

Microfinance: Out of the Woods? Assessing the Road Ahead



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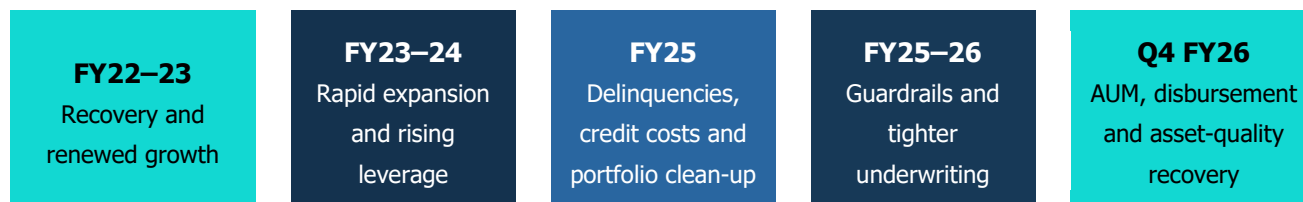
Synopsis

- **Visible growth revival in the sector:** The microfinance sector is exhibiting early signs of growth revival, with a pickup in both disbursements and assets under management (AUM). Industry AUM rose 3.3% QoQ to about Rs 3.25 lakh crore in Q4 FY26 after seven consecutive quarters of decline, while quarterly disbursements increased to nearly Rs 77,500 crore, the highest level in eight quarters. Sequentially, AUM marginally increased to Rs 3.27 lakh crore in Q1FY27, while disbursements dropped to approx. Rs 61,000 crore in Q1FY27 (against Rs 56,700 crore in Q1FY26).
- **NBFC-MFIs are leading the rebound:** NBFC-MFIs are leading the rebound, with the AUM increasing to about Rs 1.44 lakh crore as on March 31, 2026, growing faster than the overall industry during Q4 FY26. Their AUM increased marginally to Rs 1.46 lakh crore as on June 30, 2026, with market share improving to around 44% in June 2026 from 39% in March 2024, largely at the expense of banks.
- **Asset quality: healthy post-guardrails portfolio:** Asset quality has improved, supported by the clean-up of stress in the pre-guardrail portfolio and significantly lower delinquencies in the post-guardrail portfolio. PAR 1-30 declined to 0.5% in June 2026 from 1.4% in March 2025, while PAR 31-90 reduced to 0.7% from 2.8%. The post-guardrail portfolio is demonstrating healthier collection efficiency (X-bucket collection efficiency of >99.5%).
- **Lower credit costs are supporting earnings recovery:** Return on Average Total Assets (RoTA) improved to 0.5% in FY26 from -1.2% in FY25, supported by a decline in credit cost/Average Total Assets (ATA) to 5.4% from 8.7%. CareEdge Ratings expects RoTA to rise to about 2.4% in FY27 with further moderation in credit costs.
- **Inequitable funding access makes growth uneven across companies:** Funding conditions have improved, but funding access remains heavily skewed towards larger MFIs. Large¹ MFIs accounted for about 98% of incremental borrowings raised in FY26, while medium and small institutions continued to face constrained access and higher costs. Consequently, larger and well-capitalised MFIs will lead the sector growth.
- **Capital raising could constrain growth for some MFIs:** Given the losses over the last two years, some MFIs would need to raise sizeable equity capital to fund growth. A meaningful and sustained improvement in profitability, supported by healthy asset quality, would be key to attracting equity investors to the sector.

¹ NBFC-MFIs with AUM below Rs 500 crore are categorized as small, Rs 500 crore to Rs 2,000 crore as medium, greater than Rs 2,000 crore as large

From Rapid Growth to Credit Stress

The recent stress cycle followed a rapid post-Covid expansion, enabled by greater operating flexibility under the RBI's 2022 harmonised regulatory framework. The ensuing portfolio growth, however, was also accompanied by higher borrower leverage (borrowers availing loans from multiple MFIs).



- FY22–FY23: Recovery and renewed growth**
 Operating conditions normalised following Covid-19, and borrower demand improved. The RBI's 2022 harmonised framework broadened the addressable borrower base and provided greater flexibility in pricing and lending, supporting a sharp revival in industry growth.
- FY23–FY24: Rapid expansion**
 Portfolio growth accelerated significantly. However, household-income assessment, repayment-capacity-based underwriting and borrower-level credit checks remained uneven across the industry. Consequently, borrower leverage increased significantly.
- FY25: Asset-quality stress intensified**
 Higher borrower leverage translated into rising delinquencies, elevated credit costs, provisioning and write-offs. Lenders also began selling stressed portfolios to Asset Reconstruction Companies (ARCs) as part of the clean-up.
- FY25–FY26: Stress resolution and lending discipline**
 Portfolio clean-up continued through FY26, including further write-offs and sale of stressed assets to ARCs, alongside implementing tighter credit filters and lending guardrails issued by the MicroFinance Industry Network (MFIN). These measures strengthened underwriting discipline and improved portfolio quality.
- Q4 FY26: Recovery became visible**
 By Q4 FY26, recovery became visible across disbursements, AUM growth, early delinquency buckets and profitability. Going forward, growth is expected to resume under a more disciplined lending model, although the pace will vary across lending institutions, with access to debt funding being the key differentiator.

A Stronger Operating Environment Is Shaping the Next Cycle

The industry is entering FY27 with a structurally stronger operating environment than in FY24, i.e. prior to the recent stress cycle, supported by tighter lending practices, greater product diversification and stronger technology-enabled credit controls.

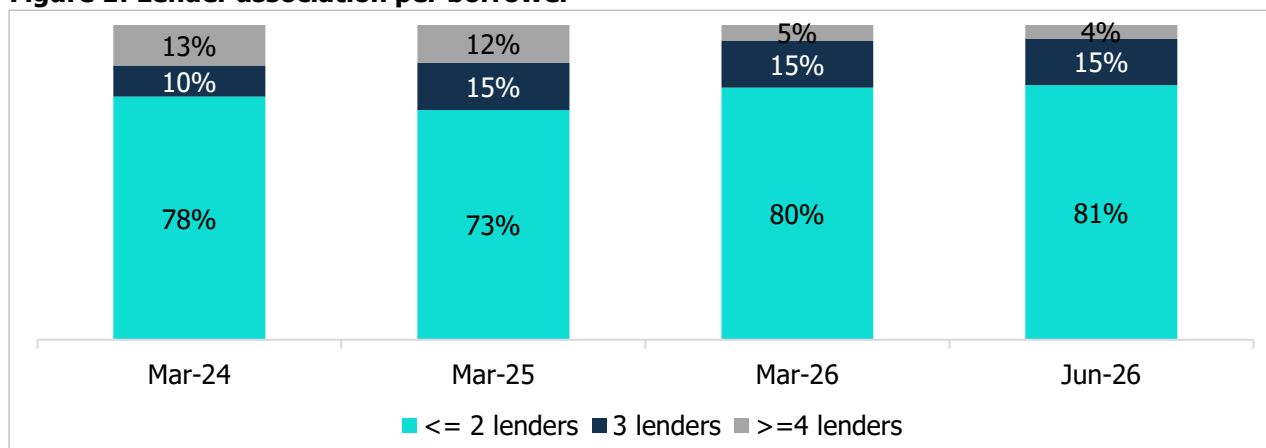
The changes are visible across three areas:

- Tighter industry guardrails and more conservative underwriting
- Policy support and flexibility to diversify beyond traditional microfinance
- Technology-enabled credit assessment, monitoring and early-warning systems

A. MFIN guardrails have tightened lending discipline

- MFIN Guardrails 1.0² and 2.0³ were introduced to address borrower overleveraging and to strengthen origination discipline.
- The framework reduced the maximum number of microfinance lenders per borrower from four to three, capped aggregate microfinance indebtedness at Rs 2 lakh, included unsecured retail loans in the borrower's leverage assessment and restricted fresh lending to borrowers with any existing loan (outstanding dues exceeding Rs 3,000) that was more than 60 days past due (60+ DPD).

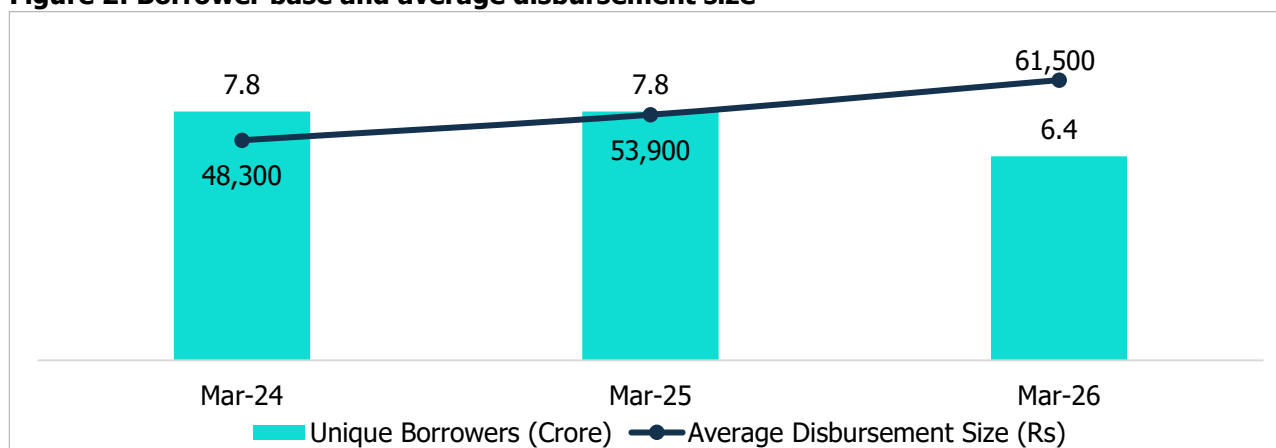
Figure 1: Lender association per borrower



Source: CRIF Data, CareEdge Ratings.

- The impact is visible in aggregate borrower-level data. The share of borrowers with four or more lender relationships declined to around 4% in June 2026 from 13% in March 2024, while the share with two or fewer lenders increased to about 81% in June 2026.

Figure 2: Borrower base and average disbursement size



Source: CRIF Data, MFIN Micrometer, CareEdge Ratings.

² **MFIN Guardrails 1.0 (effective July 2024)** capped microfinance lender relationships at four per borrower and total microfinance indebtedness at Rs2 lakh, while requiring all existing liabilities to be considered in repayment-capacity assessment and restricting lending to borrowers with existing NPAs above Rs3,000.

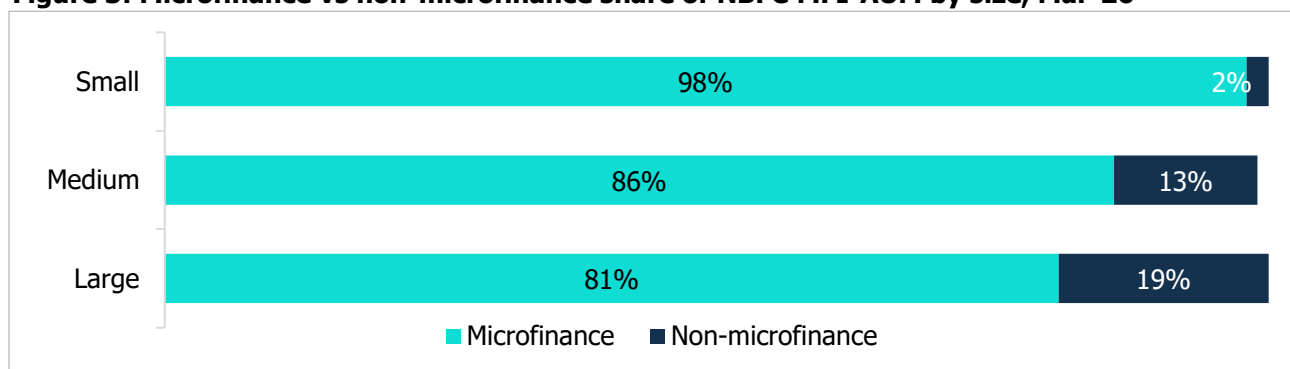
³ **Guardrails 2.0 (released November 2024; lender cap effective April 2025)** reduced the lender cap from four to three, extended the Rs2 lakh indebtedness cap to include both microfinance and unsecured retail loans, and tightened the fresh-lending criterion by restricting lending to borrowers overdue for more than 60 days with outstanding dues above Rs3,000, compared with the earlier 90-day threshold.

- The unique borrower base declined from 7.8 crore to 6.4 crore between March 2024 and March 2026, while the average disbursement size increased from Rs 48,300 to Rs 61,500. Lenders are therefore serving fewer borrowers with larger loans.

B. Product diversification is reshaping business models

- Another structural development has been the gradual diversification of NBFC-MFIs into individual lending and non-microfinance segments, reducing their reliance on Joint Liability Group (JLG) based lending.
- The relaxation of the qualifying-asset requirement from 75% to 60% has provided NBFC-MFIs with greater flexibility to expand into adjacent retail-lending segments. Larger institutions are likely to benefit disproportionately, given their stronger capital positions, relatively lower funding costs, established distribution networks and greater underwriting and risk-management capabilities.

Figure 3: Microfinance vs non-microfinance share of NBFC MFI-AUM by size, Mar-26



Source: CRIF Data, CareEdge Ratings

- This differentiation is already visible in the portfolio mix. As of March 2026, non-microfinance products accounted for approximately 19% of AUM for large MFIs, compared with 13% for medium-sized MFIs and only 2% for small MFIs.

C. Technology-enabled credit assessment and monitoring

- Greater use of borrower-level data is enabling lenders to assess overall indebtedness and repayment behaviour more effectively, strengthening credit decisions and helping limit excessive borrower leverage. This is also supported by strengthening of credit-bureau reporting standards: as part of the MFIN Guardrails 2.0, daily reporting of data to the credit bureaus was mandated.
- Analytics and early-warning systems help identify emerging portfolio stress and enable timely intervention.
- Data quality, cybersecurity and privacy controls remain important for effective technology adoption.

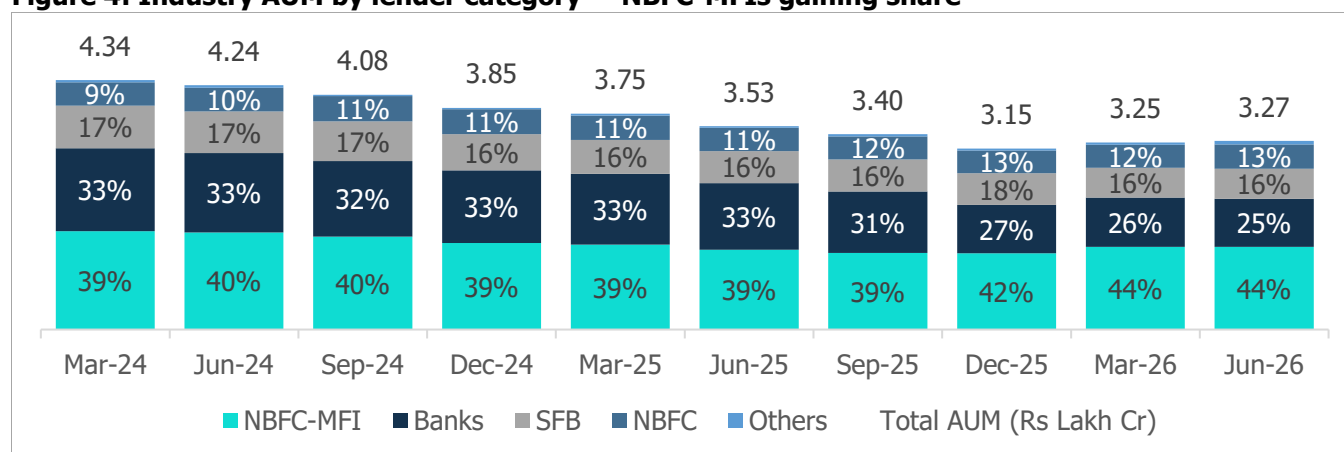
Signs of Recovery Are Emerging

NBFC-MFI recovery is visible across three indicators:

- AUM and disbursements
- Asset quality
- Profitability

A. Disbursements and AUM Have Turned the Corner

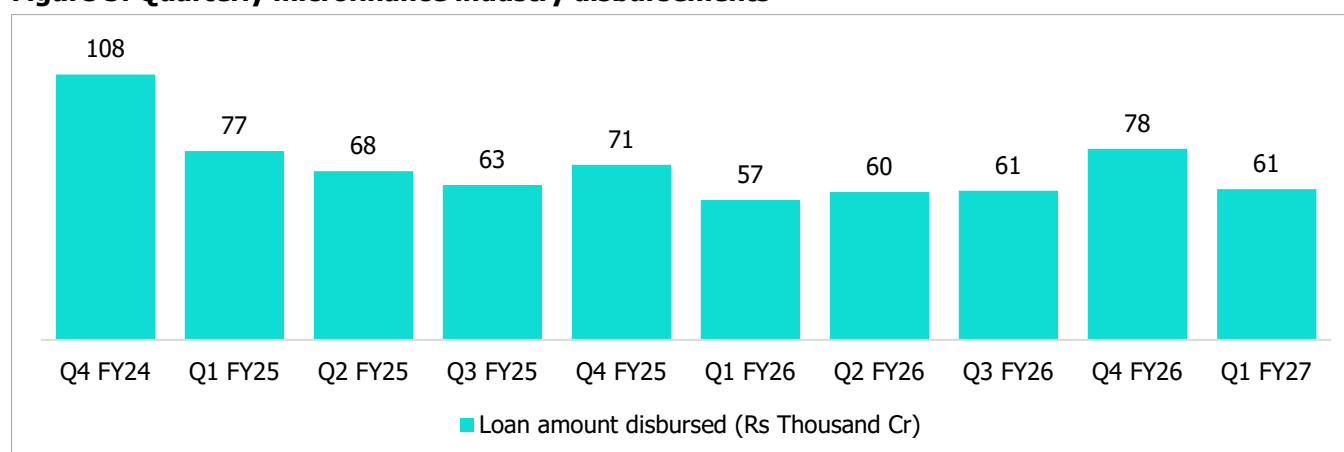
Figure 4: Industry AUM by lender category — NBFC-MFIs gaining share



Source: MFIN Micrometer, CRIF Data, CareEdge Ratings.

- Industry AUM increased to approximately Rs 3.25 lakh crore in Q4 FY26 from Rs 3.15 lakh crore in Q3 FY26, representing 3.3% QoQ growth. This was the first sequential increase after seven consecutive quarters of decline, although the portfolio remained lower year-on-year. Q1FY27 also reported a sequential increase in AUM to Rs 3.27 lakh crore. NBFC-MFIs' share in industry AUM increased to approximately 44% as on June 30, 2026, from 39% as on March 31, 2024, largely at the expense of banks.

Figure 5: Quarterly microfinance industry disbursements

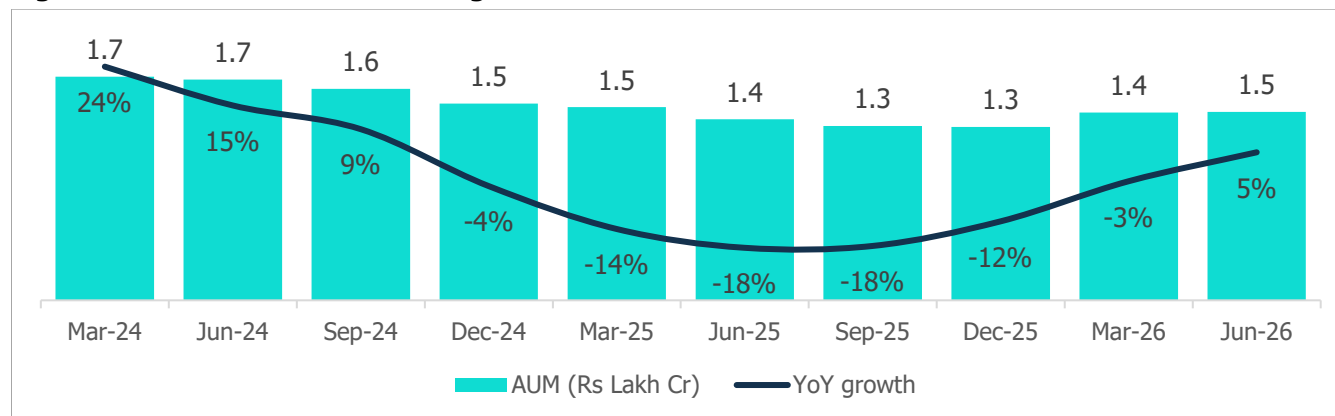


Source: MFIN Micrometer, CRIF Data, CareEdge Ratings.

- Quarterly disbursements increased to Rs 77,524 crore in Q4 FY26 from Rs 60,530 crore in Q3 FY26, a sequential rise of about 28% and the highest quarterly level in eight quarters. For Q1 FY27, disbursements dropped to Rs 61,000 crore due to cautious lending amid war- and weather-related concerns but were still

up 8% on a YoY basis. Sustenance of this growth momentum will depend on maintaining portfolio quality and improving funding availability.

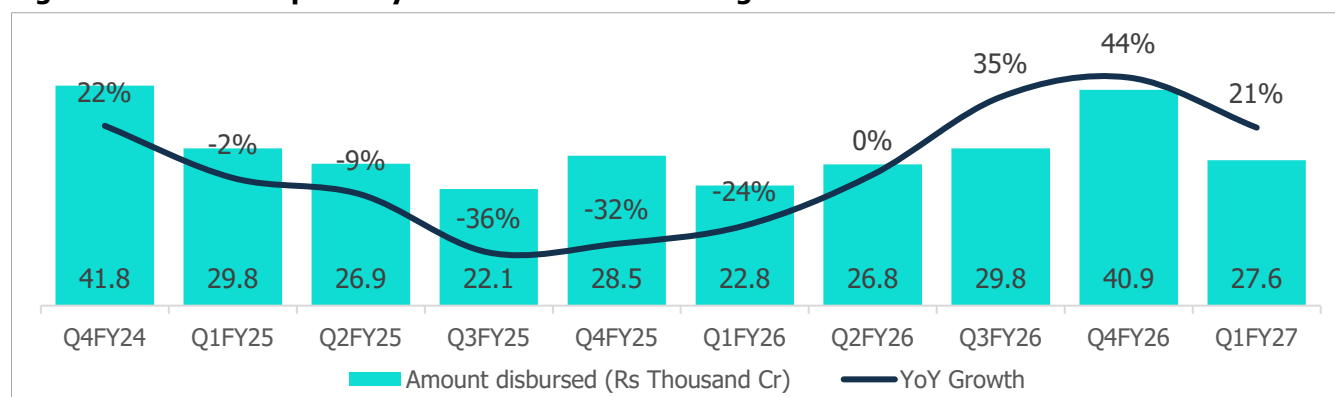
Figure 6: NBFC-MFI AUM and YoY growth



Source: MFIN Micrometer, CRIF Data, CareEdge Ratings.

- NBFC-MFI AUM rose by around 9% QoQ to Rs 1.4 lakh crore in March 2026 and increased further to Rs 1.5 lakh crore as of June 30, 2026, marking a stronger rebound than the overall microfinance industry.

Figure 7: NBFC-MFI quarterly disbursements and YoY growth



Source: MFIN Micrometer, CRIF Data, CareEdge Ratings.

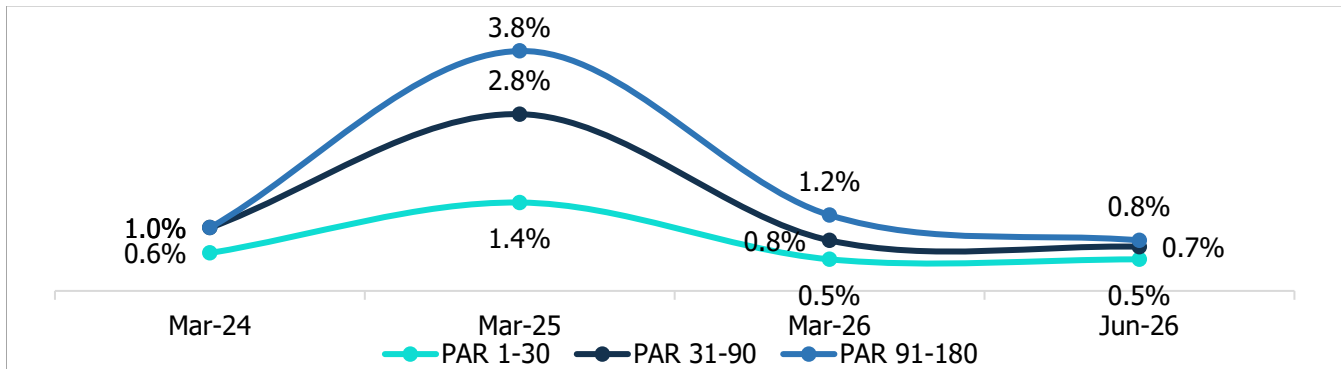
B. Asset Quality Has Improved

Figure 8: Portfolio clean-up through write-offs and ARC sales



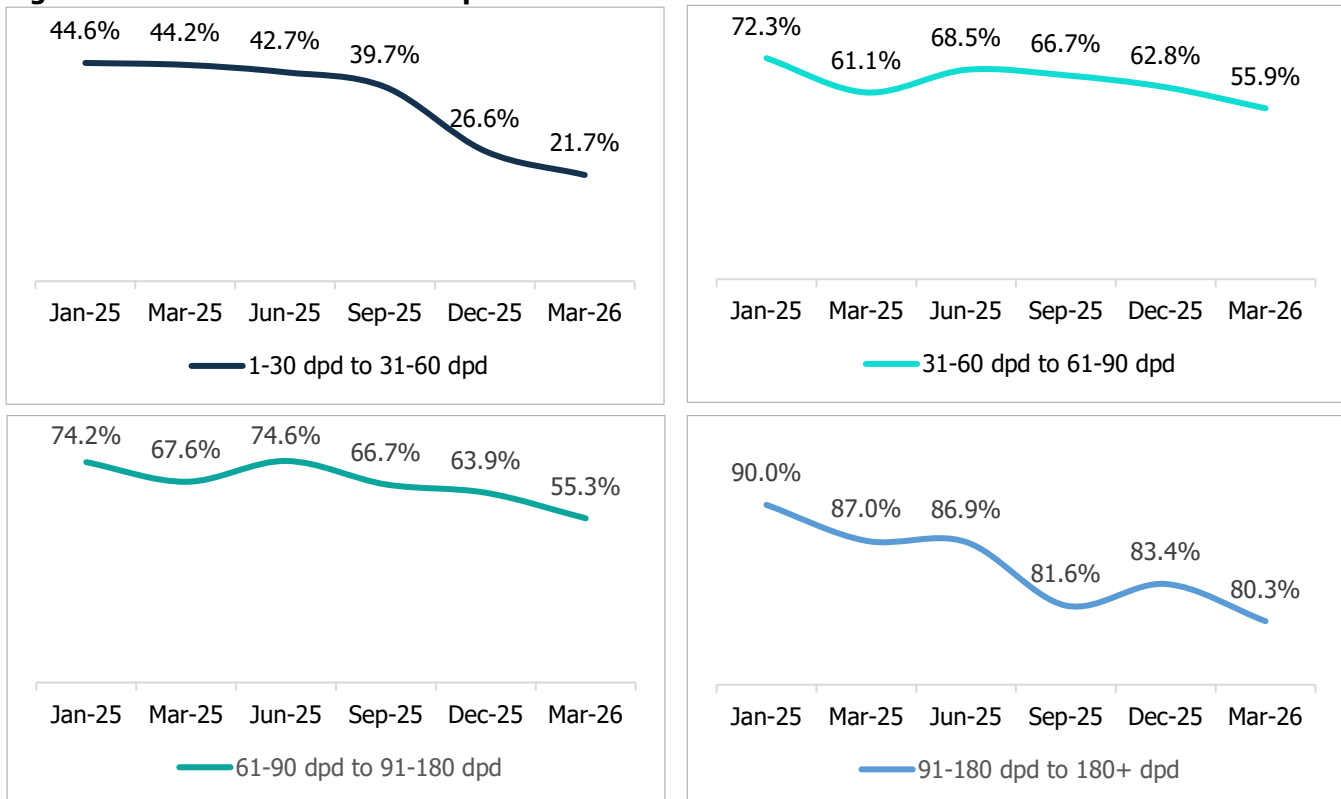
Source: CareEdge Ratings; based on reported numbers of 16 MFIs.

- Balance-sheet repair has also been substantial. Write-offs and ARC sales during FY25 and FY26 together accounted for more than 17% of the March 2024 loan book across the CareEdge-rated NBFC-MFIs sample, materially reducing the stock of legacy stressed assets.
- The portfolio originated after the guardrails is exhibiting healthy collection performance. The improvement in both PAR and forward-flow indicators suggests that the recovery is supported not only by removing old stress but also by better-quality new originations.

Figure 9: Portfolio at Risk has declined across early delinquency buckets for NBFC-MFIs


Source: CRIF Data, CareEdge Ratings.

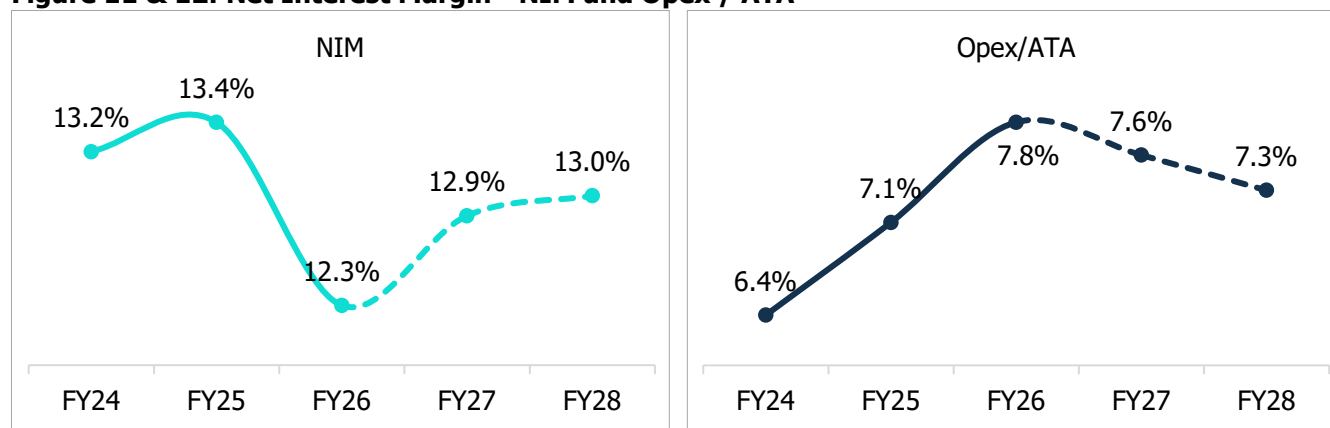
- Fresh delinquency indicators improved across early overdue buckets (up to 180 days). PAR 1-30 declined to 0.5% in June 2026 from 1.4% in March 2025, while PAR 31-90 reduced to 0.7% from 2.8%. PAR 91-180 improved to 0.8% from 3.8%, bringing early and mid-stage stress closer to pre-stress levels.

Figure 10: Forward flows show improvement


Source: CRIF Data, CareEdge Ratings.

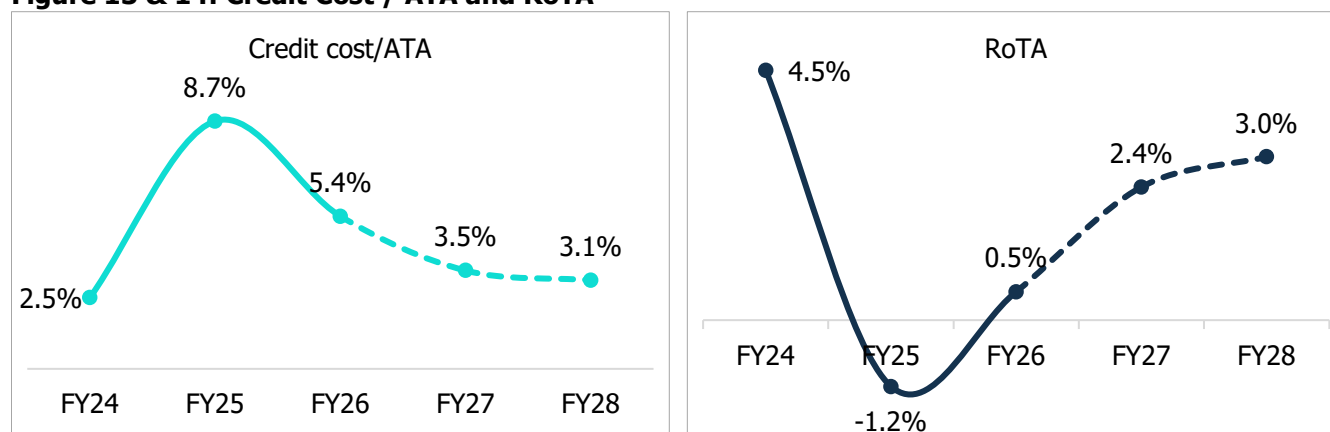
C. Credit-Cost Normalisation Is Driving Earnings Recovery

Figure 11 & 12: Net Interest Margin - NIM and Opex / ATA



Source: CareEdge Ratings; based on reported numbers of 16 NBFC-MFIs.

Figure 13 & 14: Credit Cost / ATA and RoTA

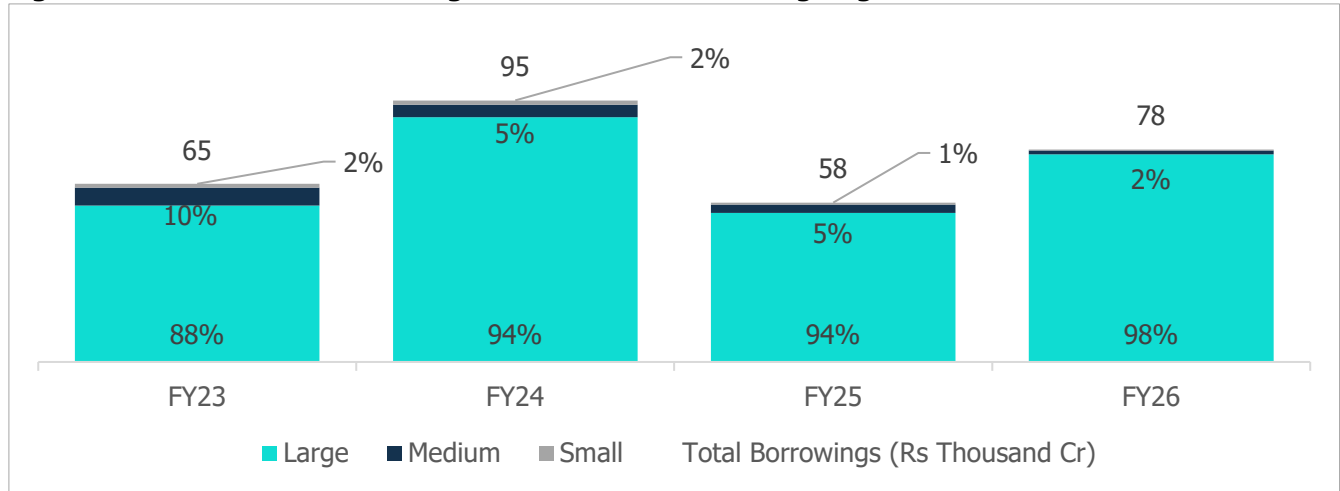


Source: CareEdge Ratings; based on reported numbers of 16 NBFC-MFIs.

- **Margins remained under pressure in FY26.** NIM (Net interest income/ATA) moderated to 12.3% in FY26 from 13.4% in FY25, while opex/ATA increased to 7.8% from 7.1%.
- **Credit-cost normalisation supported the return to profitability.** RoTA improved to **0.5% in FY26 from -1.2% in FY25**, as credit cost/ATA declined to **5.4% from 8.7%**, with fresh slippages moderating and legacy stress declining.
- **Further credit-cost moderation is expected to support profitability in FY27.** CareEdge Ratings expects credit cost/ATA to decline to about 3.5% in FY27, supporting RoTA of approximately 2.4%

Funding Will Determine the Pace of the Next Growth Cycle

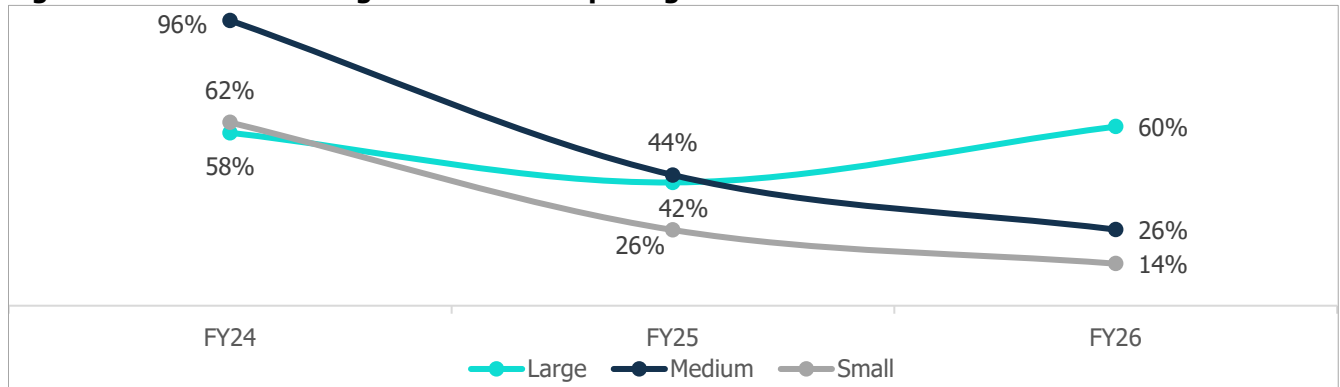
Figure 15: Incremental borrowings are concentrated among large MFIs



Source: MFIN Micrometer, CareEdge Ratings.

- Borrowings raised by the NBFC-MFIs sample increased to Rs 77,586 crore in FY26 from Rs 58,172 crore in FY25. However, the improvement was almost entirely concentrated among large institutions, which accounted for around 98% of FY26 fundraising.

Figure 16: Fresh borrowings as a share of opening AUM



Source: MFIN Micrometer, CareEdge Ratings.

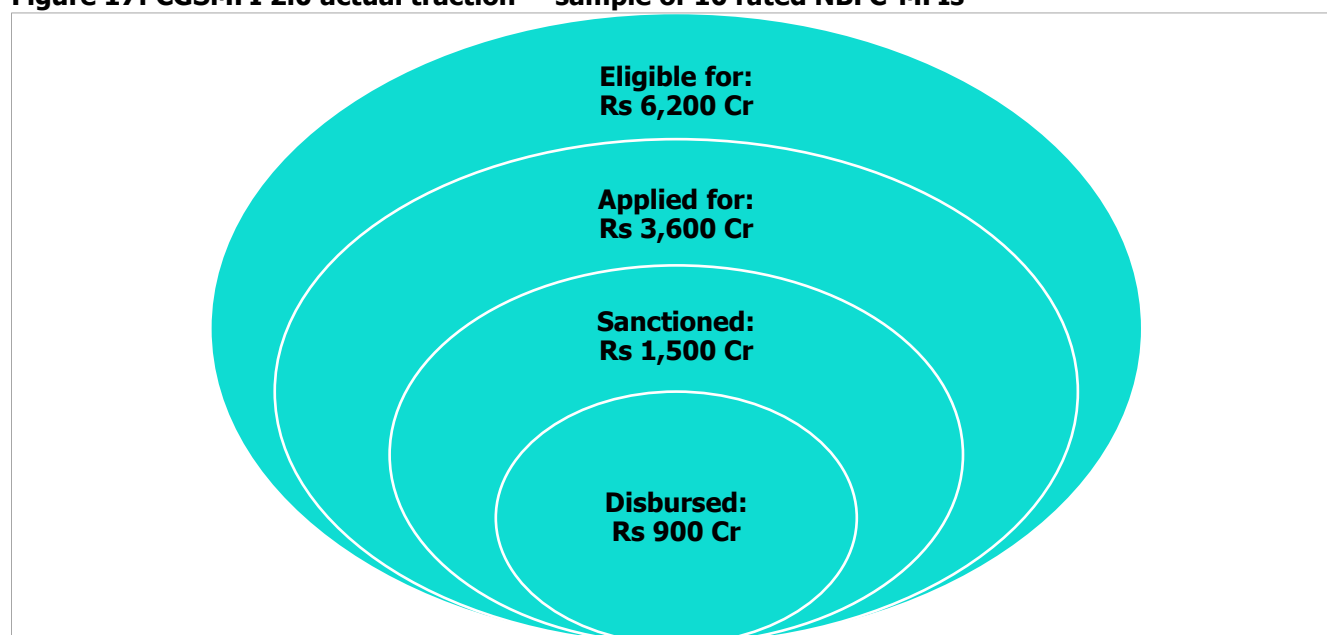
- Large MFIs raised borrowings equivalent to about 60% of opening AUM in FY26, compared with 26% for medium-sized MFIs and 14% for small MFIs. With limited access to debt funding from traditional channels, smaller MFIs will witness contraction in their balance sheets, resulting in sector consolidation.

CGSMFI 2.0 Targets the Funding Gap

- The Government introduced the scheme in March 2026 to encourage banks and financial institutions to lend to NBFC-MFIs and other eligible MFIs during a period of selective funding and sector stress.
- Purpose:** CGSMFI 2.0 provides a government-backed credit guarantee to eligible lending institutions for loans extended to NBFC-MFIs and MFIs. The funds must be used for onward lending to existing or new small borrowers falling within the RBI's regulatory definition of microfinance.
- Overall size:** The scheme sought to facilitate additional lending up to Rs 20,000 crore to the microfinance sector.

- **Eligible MFIs:** The scheme covers NBFC-MFIs and other MFIs registered with an RBI-recognised self-regulatory organisation. Scheduled commercial banks, eligible financial institutions and institutions such as SIDBI can participate as Member Lending Institutions.
- **Institution-size classification:** MFIs with AUM below Rs 500 crore are classified as small, those with AUM from Rs 500 crore to below Rs 2,000 crore as medium, and those with AUM of Rs 2,000 crore or more as large.
- **Differentiated guarantee coverage:** The guarantee covers 80% of the amount in default for small MFIs, 75% for medium MFIs and 70% for large MFIs. The higher coverage for smaller institutions is intended to encourage lenders to provide funding to entities that have faced liquidity constraints.
- **Funding limit and tenor:** Assistance can extend up to 20% of the MFI's on-balance-sheet AUM, subject to specified limits based on institution size. The loan tenor can be up to three years, including a one-year moratorium.
- **Pricing conditions:** Interest on loans from banks or financial institutions to MFIs is capped at the applicable External Benchmark Lending Rate or one-year MCLR plus 2% per annum. MFIs must lend the scheme-backed funds to eligible borrowers at a rate at least 1 percentage point below their average lending rate during the preceding six months.
- **End-use requirements:** The assistance must be used to create fresh microfinance loan assets, generally within three months of each disbursement. MFIs must maintain a separate account for scheme-backed lending and provide appropriate certification regarding utilisation and compliance.
- The scheme has witnessed limited traction to date, with actual disbursements significantly below the envisaged Rs 20,000 crore guarantee-backed loans to the sector. A survey of 10 CareEdge-rated NBFC-MFIs indicates that, although institutions were eligible to access up to Rs 6,200 crore under the scheme, applications totalled only Rs 3,600 crore, resulting in sanctions of Rs 1,500 crore and disbursements of just Rs 900 crore.

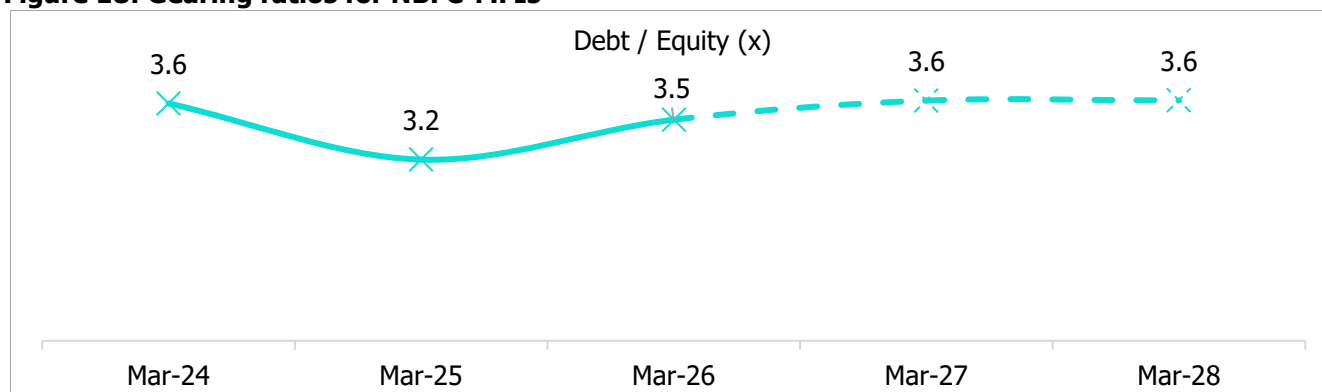
Figure 17: CGSMFI 2.0 actual traction — sample of 10 rated NBFC-MFIs



Source: CareEdge Ratings

Leverage Expected to Remain Broadly Stable

Figure 18: Gearing ratios for NBFC-MFIs

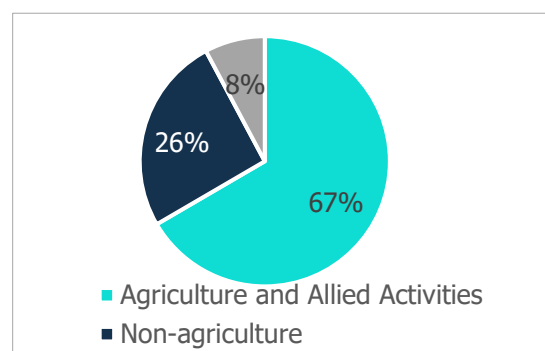


Source: CareEdge Ratings; based on reported numbers of 16 NBFC-MFIs.

- Gearing moderated from 3.6x in March 2024 to 3.2x in March 2025 as borrowings by MFIs declined following the crisis. Gearing increased to 3.5x in March 2026 as borrowings by MFIs, especially the sector leaders, resumed in FY26. However, MFIs that incurred significant losses during FY25 and FY26 may have limited capital headroom to rebuild their loan books.

Key Risks to the Recovery

- Rural and climate risks:** With ~67% of the portfolio linked to agriculture and allied activities, borrower cash flows remain sensitive to monsoon performance, weather disruptions and rural income volatility.
- Political and regulatory interventions:** Localised political developments, including loan-waiver expectations and restrictions on recovery activities, could weaken repayment behaviour in affected regions.
- Funding access:** Funding remains a key differentiator, particularly for smaller MFIs. Any weakening in lender risk appetite or system liquidity could constrain their ability to grow and prolong the recovery gap with larger players.
- Technology and cyber risks:** Increasing reliance on digital lending and collections raises exposure to cybersecurity, fraud and data-privacy risks, making technology governance increasingly important.



Outlook for FY27

Metric	FY26	FY27E
NBFC-MFI AUM growth	Contraction	~15%
GNPA	3.3%	~2.7%
Credit cost / ATA	5.4%	~3.5%
RoTA	0.5%	~2.4%
Gearing	~3.5x	~3.6x

- CareEdge Ratings expects the recovery to strengthen in FY27, supported by improving disbursements, stronger performance of newer portfolios and lower credit costs.
- NBFC-MFI AUM is expected to grow by around 15% in FY27, marking a return to growth after two years of contraction.
- GNPA is expected to decline to around 2.7% by March 2027 from 3.3% in March 2026, while credit-cost normalisation should support RoTA of approximately 2.4% in FY27.
- Gearing is expected to remain broadly stable at around 3.6 times, indicating that the projected growth remains supported by adequate capital in the base case.
- However, the recovery is unlikely to be uniform across institutions. Growth is expected to remain concentrated among well-capitalised MFIs with diversified business models, stable funding access and strong execution capabilities.

CareEdge Ratings' view

"The microfinance sector is entering FY27 on a stronger footing, with asset quality improving through the clean-up of stressed portfolios, lower borrower leverage and tighter lending practices. Importantly, the improvement is also visible in the performance of loans originated after the introduction of industry guardrails, indicating that the recovery is being supported by both the resolution of legacy stress and healthier new originations. With credit costs expected to moderate further, profitability is set to strengthen in FY27," said Ravi Nayak, Assistant Director, CareEdge Ratings

"CareEdge Ratings expects NBFC-MFI AUM to grow by around 15% in FY27. Q1FY27, however, has seen muted growth as the sector disbursed cautiously amid forecasts of a weak monsoon. Given the late pick-up in monsoons, disbursements and AUM growth are estimated to pick up starting Q2FY27. The growth, however, will be concentrated among larger institutions, while smaller institutions continue to navigate through the funding challenges," said Shreekiran Rao, Director, CareEdge Ratings

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