



Financial Constraints and Credit Accessibility of Unincorporated Enterprises in India

Dr Ashi Rooth Stuart ¹

¹ Associate Professor Department of Economics, St. John's College, Agra, Uttar Pradesh

ABSTRACT

The unincorporated sector constitutes a significant component of the Indian economy, accounting for a large number of establishments and providing substantial employment opportunities across rural and urban areas. In addition to its critical role in livelihood generation, the sector makes a notable contribution to the country's Gross Domestic Product (GDP). Despite its economic importance and growth potential, unincorporated enterprises often face financial constraints, particularly limited access to formal credit, which restricts their ability to expand operations and improve productivity.

This study examines the extent and patterns of formal credit accessibility among unincorporated enterprises in India. Using unit-level data from the Annual Survey of Unincorporated Sector Enterprises (ASUSE) 2022–23 and 2023–24, the analysis explores variations in credit access across enterprise characteristics. Descriptive statistics are employed to assess the distribution and patterns of credit access across different categories of enterprises. The findings aim to provide insights into financial inclusion within the unincorporated sector and contribute to policy discussions on enhancing institutional credit outreach to this vital segment of the economy.

Keywords: Access to Formal Credit, Informal Credit, Unincorporated Enterprises, Outstanding Loan Liabilities.

1. INTRODUCTION

The unincorporated sector constitutes a vital pillar of the Indian economy, accounting for a substantial share of employment, output, and

entrepreneurial activity. Characterized by small-scale operations, family ownership, and relatively low levels of formal registration, unincorporated enterprises dominate India's micro and small business landscape. These enterprises operate across manufacturing, trade, and services, often serving as the primary source of livelihood for a significant proportion of the workforce, particularly in rural and semi-urban areas. Despite their economic significance and growth potential, unincorporated enterprises frequently operate under severe financial constraints.

The unincorporated sector holds significant importance in the Indian economy primarily because it provides large-scale employment opportunities. It absorbs a substantial proportion of the workforce, particularly low-skilled, semi-skilled, and self-employed individuals who may not find opportunities in the organized sector. For many households, especially in rural and semi-urban areas, unincorporated enterprises serve as the primary source of livelihood and income generation. By creating employment with relatively low entry barriers and modest capital requirements, this sector plays a crucial role in reducing unemployment, supporting inclusive growth, and sustaining local economic activity.

Access to finance is widely recognized as a critical determinant of enterprise growth, productivity enhancement, and long-term sustainability. Adequate and timely credit enables firms to invest in capital, adopt new technologies, expand market reach, and integrate into formal supply chains. However, unincorporated enterprises in India often rely heavily on internal funds or informal sources of finance due to limited access to institutional credit. Barriers such as lack of collateral, inadequate financial records, limited credit history, high transaction costs, and informational asymmetries between lenders and borrowers restrict their participation in the formal financial system.

In recent years, policy initiatives aimed at financial inclusion—such as priority sector lending norms, expansion of microfinance institutions, digital financial services, and targeted schemes for micro and small enterprises—have sought to improve credit accessibility. Nevertheless, disparities in access persist across firm size, sector, location, and ownership characteristics. Understanding the determinants of formal credit access in the unincorporated sector is therefore crucial for designing effective policy interventions and strengthening the institutional credit framework.

Against this backdrop, the present study examines the nature and extent of financial constraints faced by unincorporated enterprises in India and identifies the key factors influencing their access to formal credit. By analysing firm-level characteristics and contextual determinants.

2. LITERATURE REVIEW

Access to credit plays a crucial role in enabling enterprises to expand operations and integrate into larger value (supply) chains, thereby enhancing their long-term growth prospects. Moreover, access to formal finance may influence entrepreneurs' decisions to formalize their businesses, as formal credit availability increases the benefits of operating within the formal sector (de Paula & Scheinkman, 2010; Araujo & Rodrigues, 2016). Despite its importance, inadequate access to finance remains a major constraint on the growth and sustainability of small businesses (Binks & Ennew, 1996).

A substantial body of literature examines credit constraints faced by small and medium enterprises (SMEs). Foundational work by Stiglitz and Weiss (1981) attributes credit rationing to asymmetric information between borrowers and lenders, resulting in adverse selection and moral hazard problems. The role of asymmetric information in financial markets has since been widely acknowledged (Binks & Ennew, 1996; Malhotra et al., 2007). Saito and Villanueva (1981) argue that small enterprises face credit restrictions primarily due to higher transaction costs, including administrative and default-related costs. Similarly, Tendulkar and Bhavani (1997) contend that limited credit access stems from high lending costs, behavioural risk, and production risk associated with small firms.

Empirical studies further identify firm-specific characteristics as key determinants of financial constraints. Beck et al. (2006) find that firm size, ownership structure, and age significantly influence perceived financial obstacles, with older and larger firms reporting fewer constraints. Morris et al. (2001) suggest that organizational and institutional failures exacerbate credit constraints for small enterprises. Zavatta (2008) highlights high transaction costs, lack of collateral, and asymmetric information as major barriers to credit access. Additionally, Banerjee et al. (2017) demonstrate that access to formal credit through microfinance can generate long-term positive effects, although benefits may materialize gradually due to heterogeneity in returns.

The literature broadly categorizes determinants of credit access into firm-level and owner-level factors, including firm location, size, age, ownership type, and characteristics of the entrepreneur (Coleman, 2004; Akoten et al., 2006; Beck & Demirguc-Kunt, 2006; Nikaido et al., 2012, 2015; Bhavani & Bhanumurthy, 2014; Safavian & Wimpey, 2008; Chittenden et al., 1996; Nguyen & Luu, 2013; Ayyagari et al., 2010). Among these, firm size consistently emerges as one of the most influential determinants of financial obstacles and credit choices (Devereux & Schiantarelli, 1989; Beck et al., 2004; Beck et al., 2006).

In the Indian context, Love and Peria (2005) examine firm financing patterns and find that variations in financing are associated with firm size, sector (manufacturing, trade, and services), ownership type (private, foreign private, public, or government-owned), export orientation, regional factors, and financial indicators such as debt-to-asset and interest coverage ratios. Additional studies focusing on determinants of credit access and choice in India include Nikaido et al. (2012, 2015) and Bhavani and Bhanumurthy (2014), which underscore the importance of firm heterogeneity and institutional factors in shaping credit outcomes.

Overall, the existing literature underscores that credit access is influenced by a combination of information asymmetries, transaction costs, firm characteristics, and institutional frameworks. Understanding these determinants is essential for designing policies aimed at improving financial inclusion and supporting enterprise growth.

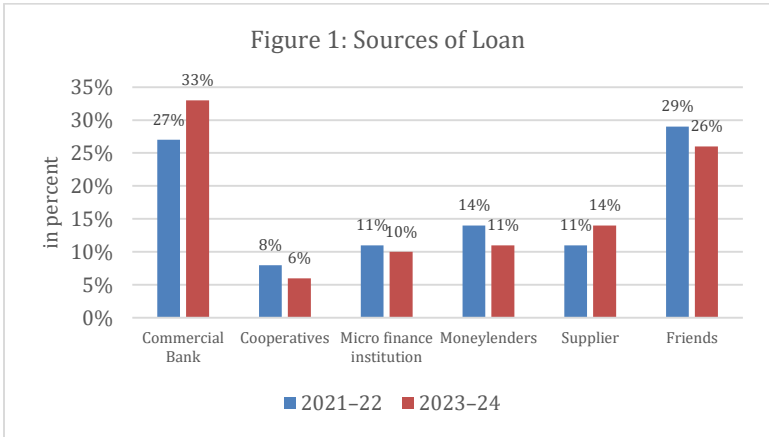
3. METHODOLOGY

This study is based on secondary data drawn from the Annual Survey of Unincorporated Sector Enterprises (ASUSE) for the years 2022–23 and 2023–24. The ASUSE provides nationally representative unit-level information on unincorporated non-agricultural enterprises engaged in manufacturing, trade, and other services (excluding construction), covering both rural and urban areas across India.

The survey follows a stratified multi-stage sampling design, ensuring adequate representation across states, sectors, and enterprise categories. It collects detailed information on enterprise characteristics such as ownership type, size of operation, employment, location, assets, financial indicators, and access to credit. For the present study, relevant variables related to credit access, sources of finance, enterprise size, age, sector, and other firm-level characteristics are extracted from the unit-

level dataset. Descriptive statistics are used to examine patterns and distribution of credit access across enterprise categories.

Adequate and timely access to credit continues to be a critical enabler of growth for the unincorporated sector. In recent years, access to finance for unincorporated enterprises has improved considerably. According to the Annual Survey of Unincorporated Sector Enterprises (ASUSE), the average outstanding loan per unincorporated non-agricultural establishment increased from ₹50,138 in 2022–23 to ₹53,710 in 2023–24, reflecting a growth of 7.12 per cent.



Source: Authors calculations using unit level data on Annual Survey of Unincorporated Sector Enterprises (ASUSE) 2021-22 and 2023-24.

The Figure 1 presents the source of loan outstanding for the years 2021–22 and 2023–24.

The most notable trend is the increased reliance on commercial banks, whose share rose from 27 per cent in 2021–22 to 33 per cent in 2023–24. This suggests an improvement in access to formal institutional credit among unincorporated enterprises. The growing role of commercial banks may indicate strengthening financial inclusion and greater outreach of the formal banking system.

In contrast, dependence on moneylenders declined from 14 per cent to 11 per cent, and loans from friends decreased from 29 per cent to 26 per cent. This decline reflects a possible reduction in reliance on informal sources of finance. However, friends and relatives continue to constitute

a significant source of borrowing, highlighting the persistent importance of informal networks in enterprise financing.

The share of cooperatives also fell from 8 per cent to 6 per cent, suggesting a relatively smaller role of cooperative credit institutions over time. Similarly, the share of microfinance institutions marginally declined from 11 per cent to 10 per cent.

Interestingly, borrowing from suppliers increased from 11 per cent to 14 per cent, indicating a rise in trade credit as a financing mechanism. This may reflect closer integration of enterprises within supply chains or limited working capital availability from formal institutions.

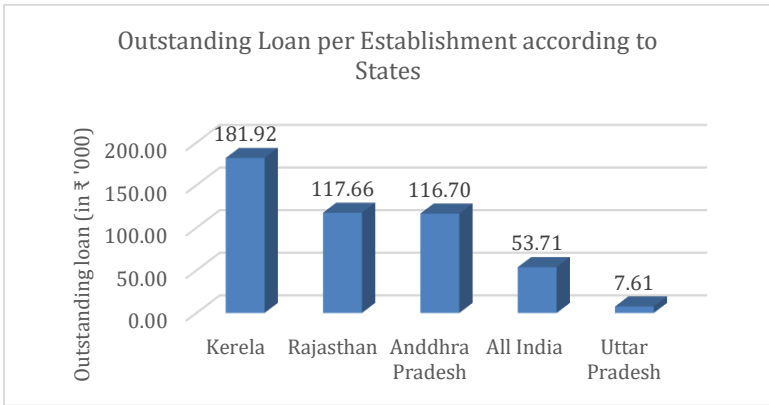
Overall, the pattern suggests a gradual shift towards formal banking sources, accompanied by a moderate decline in traditional informal credit sources. However, informal finance continues to play a substantial role in meeting the credit needs of unincorporated enterprises.

Broad Activity Category (BAC)	Own Account Establishment	Hired Worker Establishment	All
Manufacturing	2045	201717	254 71
Trade	10026	288866	545 25
Other Services	36857	301685	717 87
All	18986	27329	537 10

Table 1: Outstanding loan per Establishment (in ₹) according to BAC and Establishment type.

Source: Authors calculations using unit level data on Annual Survey of Unincorporated Sector Enterprises (ASUSE) 2022-23.

Table 1 gives the Broad activity category-wise outstanding loan per establishment by sector and establishment type. Outstanding loan per establishment, on an average, was estimated to be ₹ 53,710 at all-India level during ASUSE 2023-24. Among the Broad activity categories, the establishments engaged in 'other services' have reported the highest value of outstanding loan per establishment (₹ 71,787) followed by trade (₹ 54,525) and manufacturing (₹ 25,471)



Source: Authors calculations using unit level data on Annual Survey of Unincorporated Sector Enterprises (ASUSE) 2022-23.

Loan per establishment according to states is shown in Figure 2. Among the states having the highest loan per establishment can be seen that Kerala has the highest outstanding loan per establishment, followed by Rajasthan and Andhra Pradesh. Comparatively Uttar Pradesh has a much lower loan per establishment.

4. CONCLUSION

The unincorporated sector remains a cornerstone of the Indian economy due to its substantial contribution to employment generation, income creation, and output. Despite its economic significance and growth potential, the sector continues to face financial constraints, particularly in accessing formal sources of credit. This study examined the patterns of credit accessibility among unincorporated enterprises using recent ASUSE data and highlighted important trends in borrowing behaviour.

The findings indicate a gradual improvement in access to formal institutional finance, reflected in the increased share of commercial banks in outstanding loans and the rise in average loan per establishment. At the same time, reliance on certain informal sources such as moneylenders and friends has declined, although informal finance continues to play a considerable role. The variation in outstanding loans across broad activity categories, establishment types, and states further underscores the heterogeneity within the unincorporated sector. Enterprises engaged in other services and trade report higher levels of outstanding loans compared to manufacturing units, and significant inter-state differences persist.

These results suggest that while progress has been made in expanding formal credit outreach, gaps in accessibility remain across sectors and regions. Strengthening institutional mechanisms, improving credit appraisal systems for small enterprises, promoting financial literacy, and enhancing digital financial inclusion can help further reduce dependence on informal sources of finance.

Overall, improving access to affordable and timely formal credit is essential for enabling unincorporated enterprises to expand operations, enhance productivity, and contribute more effectively to inclusive and sustainable economic growth in India.

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