ICRA

SMALL FINANCE BANKS

Strategic shift in portfolio mix to drive growth; profitability to remain under pressure

December 2025

List of abbreviations

ARC	Asset reconstruction company
ATA	Average total assets
AUM	Assets under management
Bps	Basis points
CAGR	Compound annual growth rate
CASA	Current account savings account
CET	Common equity Tier I capital
CRAR	Capital-to-risk weighted assets ratio
GNPAs	Gross non-performing assets
LAP	Loan against property
NIM	Net interest margin
NNPAs	Net non-performing assets
NPAs	Non-performing assets
Opex	Operating expenses
RBI	Reserve Bank of India
RoA	Return on assets
SFBs	Small finance banks

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Highlights

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ICRA expects SFBs to report 18-20% growth in gross advances in FY2026 with secured products being primary growth drivers; adequate capital and liquidity support growth plans

Uptick in delinquencies in microfinance segment and limited seasoning of secured products would keep asset quality volatile; ICRA expects GNPAs of 3.7-3.9% as of March 2026

RoA projected to moderate to 1.0-1.2% in FY2026 amid margin compression and elevated credit costs; some improvement expected in FY2027

- SFBs demonstrated a healthy portfolio growth of 17% year-on-year (YoY) in H1 FY2026 (21% in FY2025; 24% in FY2024) accompanied by a strategic shift in the portfolio mix. Given the asset quality challenges persisting in the microfinance segment, ICRA expects the portfolio growth of SFBs to moderate to 18-20% in FY2026, followed by an improvement to 22-25% in FY2027 with secured lending segments being the primary growth drivers.

- SFBs reported a ~120-bps increase in GNPAs to 3.6% as of March 2025, largely due to slippages in the microfinance segment; this inched up to 3.9% as of September 2025. ICRA expects the stress in the microfinance segment and limited seasoning of new products to keep the asset quality volatile and credit costs elevated in the near term.

- With SFBs strategically realigning their product mix towards relatively lower-yielding secured asset classes, portfolio yields declined in FY2025 and H1 FY2026, leading to a contraction in margins. Given the reduced NIMs and elevated credit costs, ICRA expects SFBs to report an RoA of 1.0-1.2% in FY2026 vis-à-vis 1.3% in FY2025, followed by some improvement in FY2027.

- In line with the trend seen for universal banks, depositors have moved towards term deposits, leading to a drop in the share of CASA deposits over the last few years. While deposit growth has remained healthy for SFBs, their CASA dropped to 27% as of September 2025 from 35% as of March 2022; increasing the share of CASA deposits remains a challenge for SFBs.

- As of September 2025, all SFBs were operating with adequate capital cushions over the regulatory levels. ICRA expects them to continue maintaining sufficient capital buffers in FY2026 with the Tier I ratio expected to be around 19% as of March 2026.

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Thank You!