ICRA

Non-banking Financial Companies – Microfinance Institutions

Persistent asset quality challenges to dampen profitability and growth expectations in FY2026

August 2025

List of abbreviations

ARCs	Asset reconstruction companies
AUM	Assets under management
bps	Basis points
BC	Business correspondent
CoF	Cost of funds
CP	Commercial paper
DA	Direct assignment
dpd	Days past due
FI	Financial institution
MCE	Monthly collection efficiency
MFIs	Microfinance institutions

NBFCs	Non-banking financial companies
NBFC-MFIs	Non-banking financial companies – microfinance institutions
NCDs	Non-convertible debentures
NIM	Net interest margin
p.a.	Per annum
PTCs	Pass-through certificates
RBI	Reserve Bank of India
RoMA	Return on average managed assets
SFB	Small finance bank
SHG	SHG Bank Linkage Programme
YoY	Year-on-year

Agenda

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2 Asset Quality Trends

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Highlights

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Asset quality stress increased in FY2025 amid borrower overleveraging, sociopolitical disruptions, and operational challenges; pressure expected to persist in H1 FY2026.

The AUM of NBFC-MFIs declined by 12% in FY2025 and 17% in Q1 FY2026. However, ICRA anticipates growth to resume in FY2026 to 8-12%.

ICRA has a Negative outlook on the sector, given the lingering asset quality stress and subdued profitability.

- Delinquencies decreased in Q1 FY2026 due to significant write-offs and the sale of portfolio to ARCs by NBFC-MFIs. In FY2025, 0+dpd and 90+dpd increased by ~510 bps and ~230 bps to ~9.2% and ~4.6%, respectively. The sector is facing challenges stemming from borrower overleveraging, sociopolitical disruptions and operational challenges, which are largely related to employee attrition.
- Nevertheless, the elevated overall overdue book poses significant downside risks to the near-term loan quality of the sector. Delinquencies are expected to remain elevated in H1 FY2026 amid rising rejection rates, resulting in lower incremental credit and liquidity available with borrowers.
- The share of NBFC-MFI borrowers with loans from more than three lenders fell to 17% by March 2025 (~14% in June 2025) from 25% in September 2024, following the implementation of guardrails for responsible lending.
- Nonetheless, given the growth outlook, ICRA expects the industry to maintain adequate leverage amid the moderate capital requirement. Further, NBFC-MFIs are well-placed from an asset-liability management (ALM) perspective with no mismatches up to at least a year, owing to the relatively shorter tenure of loans.
- The AUM of NBFC-MFIs declined by 12% in FY2025 and 17% YoY in Q1 FY2026 amid operational challenges and asset quality concerns. Further, the increase in borrower rejection rates resulted in subdued disbursements. ICRA expects the NBFC-MFIs' AUM growth to resume in FY2026 and reach 8-12%.
- Downward revisions in lending rates and the increase in cost of funds compressed NIMs. This, along with higher credit costs, impacted the earnings in FY2025 and Q1 FY2026, with NBFC-MFIs reporting a loss during these periods. ICRA expects that with estimated moderation in credit costs, some improvement in profitability is likely to be visible in FY2026. NBFC-MFIs are expected to report RoMA of 1.0-1.5% in FY2026.
- Lenders remain cautious in extending credit to the sector, owing to the ongoing asset quality concerns and regulatory actions involving two entities. Nonetheless, funding is likely to remain adequate amid the moderate growth expectations in the near term.

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Thank You!