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Medium & Small Non-Banking Financial Companies

Credit expansion is expected to stay moderate compared to historical levels; managing loan quality continues to be crucial

NOVEMBER 2025

Highlights – I

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AUM expansion decelerated in FY2025 on the back of multiple headwinds, especially in the unsecured lending segments; AUM growth of M&S NBFC expected to moderate to 16-18% in FY2026.

Capital adequate to meet near-term requirements.

Asset quality expected to be under pressure in the near-term after the weakening in FY2025, especially in the unsecured segments, viz., MFI, SME and PL/CL. Seasoning impact on secured assets remain a monitorable.

This report assesses the performance of medium and small (M&S) non-banking financial companies (NBFCs), defined as entities[1] with assets under management (AUM) of less than Rs. 150 billion as of March 2025.

These NBFCs have grown at a faster pace (5-year CAGR of 26%) than other larger NBFCs (5-year CAGR of 14%), given their smaller base and larger share of presence in high growth segments, viz., affordable housing, microfinance, loan against property (LAP), unsecured business loans (SME) and personal/consumption (PL/CL) loans.

M&S NBFCs AUM growth moderated sharply to 13% in FY2025 (about 36% in FY2024) because of the contraction in microfinance loans and significant slowdown in the growth rates of PL/CL and SME; their growth was even lower than their larger peers. AUM growth in FY2026 is expected to be at about 16-18%, better than last fiscal and closer to their larger NBFCs[2].

These NBFCs constituted about 14-15% of the overall NBFC (excluding infrastructure financiers) AUM as of March 2025, up from about 11% as of March 2022. Their share moderated somewhat in FY2025 but is expected to be stable in the current fiscal. This note assesses their performance in relation to large NBFCs.

M&S NBFCs witnessed an increase in loan write-offs during FY2025, like their larger peers. However, they also saw an increase in their gross stage 3 (GS3) while their larger peers reported some reduction. GS3 of M&S NBFCs have typically been in line with those of their larger peers. M&S entities are expected to face the seasoning impact in their long tenure loan segments as growth stablises, and segment specific issues in microfinance, SME and PL/CL in the near term.

Stage 2 and 3 assets for M&S NBFCs have been lower than their larger peers in the past; the gap, however, has narrowed in FY2025, largely due to the stress in the unsecured segments. While they carry higher provisions, given the loan losses, limited seasoning and the increase in the stress in their target segments provide a scope for them to further augment their provisions.

[1] Based on ICRA's sample set of 133 M&S NBFCs
[2] Based on ICRA's sample set of 42 large NBFCs
CAGR – Cumulative annual growth rate

Highlights – II

Despite improvements, profitability in FY2026 is expected to remain moderate compared to FY2024.

M&S NBFCs carry higher liquidity vis-à-vis their larger peers; adequate funding support from the banks is crucial.

M&S NBFCs are likely to witness range-bound interest margins, benefiting from the reduction in the cost of funds (CoF), even as their lending rates shall be pressurised by the competition from larger players and banks. M&S NBFCs generally target self-employed borrowers and those with average credit profiles and limited income proofs, which provides them with some pricing flexibility.

Secured asset segments have had a relatively stable return on average managed assets (RoMA) over the recent years. The impact of loan seasoning and balance-sheet leveraging shall impact their earnings, going forward. Thus, key would be to improve operating efficiencies, which is elevated compared to larger peers. The profitability of MFIs shall marginally revive in FY2026; while the performance of other unsecured loans shall remain a monitorable considering the spillage of the borrower over-leverage concern to other adjacent asset segments.

The capital position of M&S NBFCs remains adequate in the near term. While growth is expected to be at relatively lower levels, some entities in segments that come under asset quality pressures, viz, some MFIs, SME and PL/CL, would require capital raises to shore up their solvency position. Over the past few years, capitalisation has been supported by regular and sizeable capital raises. Investors – both private equity (PE) participants and retail investors – viewed the segment favourably, with PEs purchasing majority stakes of some entities and some entities listing at the stock exchanges.

M&S NBFCs have maintained a steady liquidity over the last few years. Loan quality stress in the microfinance and unsecured loan segments can impact fund flow, especially from banks, which is the largest lender to the segment.

Incrementally, with the tightening of credit flows to NBFCs from the banking sector in FY2025, M&S NBFCs have begun to raise funds via the NCD route, targeting the private and retail credit segments. Unlike larger players, key investors in these entities are typically foreign financial institutions and the HNIs. Entities will likely increase their reliance on securitisation, which is also one of the key constituents of the funding profile, channeling credit to this segment.

Note: MFI – Microfinance institutions

Agenda

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1 M&S NBFC Defined

2 Growth & Capital Profile

3 Loan Quality & Provision Coverage

4 Earnings Performance

5 Liquidity & Borrowings

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