper concludes that although India has made notable progress in financial modernization, issues like non-performing assets (NPAs), unequal access to credit, and gaps in infrastructure financing still require structural attention.

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### Introduction

With a population of nearly 1.46 billion, India, a country in South Asia, is the most populous democracy in the world and the seventh largest country by land area (*India at a Glance, Key Facts on India's*



*Economy* | IBEF, 2026). India, recognized as the fifth-largest economy globally by nominal GDP and the most populous country, boasts one of the most complex financial systems among developing nations. As of 2024, its GDP surpasses USD 3.7 trillion, and its financial sector has experienced significant liberalization since the early 1990s. This financial framework is a blend of public-sector dominance, private business activity, and emerging fintech innovations. The modern financial foundations of India were laid post-Independence in 1947, beginning with the nationalization of the Reserve Bank of India in 1949, followed by further bank nationalizations in 1969 and 1980 under Prime Minister Indira Gandhi, which solidified state control over credit distribution for many years. The 1991 balance-of-payments crisis marked a pivotal moment, as liberalization efforts led by Finance Minister Manmohan Singh opened the financial sector to private banks, foreign institutional investors, and capital market reforms. Currently, India's financial system includes over 140 scheduled commercial banks, more than 1,500 non-banking financial companies (NBFCs), two major stock exchanges (NSE and BSE), a strong insurance sector, and a growing pension fund ecosystem. The integration of digital infrastructure, especially the Unified Payments Interface (UPI), which handles over 10 billion transactions monthly, has significantly transformed the country's financial landscape. This paper is structured as follows: Section 2 delves into the banking sector's structure. Section 3 examines capital markets. Section 4 discusses monetary policy and the RBI's role. Section 5 investigates the fiscal framework. Section 6 looks into NBFCs and the shadow banking ecosystem. Section 7 reviews the insurance and pension sectors. Section 8 assesses financial inclusion. Section 9 identifies key challenges, and Section 10 concludes.

### **Structure and classification**

Under the Reserve Bank of India Act of 1934, India's banking industry is divided into scheduled and non-scheduled banks. Scheduled commercial banks (SCBs) are the main component and are further categorized into public sector banks (PSBs), private sector banks, foreign banks, regional rural banks (RRBs), and small finance banks (SFBs). By 2024, the country will have 12 public sector banks, 21 private sector banks, 45 foreign banks, 43 regional rural banks, and 12 small finance banks. Public sector banks remain dominant, holding about 60% of the total banking assets, although this is a decrease from over 80% two decades ago. The State Bank of India (SBI), the largest lender in the nation, manages assets worth more than INR 61 lakh crore (around USD 730 billion). In contrast, private sector banks, led by HDFC Bank, ICICI Bank, and Axis Bank, have rapidly expanded their market share by adopting technological advancements and innovations in retail banking.



## **Non-Performing Assets (NPAs)**

In Indian banking, non-performing assets have consistently posed a significant structural issue. The gross NPA ratio reached its highest point at 11.2% in March 2018, largely due to aggressive credit growth between 2004 and 2012, poor risk evaluation, and governance failures in public sector banks. The Reserve Bank of India's introduction of the Asset Quality Review in 2015 compelled banks to acknowledge previously unreported stress, leading to a sharp increase in disclosed NPAs. The 2016 Insolvency and Bankruptcy Code (IBC) brought about a major change by establishing a resolution process with a set timeframe (initially 270 days), altering the power dynamics between debtors and creditors, and enabling recoveries from significant cases like Essar Steel (INR 42,000 crore) and Bhushan Steel (INR 35,000 crore). By 2024, the gross NPA ratio had fallen to around 3.2%, the lowest in over ten years, indicating both successful recoveries and an improved credit culture.

## **Banking sector reforms**

Over the last ten years, significant structural changes have been made, such as reducing the number of public sector banks from 27 to 12 through mergers, injecting over INR 3.5 lakh crore into PSBs between 2017 and 2023, implementing prompt corrective action (PCA) frameworks, and launching the Pradhan Mantri Jan Dhan Yojana (PMJDY), which resulted in the creation of 500 million bank accounts. The adoption of Basel III standards has improved capital adequacy, with the overall Capital to Risk-Weighted Assets Ratio (CRAR) reaching about 16.8% by 2024, significantly exceeding the regulatory minimum of 11.5%.

## **Equity Markets**

India's capital markets are supported by two leading exchanges: the National Stock Exchange (NSE) and the BSE, which was originally known as the Bombay Stock Exchange and was founded in 1875. Established in 1992 as a demutualized electronic exchange, the NSE has evolved into the largest derivatives exchange globally in terms of volume. In 2024, the NIFTY 50 index surpassed the 25,000 mark, indicating consistent participation from domestic investors and foreign institutional investment. The market capitalization of companies listed on the BSE exceeded USD 4.3 trillion in 2024, positioning India among the top five equity markets worldwide. The Securities and Exchange Board of India (SEBI), created in 1988 and given statutory authority in 1992, acts as the chief regulator, managing market intermediaries, investor protection, and corporate governance standards.



## **Debt Markets**

India's debt market includes government securities (G-Secs), treasury bills, corporate bonds, and commercial paper. The government securities sector is the most significant, highlighting the fiscal borrowing needs of both central and state governments. The Reserve Bank of India (RBI) serves as the primary debt manager for the government. In contrast, the corporate bond market is not as developed, especially when considering India's economic scale—corporate bonds account for less than 20% of GDP, whereas in similar Asian economies like South Korea and Malaysia, they exceed 50%. The establishment of a fully accessible route (FAR) for foreign investment in G-Secs and India's anticipated inclusion in JP Morgan's Government Bond Index-Emerging Markets (GBI-EM) index in 2024 are projected to draw significant foreign investments, potentially amounting to USD 20-30 billion, thereby enhancing market depth and liquidity.

## **Derivatives and Commodity Markets**

India has established an advanced derivatives market. The derivatives segment of the NSE represents more than 95% of the nation's total equity derivatives turnover. The Multi Commodity Exchange (MCX) and the National Commodity & Derivatives Exchange (NCDEX) enable trading in commodity derivatives, covering sectors like energy, metals, and agriculture. The market has gained further complexity with the introduction of Interest Rate Futures and Currency Derivatives, although institutional investor participation is still limited due to regulatory barriers.

## **The Reserve Bank of India**

The Reserve Bank of India (RBI), which was founded in 1935 and became a national entity in 1949, serves as India's central bank, monetary authority, and chief financial regulator. Its responsibilities include ensuring monetary stability, overseeing the financial system, managing currency, handling foreign exchange reserves, and performing developmental roles. By early 2025, the RBI's balance sheet had expanded considerably, with total assets surpassing INR 70 lakh crore, including foreign exchange reserves of about USD 640 billion.

## **Inflation Targeting Framework**

In 2016, India implemented a flexible inflation targeting system by amending the RBI Act. This framework requires keeping CPI inflation at 4%, with a permissible range of  $\pm 2\%$ , over the medium



term. A six-member Monetary Policy Committee (MPC), consisting of three RBI officials and three government-appointed external members, sets the policy rates. The repo rate is the main policy tool, with the policy corridor defined by the standing deposit facility (SDF) rate at the lower boundary and the marginal standing facility (MSF) rate at the upper boundary. The inflation targeting framework has largely met its goals: after high inflation between 2021 and 2023, partly due to supply-side disruptions and global commodity prices, CPI inflation has settled back into the 4-5% range. As inflationary pressures eased and supporting growth became a priority, the RBI began a rate-cutting cycle in early 2025.

### **Foreign Exchange Management**

India employs a managed float system for its exchange rate, where the Reserve Bank of India (RBI) steps in to mitigate extreme fluctuations in the foreign exchange market rather than maintaining specific exchange rate levels. By late 2021, India's foreign exchange reserves surpassed USD 700 billion before stabilizing, offering around 11 months' worth of import coverage, which serves as a strong safeguard against external economic disturbances. The Foreign Exchange Management Act (FEMA) of 1999, which succeeded the more restrictive FERA, regulates international capital movements and has been gradually eased to encourage foreign investment.

### **Union Budget and Fiscal Consolidation**

The fiscal framework of India is structured by the Constitution, which allocates taxation and spending authority between the Union and State governments. Each February, the Union Budget is presented, detailing the central government's plans for revenue, spending, capital distribution, and fiscal objectives. India's fiscal deficit has been a longstanding issue: after expanding to 9.3% of GDP in FY2020-21 due to the pandemic, the central government has embarked on a fiscal consolidation strategy, aiming for a deficit of 4.9% of GDP in FY2025 and 4.5% in FY2026.

### **Goods and Services Tax (GST)**

The implementation of the Goods and Services Tax (GST) in July 2017 marked a pivotal moment in India's post-Independence history, representing the most significant reform of indirect taxation. This reform replaced a complex system of central and state taxes, including central excise duty, service tax, state VAT, and entry taxes, with a streamlined national market. The GST is structured with two components: Central GST (CGST) and State GST (SGST), which are collected simultaneously, along



with Integrated GST (IGST) for inter-state transactions. Since 2022, monthly GST revenues have consistently exceeded INR 1.5 lakh crore, reaching a peak of INR 1.87 lakh crore in March 2024, highlighting improved compliance and increased economic activity.

### **Direct Tax Structure**

The Central Board of Direct Taxes (CBDT) is responsible for managing direct taxes in India. In 2019, the corporate tax rate was lowered from 30% to 22%, with a further reduction to 15% for new manufacturing firms, marking a major structural change to enhance competitiveness with Southeast Asian countries. Additionally, the personal income tax system was revamped by introducing a new optional tax regime that offers lower rates but fewer exemptions, alongside the existing system. India's tax-to-GDP ratio, which stands at around 10.5-11%, is still below the OECD average of 34% and other major emerging markets, suggesting there is room for further fiscal expansion.

### **State Finances and Fiscal Federalism**

India's federal fiscal framework has undergone substantial changes due to the reforms introduced by successive Finance Commission awards and the Fiscal Responsibility and Budget Management (FRBM) Act. The 15th Finance Commission, covering the period from 2021 to 2026, proposed a 41% vertical distribution of central taxes to the states. The GST compensation to states, which was assured for five years following the GST's implementation, ended in 2022, leading to financial challenges for many states. Concerns persist regarding state fiscal deficits, as several major states have high debt-to-GSDP ratios exceeding 35%, which raises questions about their long-term fiscal sustainability.

### **Role and Classification**

Non-Banking Financial Companies (NBFCs) serve as a vital source of credit in India, particularly for sectors that traditional banks often neglect, such as micro, small, and medium enterprises (MSMEs), rural borrowers, and low-income households. By 2024, India is home to over 9,000 registered NBFCs, with their combined assets exceeding INR 60 lakh crore. NBFCs that are considered systemically important, with assets over INR 500 crore, are subject to stricter regulatory oversight. These companies are categorized into various types, including Asset Finance Companies, Loan Companies, Investment Companies, Infrastructure Finance Companies, and Microfinance Institutions (MFIs).



## **IL&FS Crisis and Regulatory Tightening**

In 2018, the downfall of Infrastructure Leasing & Financial Services (IL&FS), which defaulted on debts exceeding INR 90,000 crore, highlighted critical systemic issues in the NBFC sector. These issues included the hazardous strategy of relying on short-term loans to finance long-term projects, known as asset-liability mismatches, as well as taking advantage of regulatory loopholes and governance failures. This event triggered a liquidity crisis that affected other NBFCs, such as DHFL, prompting the implementation of more stringent regulatory measures. Consequently, the RBI introduced a Scale-Based Regulation (SBR) framework in 2021, which categorized NBFCs into four tiers (Base, Middle, Upper, and Top Layer) with increasingly strict norms based on their systemic risk.

## **Insurance Sector**

The Insurance Regulatory and Development Authority of India (IRDAI) is responsible for regulating India's insurance sector, which includes 57 companies—24 focused on life insurance and 33 on general and health insurance. Despite the expansion of private firms, the Life Insurance Corporation of India (LIC), a state-owned entity, maintains a dominant position with about 60% of the life insurance premium market share. India's insurance penetration, which is the ratio of premiums to GDP, is approximately 4.2%, falling short of the global average of 7%. This indicates a significant potential for growth, considering India's demographic characteristics and the burgeoning middle class. Government schemes like the Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) and Pradhan Mantri Suraksha Bima Yojana (PMSBY) have successfully extended micro-insurance to over 400 million citizens at affordable premiums, underscoring the government's role as a safety net for at-risk populations.

## **Pension System**

India's pension framework includes the Employees' Provident Fund Organisation (EPFO) for formal sector workers, the National Pension System (NPS) for government staff and voluntary participants, and the Atal Pension Yojana (APY) aimed at workers in the unorganized sector. With assets totaling around INR 21 lakh crore, the EPFO ranks among the largest provident fund managers globally. Introduced in 2004 for new central government employees and expanded to all citizens in 2009, the NPS has amassed assets of about INR 10 lakh crore and has 7.5 crore subscribers. The formalization of the pension system is a vital mechanism for mobilizing long-term savings in a nation with limited social security coverage.



## **Jan Dhan to Jan Suraksha**

Over the last ten years, India has made significant strides in financial inclusion. Initiated in August 2014, the Pradhan Mantri Jan Dhan Yojana (PMJDY) successfully established more than 530 million zero-balance bank accounts by 2024, marking it as the largest financial inclusion initiative globally. The integration of the JAM trinity (Jan Dhan, Aadhaar, Mobile) has developed a digital framework for identification and financial services, revolutionizing direct benefit transfers. This has led to a substantial reduction in subsidy leakages, with DBT transfers amounting to INR 34 lakh crore, reportedly saving the government over INR 2.73 lakh crore by preventing leakages.

## **Digital Payments Revolution**

The Unified Payments Interface (UPI), created by the National Payments Corporation of India (NPCI) and introduced in 2016, has significantly altered the payment landscape in India. By January 2025, UPI was handling over 16.5 billion transactions each month, amounting to roughly INR 23 lakh crore, establishing it as one of the most extensive real-time payment systems globally. The adoption of digital payments in India has surpassed that of most developing nations, driven by a combination of widespread smartphone use, affordable data (spurred by Reliance Jio's market disruption), the Aadhaar infrastructure from UIDAI, and supportive government policies.

## **Financial Inclusion Gaps**

Despite these successes, a large segment of the population continues to face financial exclusion. Access to formal credit remains restricted for sectors such as agriculture, MSMEs, and rural households. Approximately 190 million adults are still without formal banking services. Women's financial inclusion is about 6 percentage points lower than that of men. The next area for policy focus is improving the quality of financial inclusion, which involves not just having an account but also ensuring active engagement, savings, insurance, and credit access.

## **Structural Challenges**

India's financial system faces several structural hurdles. Firstly, public sector banks, despite some progress, still raise concerns about governance and efficiency due to political influences on credit distribution and issues with management stability. Secondly, infrastructure financing is insufficient: India needs an estimated USD 840 billion for infrastructure investment from 2022 to 2027 (according to the



Economic Survey), but the domestic bond markets are not deep enough to handle such large volumes effectively. Thirdly, household savings are increasingly being directed towards physical assets like gold and real estate, as well as equity markets, rather than bank deposits, leading to structural changes in the liability profiles of the banking system.

### **Climate Finance**

India's commitment to achieving net-zero carbon emissions by 2070 and reaching 500 GW of renewable energy capacity by 2030 presents a formidable challenge for the financial sector, which must mobilize green finance on an unprecedented scale. The Securities and Exchange Board of India's (SEBI) requirement for the top 1,000 listed companies to disclose ESG information, along with the introduction of Sovereign Green Bonds in January 2023, reflects a clear policy trajectory. However, effectively pricing climate risk, expanding the green bond market, and embedding climate considerations into banking lending frameworks demand significant structural advancements.

### **Fintech and Regulatory Sandboxes**

India's fintech sector, which ranks third worldwide in terms of deal value, offers both potential and challenges. Regulatory sandboxes created by RBI, SEBI, and IRDAI facilitate the controlled experimentation of new financial products. Initiatives like the Account Aggregator framework, Open Credit Enablement Network (OCEN), and Open Network for Digital Commerce (ONDC) signify India's efforts to establish an open financial infrastructure. The main challenge is to strike a balance between fostering innovation and ensuring consumer protection, data privacy (as regulated by the Digital Personal Data Protection Act, 2023), and maintaining systemic stability.

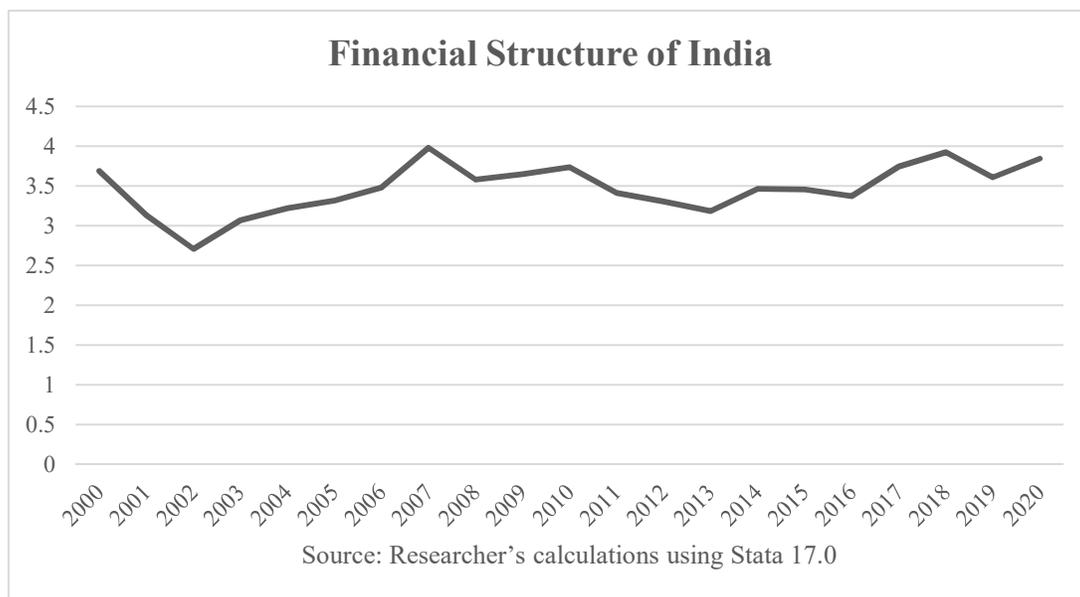
### **Financial Structure of India: An Analysis Based on Levine's Framework**

The financial structure aggregate of India, computed following (Levine, 2002) methodology, reveals a predominantly bank-based financial system over the period 2000 to 2020, with values consistently ranging between 2.706 and 3.980. The index recorded its lowest point in 2002 at 2.706, reflecting the subdued state of capital markets in the early post-liberalization period and the continued dominance of scheduled commercial banks in financial intermediation. From 2003 onward, the aggregate displayed a gradual upward trajectory, peaking at 3.980 in 2007, which coincided with the pre-global financial crisis boom when Indian equity markets experienced extraordinary growth, foreign institutional investment surged, and stock market capitalization expanded significantly relative to banking sector activity. This



period suggests a transitional momentum toward a more market-oriented financial structure, though the system remained fundamentally bank-anchored.

Following the global financial crisis of 2008, the structure aggregate declined to 3.185 in 2013 and recovering to 3.923 in 2018. This fluctuation reflects the uneven development of India's capital markets relative to its banking sector, compounded by episodes of banking sector stress particularly rising non-performing assets between 2012 and 2016 which temporarily altered the relative balance between market-based and bank-based finance. The aggregate's recovery toward 3.844 by 2020 suggests a gradual strengthening of market-based financial activities, driven by increased mutual fund penetration, equity market deepening, and the growth of non-banking financial institutions. Overall, the two-decade trend indicates that while India's financial structure is evolving, it continues to retain its bank-based character, consistent with findings in the broader literature on developing economies following Levine's financial structure framework.



### Conclusion

Over the past thirty years, India's financial landscape has experienced a profound transformation, evolving from a state-controlled, credit-limited system to a dynamic, market-oriented framework. The analysis of India's financial structure aggregate over 2000–2020, computed using Levine's framework, reveals that despite episodic shifts toward market-based finance, India's financial system has remained persistently bank-based throughout the period, with only gradual and incomplete convergence toward a



more market-oriented structure. The Reserve Bank of India's adoption of inflation targeting, the Securities and Exchange Board of India's initiatives to bolster capital market integrity, the improved health indicators of the banking sector, and the impressive success of digital payments through the Unified Payments Interface are notable structural accomplishments. Despite these achievements, the financial system must address several critical challenges, including cycles of non-performing assets, vulnerabilities in non-banking financial companies, infrastructure financing shortfalls, incomplete financial inclusion, and the demands of climate transition, to support India's ambition of becoming a USD 10 trillion economy by 2035. To advance, it is crucial to deepen corporate bond markets, further refine public sector bank governance, expand green finance, and harness digital infrastructure to improve the quality, not just the reach, of financial services. The global impact of India's financial evolution is substantial, the world's most populous nation and the fastest-growing major economy, the structure of India's financial system will significantly influence global capital flows, emerging market benchmarks, and the international monetary system in the coming decade.

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