Viewpoint: Private credit investments in India—reflecting on the opportunities and challenges

Anuj Kapoor

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The author is managing director & CEO, private wealth group and alternatives asset management, JM Financial Ltd.

Private credit as an asset class has witnessed significant growth in recent years. Its global market size, dominated by the US and Europe, is currently estimated at $1.5 trillion and forecasted to reach $2.7 trillion by 2027.

India's private credit market, on the other hand, is still at an early stage with assets under management (AUM) of around $15 billion as of 2022.

The industry is, however, gaining traction and is estimated to reach close to $70 billion by 2028. Also, a significant portion of India's private credit AUM is skewed towards special situations and distressed debt funds, as opposed to areas such as performing credit and real assets.

In India, private credit in fund format has typically grown across four main areas:

- **Distressed debt and special situations:** This area is dominated by asset reconstruction companies (ARCs) and global funds and has been buoyed by the instatement of the IBC (Insolvency and Bankruptcy Code) in 2016. This has largely been centred around secondary purchases from banks, NBFCs, and other lenders. The predominant underlying sectors include metals and mining, real estate, and infrastructure. With significant capital-raising among corporates and an increase in systemic liquidity given low interest rates over the past several years, the system has seen considerable deleveraging, and consequently, this area has slowed in respect of deal flows. JM Financial continues to be a significant player in this space.
- **Performing credit:** One of the fastest-growing areas, this is also a key focus for JM Financial as a house, across both the NBFC and fund platforms. Given the regulatory restrictions and liability-side limitations across banks and NBFCs, several types of lending, including capital markets-led end uses, acquisition financing, and situations where flexibility is required across tenor and end uses, have moved to the fund format.
- **Real assets:** Funds across the real estate and infrastructure space are relatively limited, with several large players choosing to be direct sponsors and banks and NBFCs continuing to lend extensively to these sectors. However, with the rapid growth in these sectors in line with GDP growth, there has been increasing interest in looking at a fund format in these sectors that can invest in multiple high-quality sponsors. The growth of REITs and InvITs in India has also created a meaningful exit possibility here.
- **Venture debt:** This is an active asset class that has grown considerably with the growth of venture capital, in lockstep with "growth investing" in India. This area has seen some ponderable developments across 2022 and 2023 with the slowdown in the startup market. However, the long-term prospects of backing upcoming entrepreneurs across fast-growing sectors such as healthcare, consumer, and industrials remain positive.

The opportunities

Private credit as an opportunity can be viewed from the lens of growth – which drives both the demand- and supply-side drivers.

The central driver for the growth of private credit is GDP growth. India has already crossed the $4-trillion mark in late 2023 and is on its way to becoming a $7-trillion economy by 2030. This growth gives fillip to both the demand- and supply-side drivers.

Demand-side drivers: On the demand side, there is a massive credit need to be fulfilled in the country. Though banks and NBFCs continue to be the predominant lenders in India, their focus continues to be towards investment-grade instruments. As a result, mid-to-large corporates (rated below A-) lack access to debt financing, creating a significant opportunity for private credit funds. Moreover, banks face regulatory limitations in terms of various end-use restrictions, including those related to capital markets, domestic acquisitions, refinancing situations, and tenor flexibility.

Supply-side drivers: On the supply side, private wealth investors are keen to look at risks beyond traditional fixed-income instruments. Post the dispensation of capital gains tax in debt mutual funds and market-linked debentures earlier this year, investors are looking out for alternative investment funds (AIFs) to tap the 13-18% per annum gross fixed returns. HNWIs are estimated to grow to around 611k by 2025 (from around 278k in 2020), and we can expect at least a commensurate growth in allocations to this asset class.

The challenges

The primary challenge to private credit in India relates to the relatively limited track record of the asset class in the country. A large number of private credit AIFs have been registered in India in the last five years. Going forward, building for the longer term, using multiple pockets of the franchise for origination as well as risk management and portfolio monitoring along with demonstrated strong underwriting will be the key differentiators in this industry.

Having a strong track record across the firm and team is of paramount importance. As a relevant example, JM Financial (which has recently launched its flagship performing credit fund – JM Financial Credit Opportunities Fund I) has three decades of experience in wholesale credit in NBFCs (two AA-rated vehicles), an ARC, and distressed debt formats which we believe would be instrumental to its success in this area.

JM Financial private credit