Report on Loans and Financial Services Industry in India

For Aye Finance

December 2024

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CRISIL Limited
Mumbai

1. Macroeconomic Scenario in India

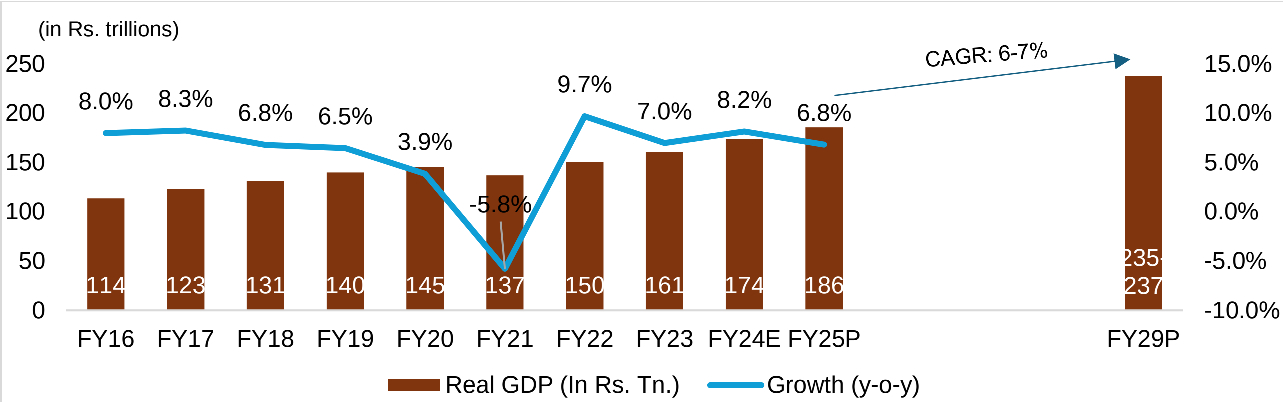
1.1 Global economy is witnessing tightening of monetary conditions

As per the International Monetary Fund (IMF) (World Economic Outlook – October 2024), global GDP growth prospects for CY24 and CY25 will hold steady at 3.2% Major global economies showed resilience in the second quarter of 2024, despite a slight moderation experienced in some of the economies. The US and Japan performed better in the first quarter, while the UK and China saw growth moderation. The Euro area, meanwhile, held steady. The Bank of Japan turned hawkish and raised interest rates once again, while the weak US payroll data in July sparked fears of a rapidly cooling labor market and an imminent recession, resulting to rate cut of 50 basis point in September 2024 by the Federal Reserve. The combination of these developments led to an unwinding of the global Yen carry trade and a rush of outflows from emerging markets to safe-haven assets with most emerging market currencies (and some developed market ones) seeing depreciation. Heightened geopolitical tensions in the Middle East also added to the global volatility.

1.2 India is expected to remain one of the fastest growing economies in the world

The Indian economy was amongst the fastest-growing in the world prior to onset of the Covid-19 pandemic. In the years leading up to the global health crisis which disrupted economic activities, the country's economic indicators posted gradual improvements owing to strong local consumption and lower reliance on global demand. Despite global geopolitical instability, India continues to maintain its position as one of the fastest-growing economies globally. In May 2024, the National Statistical Office (NSO) in its provisional estimate of national income estimated the real GDP to have grown at 8.2% year-on-year in fiscal 2024, while in Q4 FY24, growth was much stronger at 7.8% than 5.9% factored in the second advance estimates in February 2024. Going forward, CRISIL MI&A expects a moderation in GDP growth rate to 6.8% in Fiscal 2025, largely due to various factors like Government's focus on fiscal consolidation, which is likely to lead to moderation in investments, which is a key factor for economic growth. Additionally, ongoing transfer of increased interest rates to retail borrowers and regulatory measures by the RBI to control risky lending could further affect credit support for consumption. Slower global growth and possible spikes in commodity price, especially crude oil may also contribute to moderation in economic growth of India. However, the normal monsoon offered some hope for the rural economy which may lead to reduction in food inflation and enhanced purchasing power.

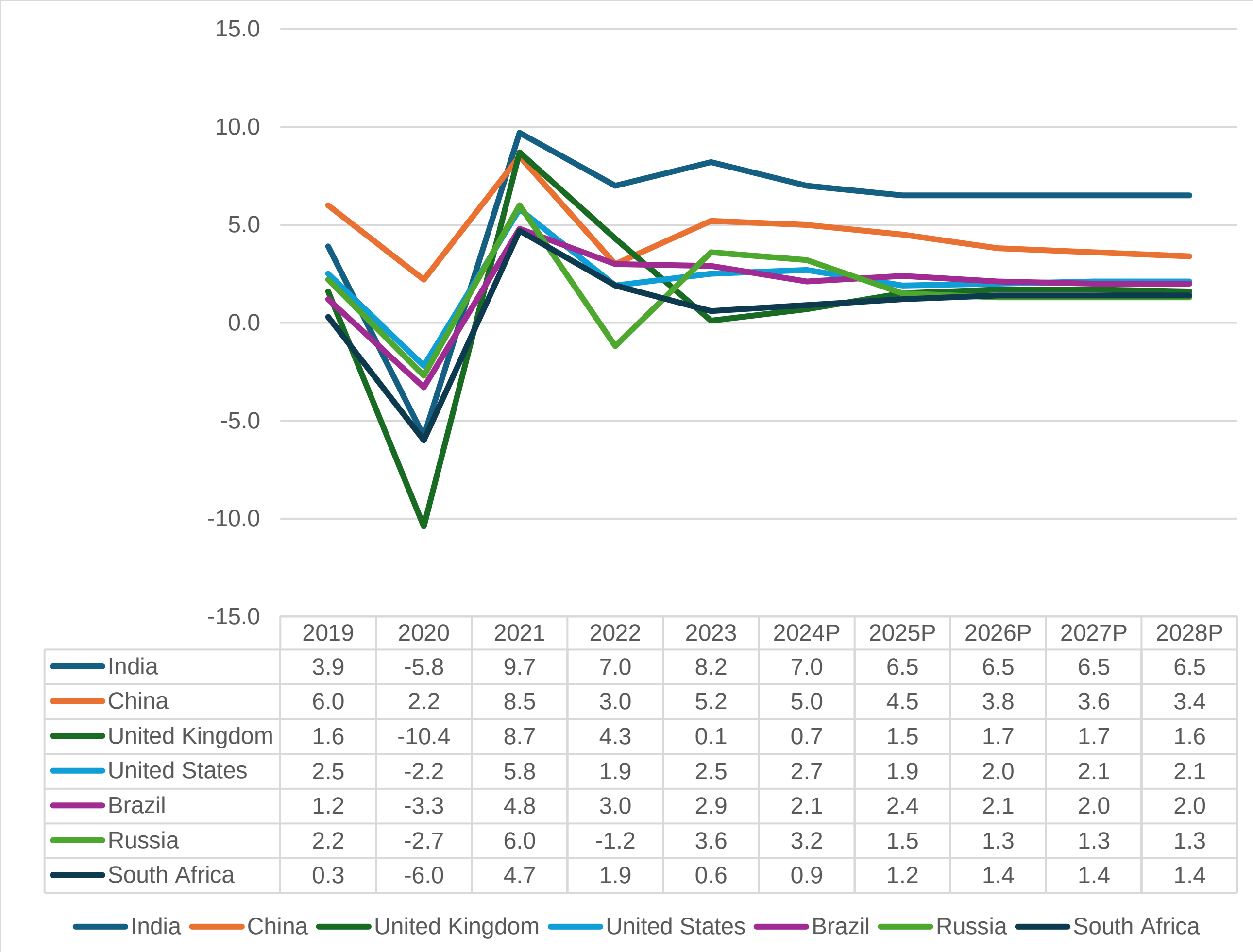
India's economy expected to grow at 6.8% in Fiscal 2025



Note: E = Provisional Estimate, P = Projected; GDP growth till fiscal 2023 is actuals. GDP Estimates for fiscals 2023- 2024 is based on NSO Estimates and 2024-2025 is projected based on CRISIL MI&A estimates and that for fiscals 2025-2029 based on IMF estimates; Source: NSO, CRISIL MI&A, IMF (World Economic Outlook – October 2024 update)

Over the past three fiscals (FY22-FY24), India's economy has demonstrated remarkable robustness and resilience over, outperforming many of its global counterparts in terms of growth. The government's commitment to fiscal discipline, inflation control, and structural reforms has created a favorable business environment, attracted foreign investment and driven growth. Despite the challenges posed by the COVID-19 pandemic, India's economy has shown a swift recovery, with a V-shaped rebound in GDP growth. In IMF’s July 2024 update, it raised the GDP growth forecast for India highlighting India’s improved prospect for private consumption particularly in rural areas. Going forward as well, IMF projects that Indian economy will remain strong and would continue to be one of the fastest growing economies.

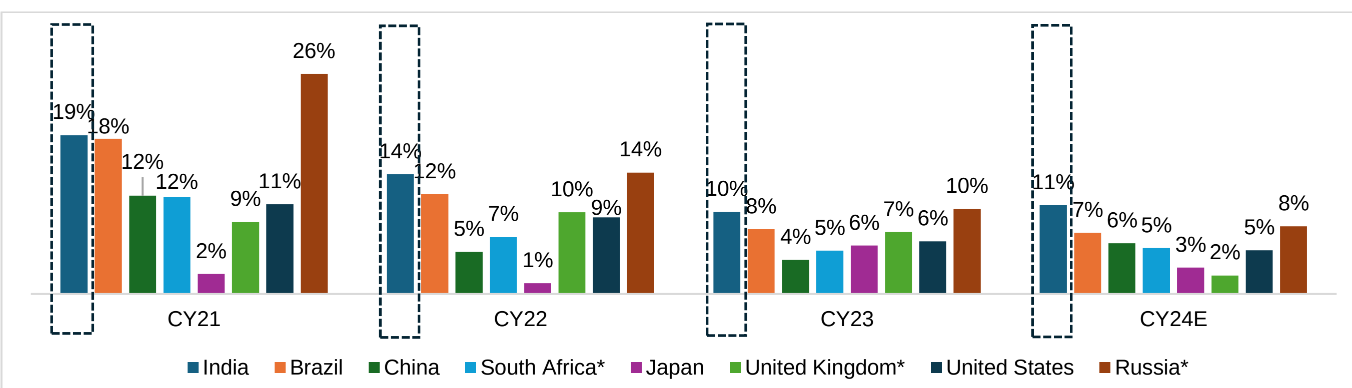
India is one of the fastest-growing major economies (Real GDP growth, % year-on-year)



	2019	2020	2021	2022	2023	2024P	2025P	2026P	2027P	2028P
India	3.9	-5.8	9.7	7.0	8.2	7.0	6.5	6.5	6.5	6.5
China	6.0	2.2	8.5	3.0	5.2	5.0	4.5	3.8	3.6	3.4
United Kingdom	1.6	-10.4	8.7	4.3	0.1	0.7	1.5	1.7	1.7	1.6
United States	2.5	-2.2	5.8	1.9	2.5	2.7	1.9	2.0	2.1	2.1
Brazil	1.2	-3.3	4.8	3.0	2.9	2.1	2.4	2.1	2.0	2.0
Russia	2.2	-2.7	6.0	-1.2	3.6	3.2	1.5	1.3	1.3	1.3
South Africa	0.3	-6.0	4.7	1.9	0.6	0.9	1.2	1.4	1.4	1.4

Note: All forecasts refer to IMF forecasts. GDP growth is based on constant prices, Data represented is for calendar years, Figures for CY 2024 & 2025 as per WEO -July 2024, P: Projected; Source: IMF (World Economic Outlook – April 2024), CRISIL MI&A

India's nominal GDP position is strengthening compared to other major economies (GDP growth, % year-on-year)



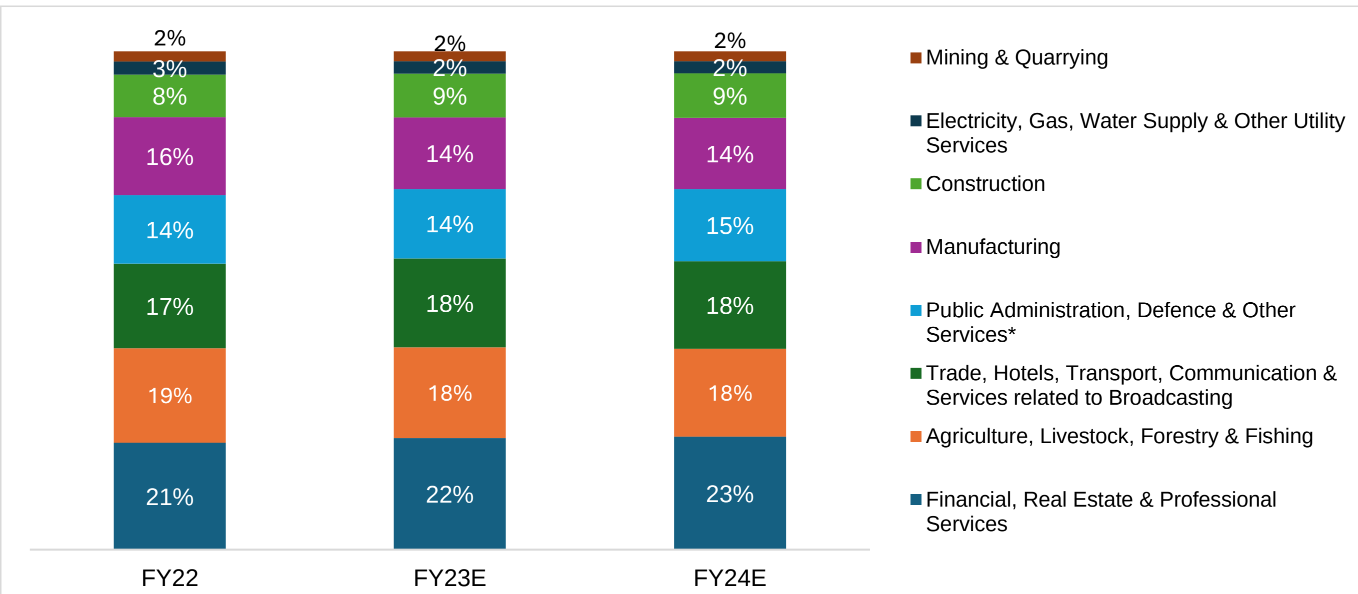
*Note: All forecasts refer to IMF forecasts. GDP growth is based on current prices in national currency for each country. * Estimated GDP growth for FY23, E - Estimated; Source: IMF (World Economic Outlook – April 2024), CRISIL MI&A*

India's nominal GDP has been growing at a rapid pace, with an average annual growth rate of around 11% over the past decade. This is one of the fastest growth rates among major economies followed by Brazil and China with an annual growth rate of 7% and 6%. India's large and young population, of its citizens below the age of 35, provides a significant demographic dividend. This demographic advantage is expected to support India's economic growth in the coming decades. India has a rapidly growing digital economy, with a large and growing base of internet users, mobile phone penetration, and digital payments. This has created new opportunities for economic growth and job creation.

1.3 Contribution of different sectors to India's growth

Trend in Gross Value Added (GVA) at current prices by economic activity denotes that financial, real estate and professional services have consistently contributed the highest to the GVA and contributed an estimated 23% in fiscal 2024. Total GVA at current prices witnessed a CAGR of 11% from FY22 to FY24.

Gross Value Added by Economic Activity



*Note: *- Public Administration, Defence & Other Services category includes other services sector i.e. Education, Health, Recreation, and other personal services; Fiscal 2023 figs are First Revised Estimates and Fiscal 2024 figs. are Provisional Estimates as per NSO.*
Source: MOSPI, CRISIL MI&A

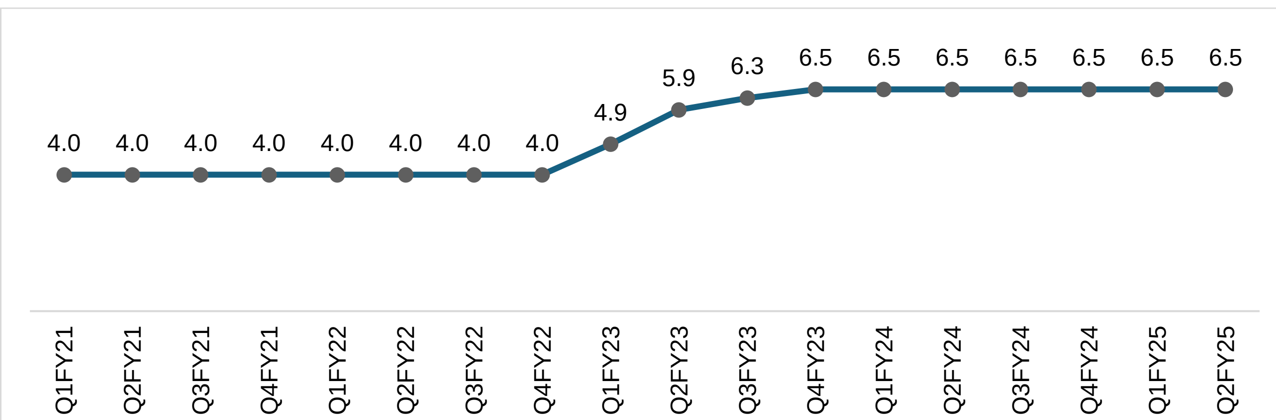
Indian Economy to be a major part of the world trade

Along with being one of the fastest growing economies in the world, India ranked fifth in the world in terms of nominal GDP according to IMF forecasts (World Economic Outlook -October Update). India overtook UK to become the fifth largest economy in the world in CY2022. In terms of purchasing power parity ("PPP"), India is the third largest economy in the world, after China and the United States. Exports of goods and services increased 8.7% year on-year in the quarter ending June 2024 vs 8.1% in the preceding quarter ending March 2024, following improvement in global trade growth. Meanwhile, growth in import of goods and services slowed down to 4.4% in quarter ending June 2024 vs 8.3% growth in the quarter ending March 2024. As the base of import values is higher than exports, net exports (exports minus imports) remained a drag on GDP in the first quarter of fiscal 2025.

1.4 Repo rate remains unchanged, with phase of aggressive rate hikes behind us

The current fiscal began with unchanged repo rates by the RBI. Globally, major central banks are currently cautious about cutting rates, amid slower disinflation and strong growth. On the domestic front, while the forecast of an above-normal monsoon bodes well for disinflation, adverse weather events and possible increase in crude oil prices poses potential risks. The Reserve Bank of India's (RBI) MPC in its August 2024 meeting voted to keep the policy rates unchanged. The repo rates have increased by 250 basis points from Q4FY22 to Q4FY23 and remained at 6.50% in Q1FY25, standing deposit facility (SDF) at 6.25%, and marginal standing facility (MSF) at 6.75%. In October 2024 meeting, keeping in view the prevailing and expected inflation-growth dynamics, which are well balanced, the MPC decided to keep the repo rates unchanged, however, changed the stance from withdrawal of accommodation to neutral and remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

Repo rate in India (%)



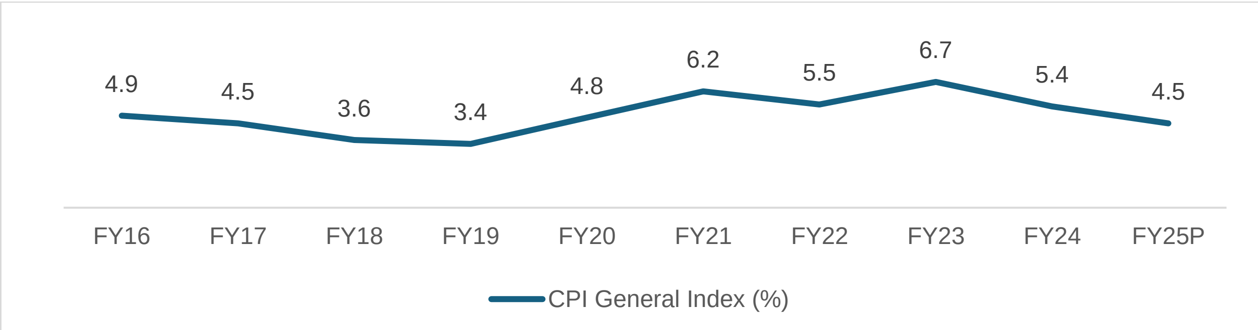
Source: RBI, CRISIL MI&A

Consumer Price Index ("CPI") inflation to average at 4.5% in FY25

CPI inflation, after remaining steady at 3.6% during July and August 2024, increased to 5.5% in September 2024 and to 6.2% in October 2024. Fuel inflation fell to -1.6% year-on-year in October 2024 compared with a decline of 5.3% in August 2024. CRISIL MI&A expects the CPI inflation for fiscal 2025 to average 4.5%. It is expected that cooling domestic demand, normal monsoon along with a high base for food inflation should help moderate inflation in the remaining months of FY25. A non-inflationary budget that focusses on asset-creation rather than direct cash support also bodes well for core inflation. However, an unusual weather event and geopolitical uncertainty, if at all, could reverse the easing. Recent developments in the

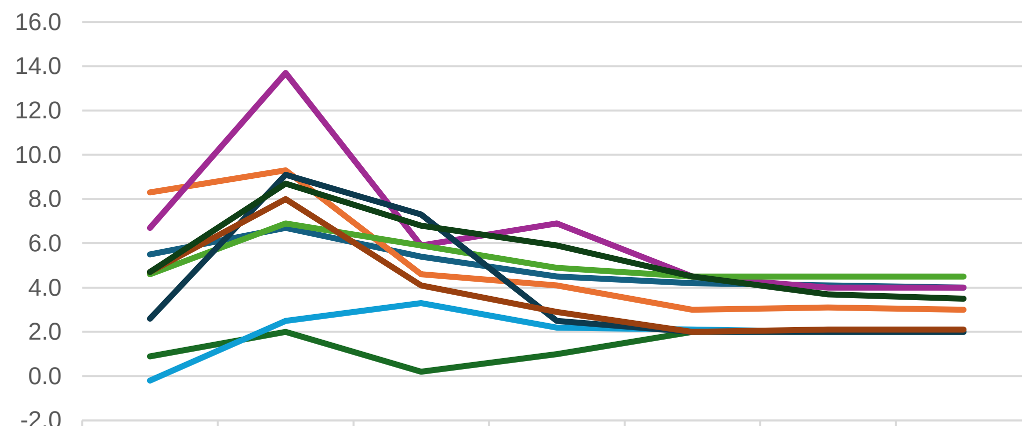
Red Sea and a fading low base effect for commodity prices could put some upside pressure on core inflation and would need monitoring.

Inflation to moderate to 4.5% in Fiscal 2025



Note: P = Projected, Source: CRISIL MI&A

India's inflation vs world's inflation



	FY22	FY23	FY24	FY25P	FY26P	FY27P	FY28P
India	5.5	6.7	5.4	4.5	4.2	4.1	4.0
Brazil	8.3	9.3	4.6	4.1	3.0	3.1	3.0
China	0.9	2.0	0.2	1.0	2.0	2.0	2.0
Japan	-0.2	2.5	3.3	2.2	2.1	2.0	2.0
Russia	6.7	13.7	5.9	6.9	4.5	4.0	4.0
South Africa	4.6	6.9	5.9	4.9	4.5	4.5	4.5
United Kingdom	2.6	9.1	7.3	2.5	2.0	2.0	2.0
United States	4.7	8.0	4.1	2.9	2.0	2.1	2.1
World's Average	4.7	8.7	6.8	5.9	4.5	3.7	3.5

India — Brazil — China — Japan — Russia — South Africa — United Kingdom — United States — World's Average

Note: All forecasts refer to IMF forecasts. Inflation rate is based on Average consumer prices (Annual percentage change), P: Projected; Source: IMF (World Economic Outlook – April 2024), CRISIL MI&A

India's inflation rate of 5.4% in FY24 is higher than that of some economies, such as Brazil and China, but lower than that of other economies, such as Russia and South Africa with a rate of 5.9% and United

Kingdom's inflation at 7.3%. The inflation rate is expected to be driven by supply-side pressures, particularly in the agricultural sector, as well as a rebound in economic activity. However, the inflation rate of India is projected to decline gradually over the next few years, reaching 4.0% by FY28. This decline is attributed to the government's efforts to improve the agricultural sector, enhance food processing, and strengthen the overall supply chain.

1.5 Macroeconomic outlook for FY25

Macro variables	FY24	FY25P	Rationale for outlook
Real GDP (y-o-y)	8.2%	6.8%	Slowing global growth is likely to weaken India's exports, while peak impact of past rate hikes and lower fiscal impulse could temper domestic demand. Despite the lower forecast in FY25P as compared to FY24, India continues to grow at the highest rate among major economies propelled by budgetary support to capital expenditure and strong rural demand to support growth.
Consumer price index (CPI) inflation (y-o-y)	5.4%	4.5%	Lower commodity prices, base effect, and cooling off domestic demand is likely to help in moderating inflation in FY25. With IMD prediction of above normal monsoon, food inflation is expected to soften. But if crude oil prices surge and stay elevated on account of geopolitical reasons, inflation can increase going forward.
10-year Government security yield (Fiscal end)	7.1%	6.8%	CRISIL MI&A expects the yield to decrease in Fiscal 2025 driven by rate cuts and fiscal consolidation. This, coupled with lower inflation, is likely to moderate yields in FY25. India's inclusion in the JP Morgan Emerging Market Bond Index is favourable for capital flows into government debt.
Fiscal Deficit (% of GDP) *	5.6%	5.1%	Persistent efforts in fiscal consolidation aided by moderation in revenue spend and robust tax collections to bring down the deficit will lead to lower government market borrowings.
CAD (current account balance/GDP) (%)	-0.7%	-1.0%	Softer crude oil prices and moderation in domestic growth will keep the trade deficit in check despite tepid exports of goods. Alongside, robust services trade surplus and healthy remittances will keep the current account deficit (CAD) in check

Rs/$ (March average)	83.0	84.0	Narrower CAD and healthy foreign portfolio flows into debt amid a favourable domestic macro environment will support the rupee

*P – Projected, # As per NSO estimates *FY24 and FY25 numbers are government's revised and budget estimates; Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL MI&A*

Positive government measures to aid economic growth for India

- The Union Budget of 2024-25 announced a 17.1% rise in capital expenditure in FY25 at Rs.11.1 lakh crore from Rs. 9.5 lakh crore in FY24, with infrastructure sectors continuing to get the highest allocation (24.5% of total budgetary capex). In a year where the Indian economy is expected to see a cyclical slowdown owing to global slowdown and impact of interest rates and tightening financial conditions on domestic demand, higher capex would support growth in the economy.
- MSMEs have received special focus, with initiatives such as the new credit guarantee scheme, offering coverage of up to Rs 100 crore per applicant, increases in the limit for the "Tarun" category under Mudra loans from Rs 10 lakhs to Rs 20 lakhs. The Credit Guarantee Fund Scheme for Micro and Small Enterprises (CGMSE) was launched to make available collateral-free credit to the micro and small enterprise sector. Both the existing and the new enterprises are eligible to be covered under the scheme. The Ministry of Micro, Small and Medium Enterprises and Small Industries Development Bank of India (SIDBI), established a Trust named Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to implement the Credit Guarantee Fund Scheme for MSMEs. Moreover, Public Banks have taken steps to develop an in-house technology-based underwriting model to assess MSMEs, which will improve credit facilities for these enterprises.
- Budgetary support towards rural areas through higher allocation under PM Awas Yojana – Rural (up 70.3% on year) and PM Gram Sadak Yojana (up 11.8% on year), aggregate allocation on major rural schemes like Pradhan Mantri Kisan Samman Nidhi (PM KISAN), Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA), PM Gram Sadak Yojana, PM Awas Yojana- Rural to Rs. 2.2 lakh crore, a 12.6% on year increase will support rural employment, income and consumption.

1.6 Key structural reforms: Long-term positives for the Indian economy

- The GST regime has been stabilized which has brought more transparency and formalization, eventually leading to higher economic growth. The number of GST returns filed saw a CAGR of ~6% from FY19 (~169 million) to FY24 (~223 million), with 97.8% (GSTR-1) of filings completed as of July 31, 2024.

- PMAY was introduced in 2015 to provide affordable housing for all by the end of 2022. The timelines were revised to fiscals 2024 and 2025 for PMAY-Gramin and PMAY-Urban respectively due to delays in completion. A total of 2.94 crore houses have been sanctioned and 2.65 crore houses have been completed by Sept 5, 2024, under the scheme. In the Union Budget of fiscal 2025, the government increased the target by 3 crore houses (2 crore for rural & 1 crore for urban) bodes well for those who could not avail the benefits of the scheme till date. It will also facilitate accommodation of growing number of families, particularly in rural areas. Also, the planned allocation of Rs 2.2 lakh crore for PMAY–Urban over the next five fiscals is likely to revive interest in affordable housing, which has lately seen a decline in construction activity, with developers increasingly shifting focus towards the premium and luxury segments in metros, Tier I and II cities, etc.

- The government has also launched the JAM trinity which aims to link Jan Dhan accounts, mobile numbers and Aadhar cards of all Indian nationals to transfer cash benefits directly to the bank account of the intended beneficiary and avoid leakage of government subsidies.

- Government launched the Digital India program, on 1st July 2015 with the vision of transforming India into a digitally empowered society and a knowledge-based economy, by ensuring digital access, digital inclusion, digital empowerment and bridging the digital divide. Some of the key initiatives and related progress under Digital India are as follows-

    - Unified Mobile Application for New-age Governance (UMANG) – for providing government services to citizens through mobile. More than 1,984 e-Services as of March 2024 and over 4 billion transactions have taken place on UMANG as of March 2024.

    - Unified Payment Interface (UPI) is the leading digital payment mechanism, it has onboarded 572+ banks and has facilitated more than 1,31,165 million transactions (by volume) worth Rs 199.9 trillion in FY24.

    - Cyber Security: The Government has taken necessary measures to tackle challenges about data privacy and data security through introducing the Information Technology (IT) Act, 2000 which has necessary provisions for data privacy and data security.

    - Common Services Centers – CSCs are offering government and business services in digital mode in rural areas through Village Level Entrepreneurs (VLEs). Over 400 digital services are being offered by these CSCs. As of March 2024, 0.58 million CSCs are functional (including urban & rural areas) across the country, out of which, 0.47 million CSCs are functional at Gram Panchayat level.

Overall, these initiatives will improve the digital connectivity of Indians along with boosting business sentiment, thereby creating new opportunities.

1.7 Government Measures

Pradhan Mantri Jan Dhan Yojana (PMJDY)

Launched in 2014, Pradhan Mantri Jan Dhan Yojana (PMJDY) is a flagship financial inclusion program of the Government of India. The scheme aims to provide universal access to banking facilities, particularly to the marginalized and underserved sections of society. As of Sept 2024, over 535 million bank accounts have been opened under PMJDY, with a total deposit balance of over ₹2.3 trillion.

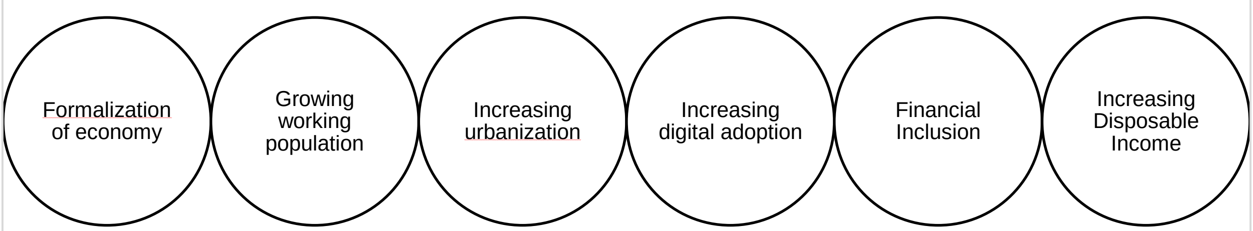
Emergency Credit Line Guarantee Scheme (ECLGS)

Launched in 2020, the Emergency Credit Line Guarantee Scheme (ECLGS) is a collateral-free loan scheme aimed at supporting Micro, Small, and Medium Enterprises (MSMEs) affected by the COVID-19 pandemic. The Finance Ministry introduced the Emergency Credit Line Guarantee Scheme (ECLGS) in May 2020, as a part of the government's COVID-19 financial relief package. Under this scheme, financial institutions provide emergency credit facilities to MSMEs that have suffered due to the pandemic. The scheme aimed at aiding MSMEs to meet their working capital and operational expenditure needs. Banks and NBFCs are directed to offer up to 20% of entire outstanding credit to MSMEs. MSMEs with up to Rs. 250 million outstanding credits and Rs. 1 billion turnover are eligible for these loans.

Housing for all

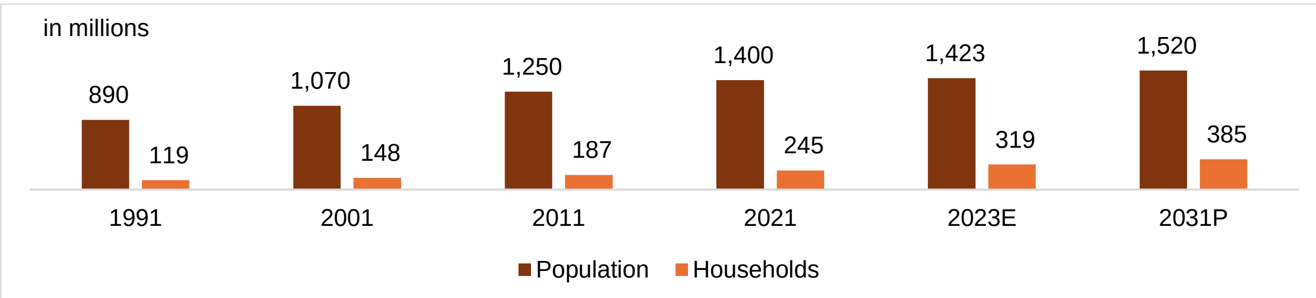
The Pradhan Mantri Awas Yojana – Gramin (PMAY-G) was launched in November 2016 with the aim of providing around 3 crore pucca houses with basic amenities to all eligible houseless households living in kutcha and dilapidated houses in rural areas. Under the scheme, landless beneficiaries are accorded the highest priority in the allotment of houses. A total of 2.94 crore houses have been sanctioned and 2.65 crore houses have been completed by Sept 5, 2024, under the scheme. Other initiatives of the government are towards promoting smoke-free rural homes and rural infrastructure.

1.8 Key growth drivers



Favorable demographics

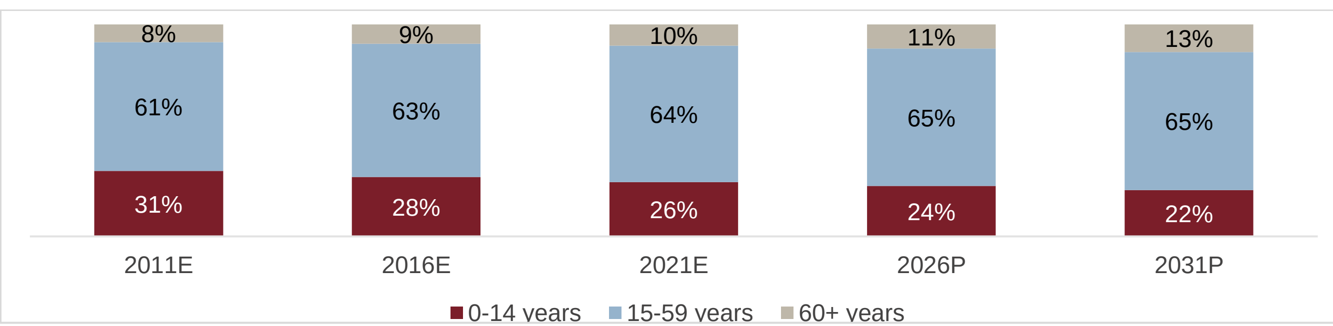
As per Census 2011, India's population was ~1.3 billion and comprised nearly 187 million households. The population, which grew at nearly 1.5% CAGR between 2001 and 2011, is expected by CRISIL MI&A to have increased at 1.1% CAGR between 2011 and 2021 and reached 1.4 billion. The population is expected to reach 1.5 billion by 2031, and the number of households is expected to reach ~385 million over the same period. With the largest population in the world, India stands as one of the largest and most promising market for any industry, offering immense potential for growth & innovation. As of 2024, Share of women in rural area stood at 48.9% as compared to 48.2% in urban areas.



Note: As at the end of each Fiscal. P: Projected, Source: United Nations Department of Economic and Social Affairs, (https://population.un.org/wpp/), Census India, CRISIL MI&A

India has one of the world's largest youth populations, with a median age of 28 years. About 90% of Indians are below 60 years of age. In 2022, it is estimated that India had the highest share of young working population (15-30 years) compared to major developed and developing countries with the share of 27%. CRISIL MI&A expects that the large share of the working population, coupled with rapid urbanization and rising affluence, will propel growth in the economy.

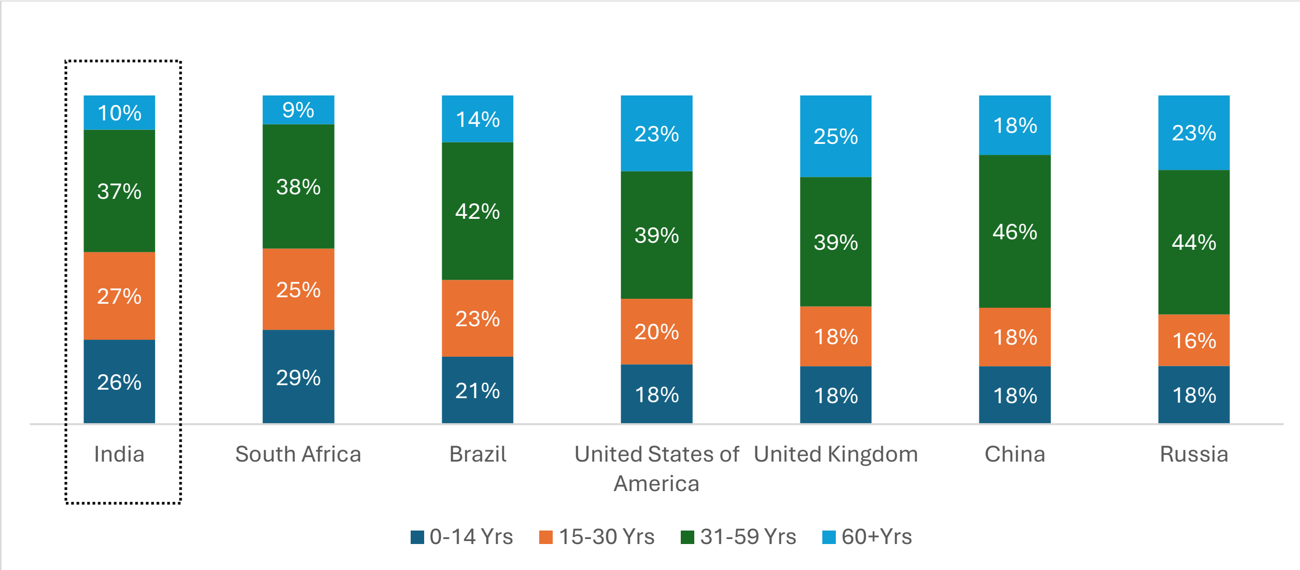
India's demographic division (share of different age groups in population)



Note: P – Projected, E – Estimates

Source: Census of India 2011, Ministry of Health and Family Welfare, CRISIL MI&A

India has the highest share of young population (15-30 years of age) among the major economies



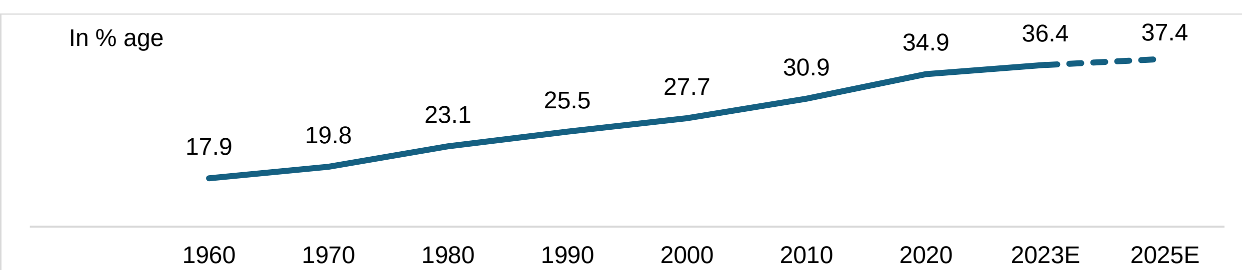
Source: Census 2011, World Urbanization Prospects: The 2018 Revision (UN)

Rising Urbanization

Urbanization is one of India's most important economic growth drivers. It is expected to drive substantial investments in infrastructure development, which in turn is expected to create jobs, develop modern consumer services, and increase the ability to mobilize savings. India's urban population has been rising consistently over the decades, witnessing a CAGR of ~1.3% from 2000 to 2023. As per the 2018 revision of World Urbanization Prospects, the urban population was estimated at 36% of India's total population in 2023. According to the World Urbanization Prospects, the percentage of the population residing in urban areas in India is expected to increase to 37.4% by 2025.

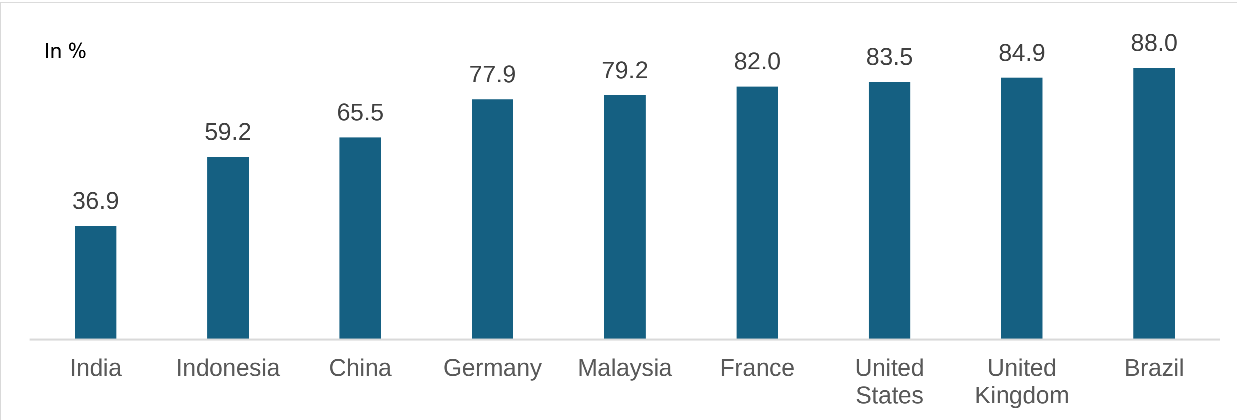
- Urban areas often provide better access to essential services such as healthcare, education, and social amenities, leasing to an enhanced standard of living that attracts rural population.
- The growth of industries and the services sector in urban areas contributes to higher income levels and job creation. Also, with cities acting as hubs for international trade and foreign investment, urban areas are seeing rapid expansion.

Urban population as a percentage of total population in India (%)



Note: E- Estimated, P – Projected, Source: Census 2011, World Urbanization Prospects: The 2018 Revision (UN)

Comparison of urban population as a percentage of total population in India with other major global economies (2024E)



Note: E: Estimated; Source: United Nations World Urbanization Prospects: The 2018 Revision (UN)

Rural & Semi-Urban Population aspire for recognition and equal opportunities for growth

Rural and semi-urban areas continue to dominate India's population, with approximately over 63% of the country's people residing in these regions. Despite being the majority, these populations historically faced barriers to accessing formal financial services, particularly credit, which stifled their ability to pursue economic growth and entrepreneurial ventures. However, as these communities increasingly aspire for recognition and equal opportunities for advancement, there is a growing demand for financial inclusion and access to resources that can help them realize their economic potential. NBFCs have played a pivotal role in addressing these needs by offering tailored credit facilities that empower individuals and small businesses in rural and semi-urban areas to build and scale their enterprises. NBFCs provide more flexible loan products, quicker disbursals, and easier documentation requirements compared to traditional banks. Using technology and microfinance models, NBFCs help small-scale entrepreneurs, farmers, and artisans invest in their businesses, enhancing productivity and enabling them to participate more fully in the economy. By incorporating local knowledge and fostering financial literacy, NBFCs ensure that rural and semi-urban populations not only gain access to credit but also utilize it effectively to achieve their aspirations for growth and recognition in society.

Increasing per capita GDP

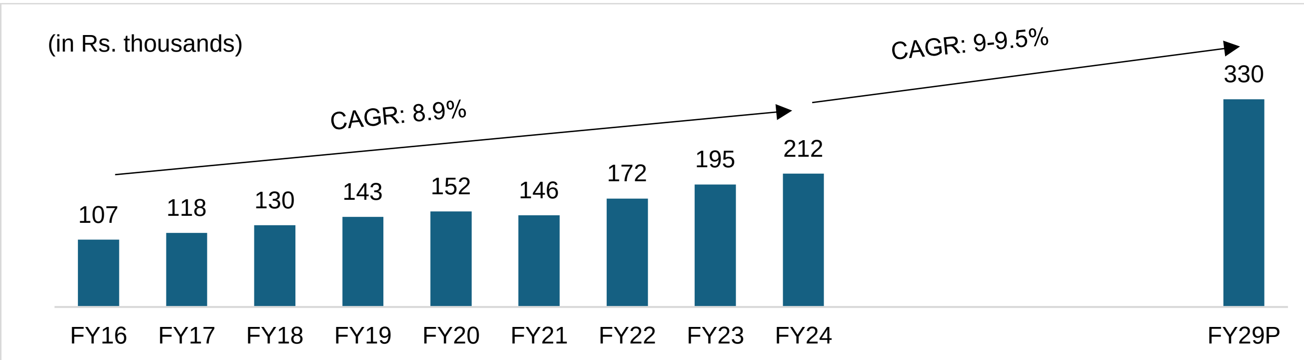
India's per capita net national income at constant price expanded 7.4% in fiscal 2024 to reach ~Rs 1,07,000, reflecting robust economic growth and the government's continued endeavour to make the country an upper middle-income economy. As per IMF estimates, India's per capita income (at constant prices) is expected to grow at 5-6% CAGR in real terms from FY25 to FY27.

Per capita NNI	FY2024 (Rs. '000)		Growth of Real GDP Per Capita at constant prices (%)										
	Current prices	Constant prices	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
	184	107	4.6	6.2	6.7	6.9	5.5	5.2	2.5	-8.9	7.6	5.7	7.4

Note: P – projected. (^) Per capita NNI as per Provisional Estimates of Annual GDP, 2023-24

Source: Ministry of Statistics and Program Implementation (MoSPI), International Monetary Fund (IMF), CRISIL MI&A

Trend in nominal GDP per capita at current prices



Note: P - Projected. FY24 estimates are based on provisional estimates by MoSPI; FY29 projections are based on IMF – World Economic Outlook (April 2024 update)

Source: MOSPI, IMF, CRISIL MI&A

Trend in state-wise per capita GSDP at current prices (in Rs. '000s)

State	FY19	FY20	FY21	FY22	FY23	FY24	CAGR FY19-FY24
Sikkim	430.3	471.4	490.6	553.7	622.1	707.2	10.4%
Goa	467.8	485.6	476.9	519.7	567.3	-	4.9%*
Delhi	375.7	395.8	364.6	423.7	478.7	513.1	6.4%
Chandigarh	342.2	365.8	327.9	379.0	448.5	-	7.0%*
Telangana	231.2	254.4	250.8	297.3	345.2	393.4	11.2%
Karnataka	225.6	244.4	246.4	294.8	336.2	368.1	10.3%
Haryana	247.8	258.0	251.3	295.3	329.8	362.0	7.9%
Tamil Nadu	215.8	229.7	234.5	270.8	311.8	353.5	10.4%
Gujarat	223.4	239.0	232.9	273.3	309.7	-	8.5%*
Andaman Nicobar	227.4	245.4	232.8	259.2	290.3	-	6.3%*
Maharashtra	207.8	216.3	210.6	251.5	289.4	318.6	8.9%

Kerala	227.4	233.3	220.4	259.9	286.6	317.7	6.9%
Puducherry	224.2	240.4	232.4	256.8	274.2	287.4	5.1%
Uttarakhand	207.7	213.3	198.9	232.9	262.2	295.8	7.3%
Himachal Pradesh	203.8	217.2	205.6	232.2	257.2	276.9	6.3%
Mizoram	184.8	208.6	197.7	218.6	248.9	-	7.7%*
Andhra Pradesh	170.2	179.3	188.4	219.8	245.6	270.3	9.7%
Arunachal Pradesh	169.4	198.7	200.0	212.4	225.8	-	7.5%*
Punjab	167.4	173.1	172.1	197.2	211.2	228.0	6.4%
Tripura	125.4	135.0	132.1	152.3	175.3	198.4	9.6%
Rajasthan	118.6	128.5	129.1	149.8	168.3	187.5	9.6%
Nagaland	123.7	137.5	136.1	145.8	166.4	-	7.7%*
Odisha	111.1	118.9	118.6	152.0	164.6	183.8	10.6%
Jammu & Kashmir	118.8	123.7	125.5	140.0	162.4	176.5	8.2%
West Bengal	114.0	121.2	116.7	135.1	154.9	171.2	8.5%
Chhatisgarh	113.4	119.1	120.1	138.3	154.6	166.5	8.0%
Madhya Pradesh	101.5	111.9	112.6	128.4	144.7	156.4	9.0%
Meghalaya	99.3	106.3	102.3	120.7	138.4	156.3	9.5%
Assam	90.6	100.5	97.4	116.6	134.6	158.8	11.9%
Manipur	81.4	86.7	84.7	110.2	125.4	-	11.4%*
Jharkhand	82.2	82.3	77.6	97.0	106.3	116.0	7.1%
Uttar Pradesh	70.6	74.7	71.4	85.3	97.3	107.5	8.8%
Bihar	44.5	48.3	46.4	52.1	59.2	66.8	8.5%

*Note: States are arranged in decreasing order as per capita for FY23, * - CAGR for FY19-23, FY24 data not available for Goa, Chandigarh, Gujarat, Andaman Nicobar, Mizoram, Arunachal Pradesh, Nagaland & Manipur*

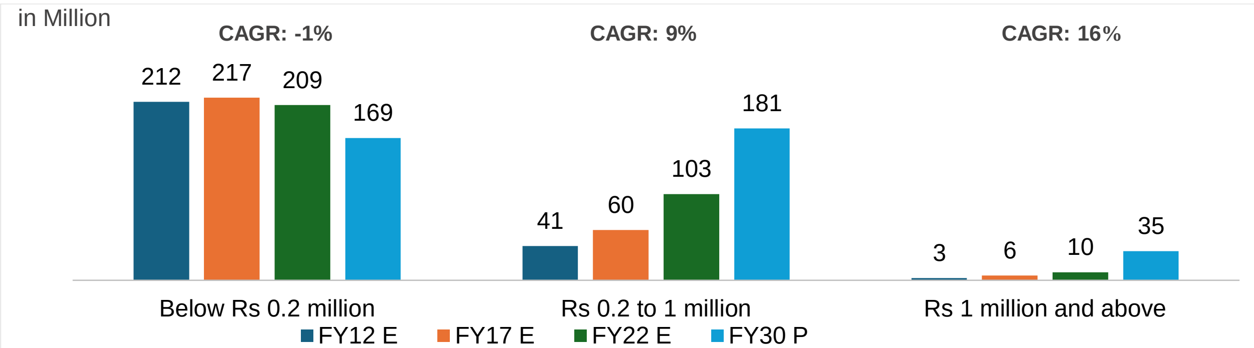
Source: MOSPI, CRISIL MI&A

Rising Middle India population to help sustain economic growth

The proportion of "Middle India" (defined as households with annual income of Rs 0.2-1.0 million) has been on the rise over the past decade and is expected to continue increasing with rising GDP and household incomes. CRISIL MI&A estimates there were 41 million middle-income households in India in fiscal 2012 and by fiscal 2030, expects it to increase to 181 million households. A large number of households that have entered the middle-income bracket in the past few years are likely to be from semi-urban and rural areas. CRISIL MI&A believes that improvement in literacy levels, increasing access to information increase in the availability of necessities and improvement in road infrastructure have increased the aspirations of

Middle India, which is likely to translate into increased demand for financial products and opportunities for providers of financial services.

Middle India households to witness high growth over fiscals 2012-2030

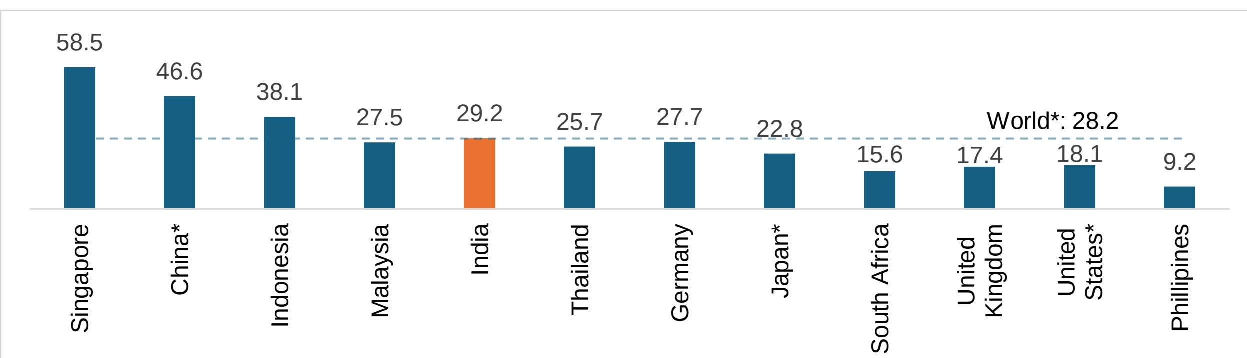


Note: E: Estimated, P: Projected; Source: CRISIL MI&A

Household savings expected to increase

In 2023, India's gross domestic savings as a percentage of GDP rose to 29.2%, reflecting an upward trend from 2022 when it reached 28.4%, highlighting the economy's recovery and improved income levels. However, in 2020, this percentage had declined to 27.3% due to the economic disruptions caused by the pandemic. India remains favorable in terms of gross domestic savings rate compared with most other emerging market peers at 29% in 2023, greater than the world average of 28% in 2022.

India's gross domestic savings rate is higher than global average (2023)

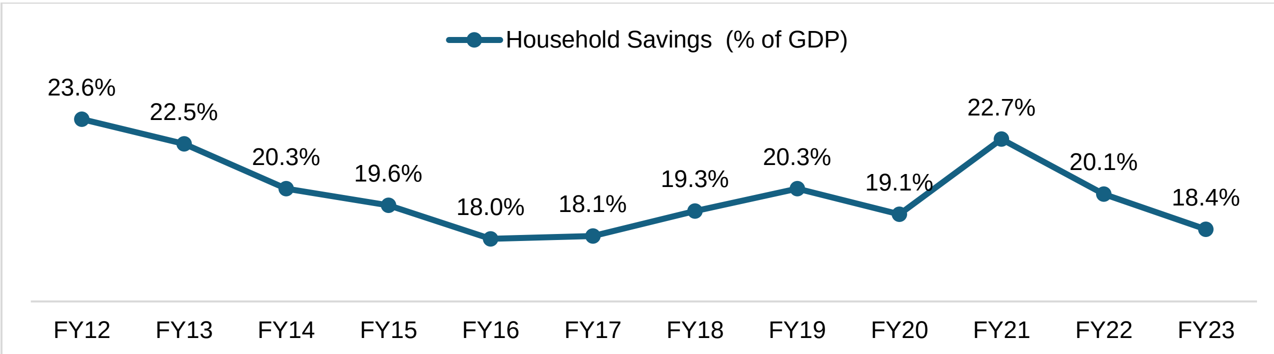


*Note: The savings rate is in %, *Data as of 2022.*

Source: World Bank, CRISIL MI&A

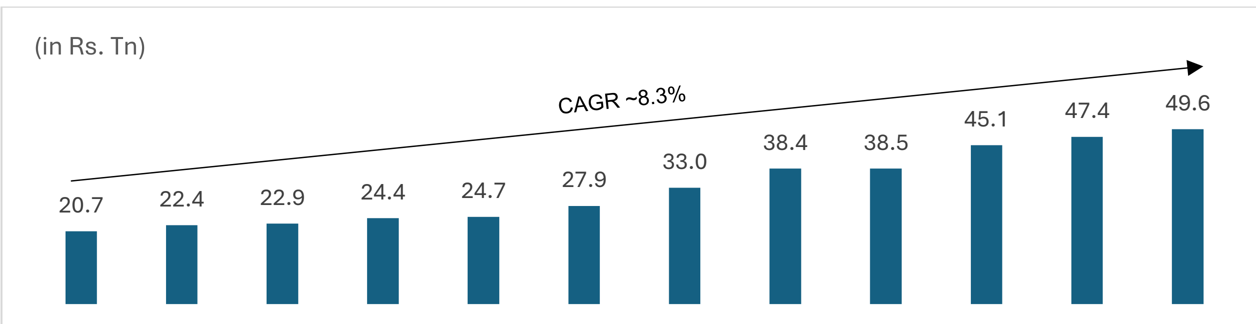
Household savings (% of GDP) increased from 19.1% in FY20 to 22.7% in FY21 during the pandemic. However, there has been a decline in household savings which moderated in FY22 (20.1%) and FY23 (18.4%). The decline may be attributed to households borrowing at a faster pace than they have been saving since the Covid pandemic, significant retail credit push by lenders, an increased willingness among individuals, particularly the younger demographic, to borrow, and enhanced access to lenders facilitated by technological advancement. CRISIL MI&A expects India to continue being a high savings economy owing to higher gross domestic savings rate as compared to world average.

Household savings as a percentage of GDP moderated in FY22 and FY23



Source: Ministry of Statistics and Programme Implementation (MOSPI), NSO, CRISIL MI&A

Household savings growth



Note: The data is for the financial year ending March 31.

Source: MOSPI, CRISIL MI&A

CRISIL MI&A expects India to continue being a high savings economy and savings rate increasing in the medium-term, as households become more focused on building a budget and financial plan for the future post the COVID-19 pandemic-induced uncertainty.

Gross domestic savings trend

Parameters (Rs. Billion)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
GDS	36,082	40,200	42,823	48,251	54,807	60,004	59,411	57,869	73,631	81,500
Household sector savings (net financial savings, savings in physical assets and in the form of gold and silver ornaments)	22,853	24,391	24,749	27,871	32,966	38,446	38,452	45,056	47,423	49,632
Household sector savings as proportion of GDS (%)	63%	61%	58%	58%	60%	64%	65%	78%	64%	61%
Gross financial savings	11,908	12,572	14,962	16,147	20,564	22,637	23,246	30,670	26,120	29,736

Gross financial savings (% of GDS)	33.0%	31.3%	34.9%	33.5%	37.5%	37.7%	39.1%	53.0%	35.5%	36.5%
Financial liabilities	3,587	3,768	3,854	4,686	7,507	7,712	7,747	7,374	8,993	15,572
Savings in physical assets	14,164	15,131	13,176	15,946	19,442	23,095	22,522	21,355	29,683	34,834
Savings in physical assets as a proportion of GDS (%)	39%	38%	31%	33%	35%	38%	38%	37%	40%	43%
Savings in the form of gold and silver ornaments	368	456	465	465	467	427	431	405	613	634
Savings in the form of gold and silver ornaments as a proportion of GDS (%)	1.0%	1.1%	1.0%	0.9%	0.8%	0.7%	0.7%	0.7%	0.8%	0.8%

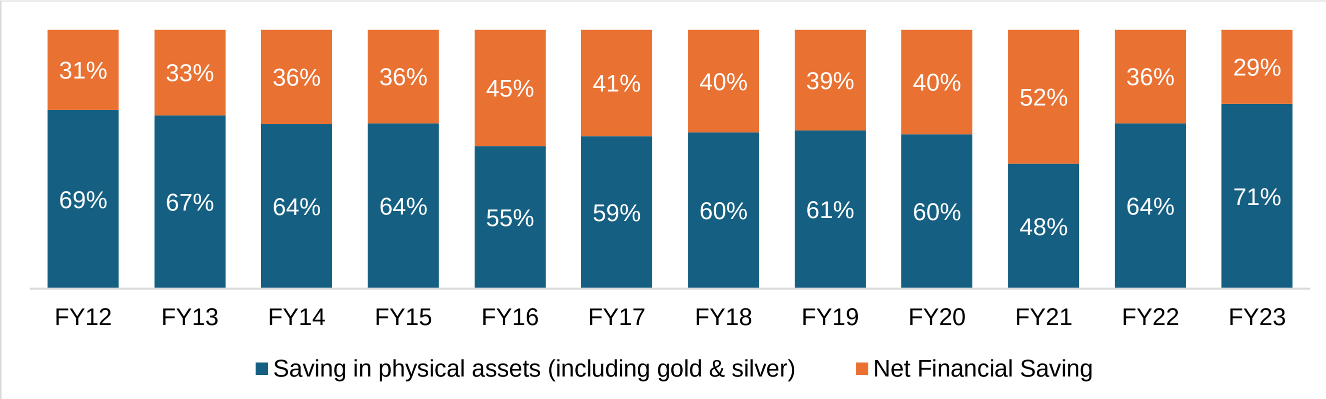
Note: The data is for financial year ending March 31. Physical assets are those held in physical form, such as real estate, etc.

Source: MOSPI, National Accounts Statistics, CRISIL MI&A

Unlike most other countries, where financial savings account for a significant proportion of savings, physical assets in the form or real estate, gold and silver still account for most household savings in India. Household savings in physical assets witnessed an increase to 70% in FY23 from 69% in FY12. The share of savings in physical assets dipped during FY21 (covid pandemic year) to 48% due to nation-wide lockdowns and slowdown in household construction. Post covid, during FY22 with opening of lockdown's this share increased significantly to 64% and further to 70% in FY23, due to increase in prices of gold and silver during the fiscals along with rise in construction of houses.

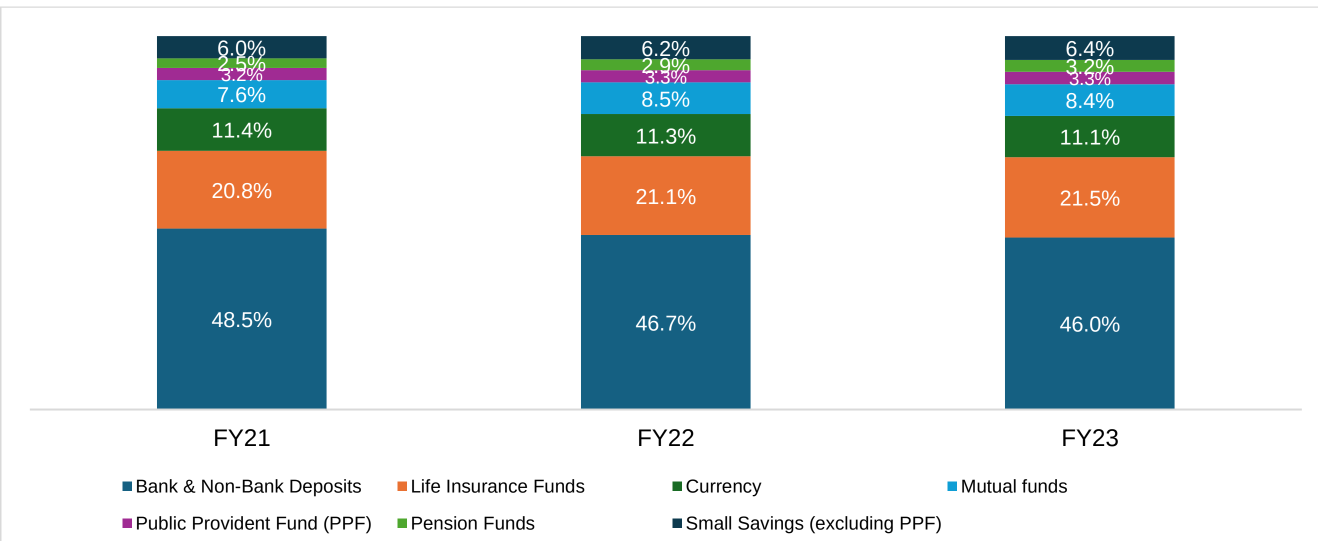
Going forward, CRISIL MI&A expects the share of financial assets as a proportion of net household savings to increase over the next five years as elevated inflation after the pandemic could have further goaded investors to move to higher-yielding instruments in real terms. Interestingly, households are also preferring to keep more cash with themselves after enduring the pandemic shock. Mutual fund investments by households have grown at a faster rate compared with the recent past. Investments through systematic investment plans (SIPs), mostly opted by individuals in the country, continued to rise in fiscal 2024. For households, among financial instruments, there is gravitation from savings in deposits to equities, mutual funds and small savings. Retail participation increased, with average monthly inflows into mutual funds through the SIP route increasing from approximately Rs 77.2 billion in fiscal 2019 to approximately Rs 166.0 billion in fiscal 2024.

Trend of household savings in India



Note: The data is for financial year ending March 31, Source: Handbook of Statistics on Indian Economy 2022-23, RBI, MOSPI, CRISIL MI&A

Trend in constituent of financial savings in India



Note: FY24 data not available

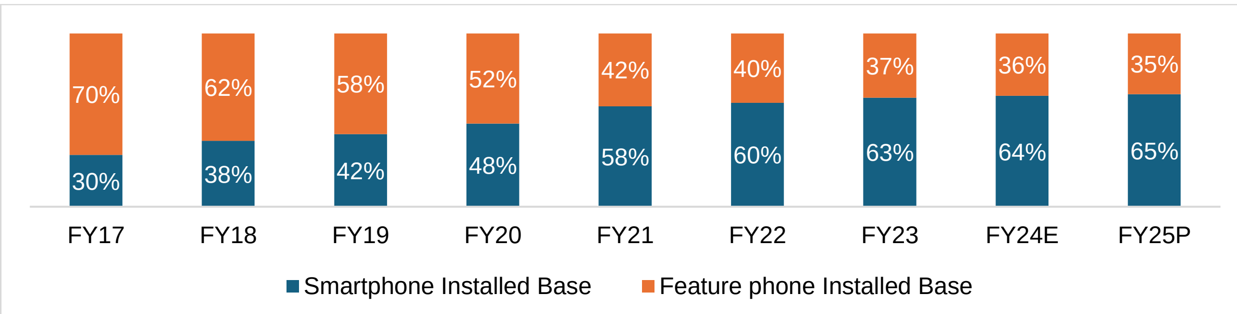
Source: RBI, CRISIL MI&A

In recent years, there has been a shift from physical assets like gold, real estate, and other tangible assets to financial assets like bank deposits, mutual funds, and insurance products. 46% of the savings in FY23 still continue to be invested in banks and non-banks deposits. Mutual funds have gained popularity in recent years, with 8.4% of the savings being invested in mutual funds (FY23) driven by the growth of the equity market and increasing awareness of the benefits of mutual funds. With increasing life expectancy and a growing awareness about the importance of retirement planning, there has been a growing focus on retirement savings products, such as the National Pension System (NPS) and pension plans offered by insurance companies.11.1% of the savings in FY23 were invested in Pension Funds and 3.3% of the savings in FY23 were invested in Public Provident Fund.

Digitisation aided by technology to play pivotal role in growth of economy

Technology is expected to play an important role by progressively reducing the cost of reaching out to smaller markets. India has seen a tremendous rise in fintech adoption in the past few years. Among many initiatives by the government, the Unified Payments Interface (UPI) is playing a pivotal role towards financial inclusion. It provides a single-click digital interface across all system for smartphones linked to bank accounts and facilitates easy transactions using a simple authentication method. The volume of digital financial transactions has increased from 43.7 billion in FY21 to 164.4 billion, in FY24 growing at a CAGR of ~56%. driven by increased adoption of UPI. Apart from financial services industry, digitisation in other industries like retail will also play an important role in growth of economy.

Data-savvy and younger users to drive adoption of smartphones



Note: E: Estimated, P: Projected; Source: CRISIL MI&A

Rise in 4G and 5G penetration and smartphone usage

India had 1,165 million wireless subscribers at the end of FY24. The reach of mobile network, internet and electricity is continuously expanding the subscriber footprint to remote areas leading to rising smartphone and internet penetration in India. In FY23, 5G was launched which led to conversion of 25 million subscribers to 5G. This shift was facilitated by offering 5G services at the price of 4G data plans, coupled with a surge in data demand and the accessibility of affordable handsets. In FY25, CRISIL MI&A expects 5G subscribers to reach 150 million since data consumption will increase due to high usage on OTT platforms, in education services, banking services, healthcare, and the gaming industry.

All-India mobile and data subscriber base

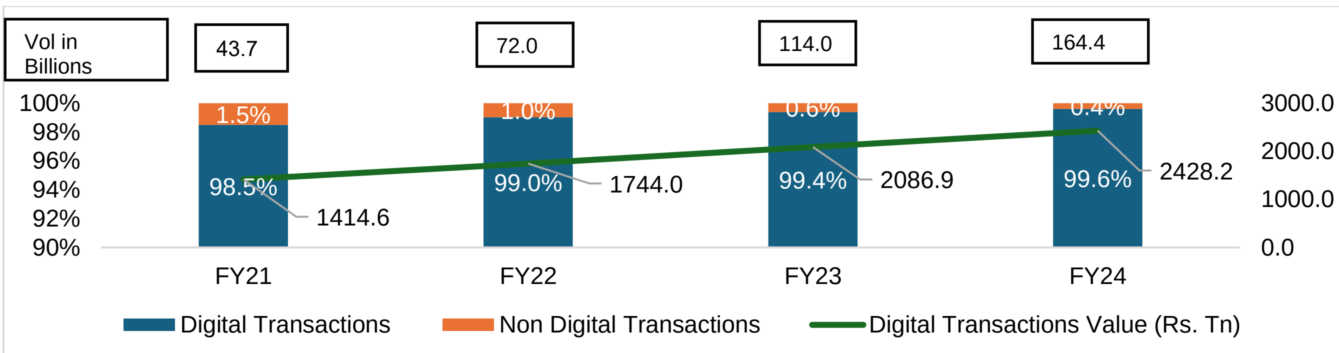
	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25P
Wireless subscribers (million)	1,170	1,183	1,162	1,157	1,181	1,142	1,144	1,165	1,177-1,183
Data subscribers (million)	401	473	615	720	799	814	883	956	989-1,006
Data subscribers as a proportion of wireless subscribers	34%	40%	53%	62%	68%	71%	77%	82%	84%-85%
4G data subscribers (million)	131	287	478	635	719	734	786	707	660-670
4G data subscribers' proportion	33%	61%	78%	88%	90%	90%	89%	74%	~67%
5G data subscribers (million)	-	-	-	-	-	-	25	175	270-280

Note: P – Projected, Source: TRAI, CRISIL MI&A

Digital payments have witnessed substantial growth

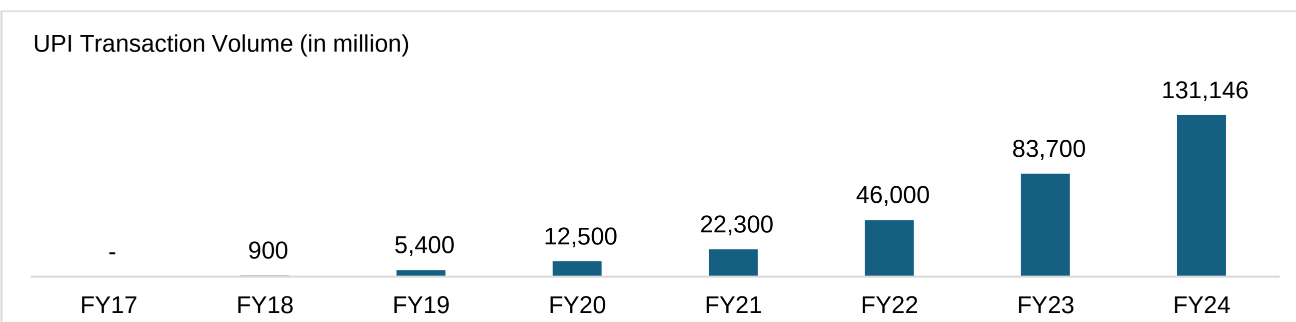
Higher mobile penetration, improved connectivity, and faster and cheaper data supported by Aadhaar and bank account penetration have led India to shift from being a cash-dominated economy to a digital one. Total digital payments in India have witnessed significant growth over the past few years. Between FY21 and FY24, the volume of digital payments transactions has increased from 43.7 billion to 164.4 billion, growing at a CAGR of ~56%. During the same period, the value of digital transactions has increased from Rs. 1,414.6 trillion in FY21 to Rs 2,428.2 trillion in FY24. Consumers are increasingly finding transacting through mobile convenient. CRISIL MI&A expects the share of mobile banking to increase dramatically over the coming years. In addition, CRISIL MI&A expects improved data connectivity, low digital payment penetration and proactive government measures to drive digitalization in the country.

Trend in value and volume of digital payments



Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments; Source: RBI, CRISIL MI&A

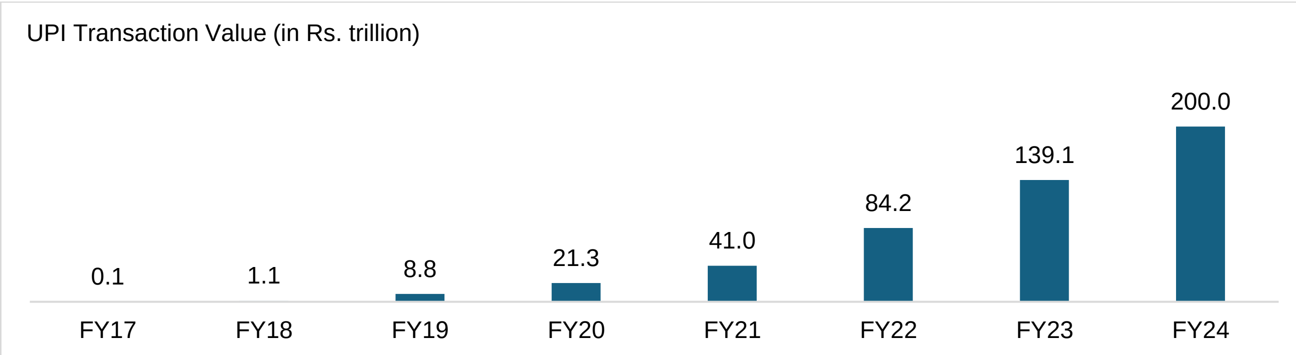
UPI transactions volumes zoomed between FY17 and FY24



Source: RBI, CRISIL MI&A

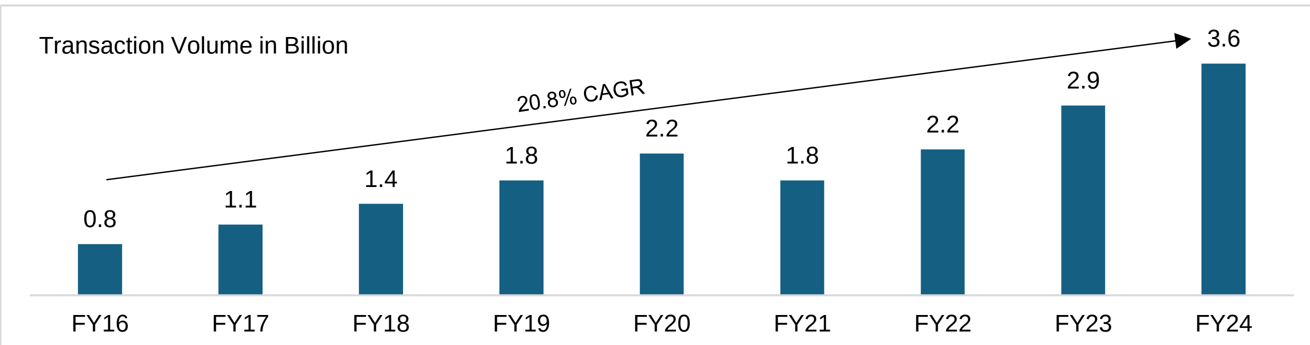
Unified Payments Interface (UPI) is a system that powers multiple bank accounts into a single mobile application (of any participating bank), merging several banking features, seamless fund routing & merchant payments into one hood. As of September 2024, there are 622 Banks live on UPI and UPI transactions volume has been increasing year on year with transactions volume amounting to 131,146 million in FY24. UPI transaction value has reached Rs 200 trillion in FY24.

UPI transactions value continue to rise with surge in volumes



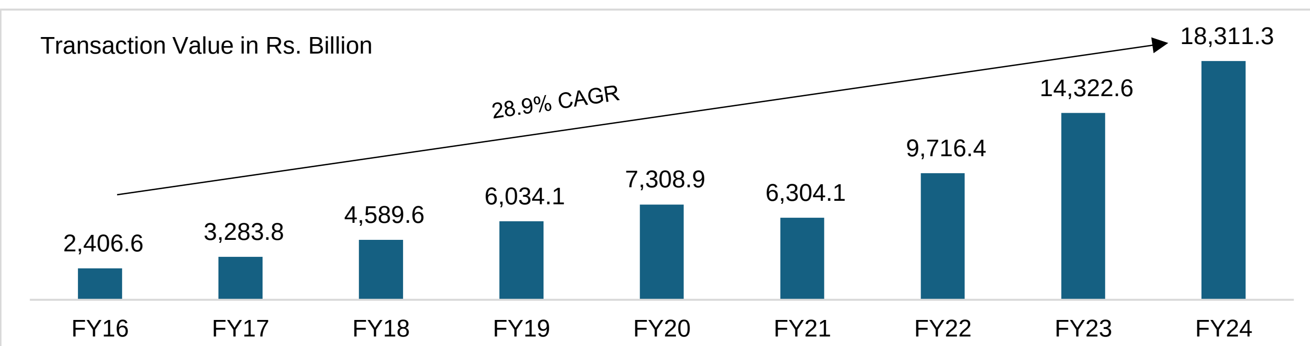
Source: RBI, NPCI, CRISIL MI&A

Volume of Credit Card Transactions from FY16 to FY24



Source; RBI payment system indicator, CRISIL MI&A

Value of Credit Card Transactions from FY16 to FY24



Source; RBI payment system indicator, CRISIL MI&A

Credit cards have emerged as a popular financial tool in India driven by increasing urbanization, digitalization and a rising middle class. Increasing smartphone penetration and UPI integration have boosted cashless transactions, encouraging consumers to explore credit-based spending. The volume of credit card transactions has grown at a CAGR of 20.8% from the period FY16 to FY24. The value of credit card transactions has also seen a growth of 28.9% for the same period FY16 to FY24.

Digital Public infrastructure reforms by Government of India

Digitization improves the transparency and efficiency of government processes, and widespread digital transformations help governments and institutions with policy implementation and broad policy outreach. The key idea for Digital Public Infrastructure (DPI) is not the complete digitization of narrow public services but the establishment of a building block of digital modularity, which can be used modularly by both government and private players to create the specific digital infrastructure required. The India Stack is a collective name for a set of open APIs and public goods in digital form like DigiLocker, UPI, e-sign etc.

Open Credit Enablement Network (OCEN)

Open Credit Enablement Network (OCEN) was introduced as a step for promoting financial inclusion and democratization of credit in India. OCEN is set of open standards which facilitates interactions and collaborations among borrowers, lenders, lending service providers, and technology service providers. This will help various digital platforms in leveraging their position in delivery of credit and value addition in lending value chain. Moreover, OCEN will also promote innovation in distribution of credit, making loans accessible to MSMEs, small vendors and individuals, leading to financial inclusion.

Account Aggregators

The RBI launched the account aggregator system on September 2, 2021, which has the potential to transform the MSME finance space once there is widespread adoption amongst the lending community. These account aggregators would provide granular insights to lenders into customers' financial assets and their borrowing history centrally, based on customer consent. Inclusion of additional data such as electricity bill payments and mobile recharges/bill payment data under the purview of account aggregators would further enhance its utility.

BBPS (Bharat Bill Payment System)

BBPS is a unified bill payment system introduced by the Reserve Bank of India (RBI) to facilitate bill payments across various categories. It is a centralized system that enables customers to pay their bills anytime, anywhere, using various payment modes. BBPS is designed to provide a seamless and efficient bill payment experience to customers, while also reducing the complexity and costs associated with bill payments. For the year 2023-24, there were a total transactions volume of 1,063.76 million and value worth 2,360,380 million. For the year 2025 till the end of Quarter 3, there were 66,078 billers with a total transactions volume of 1323.07 million and value worth Rs 4,669,360 million.

ACH (Automated Clearing House)

ACH is an electronic payment system that enables the transfer of funds between banks. It is a batch processing system that allows for the exchange of payment instructions between banks, facilitating the transfer of funds between accounts. ACH is widely used for various types of transactions, including bill payments, salary payments, and vendor payments.

Revenues from Goods and Services Tax ("GST") collection among Indian states

Maharashtra recorded highest revenues collected from GST at Rs 3,201.2 billion among Indian states during fiscal 2024 and Rs 2,703.5 billion during fiscal 2023. It is followed by Karnataka (Rs 1,452.7 billion in fiscal 2024 and Rs 1,228.2 billion in fiscal 2023) and Gujarat (Rs 1,251.7 billion in fiscal 2024 and Rs 1,142.2 billion in fiscal 2023).

In Fiscal 2024, Maharashtra, Karnataka, and Gujarat were the top three states with the highest GST revenue collection

GST Revenues across states

State/UT	FY23 (Rs in billion)	FY24 (Rs in billion)	Share in FY23 (%)	Share in FY24 (%)
Maharashtra	2,703.5	3,201.2	20.4%	21.0%
Karnataka	1,228.2	1,452.7	9.3%	9.5%
Gujarat	1,142.2	1,251.7	8.6%	8.2%
Tamil Nadu	1,043.8	1,213.3	7.9%	8.0%
Haryana	866.7	1,029.1	6.5%	6.8%
Uttar Pradesh	879.7	1,016.9	6.6%	6.7%
Delhi	558.4	664.5	4.2%	4.4%
West Bengal	580.6	626.1	4.4%	4.1%
Telangana	518.3	599.4	3.9%	3.9%
Odisha	494.4	547.5	3.7%	3.6%
Rajasthan	454.6	501.7	3.4%	3.3%
Andhra Pradesh	402.3	443.0	3.0%	2.9%
Madhya Pradesh	362.3	421.7	2.7%	2.8%
Chhattisgarh	319.7	348.7	2.4%	2.3%
Jharkhand	320.2	347.4	2.4%	2.3%
Kerala	273.7	306.8	2.1%	2.0%
Punjab	209.5	240.6	1.6%	1.6%
Uttarakhand	168.5	192.3	1.3%	1.3%
Bihar	165.5	180.2	1.2%	1.2%
Assam	137.1	156.0	1.0%	1.0%

Himachal Pradesh	87.8	99.6	0.7%	0.7%
Jammu and Kashmir	52.5	67.0	0.4%	0.4%
Goa	55.2	64.8	0.4%	0.4%
Dadra and Nagar Haveli	37.7	43.3	0.3%	0.3%
Sikkim	31.6	37.1	0.2%	0.2%
Chandigarh	23.7	27.7	0.2%	0.2%
Puducherry	23.7	26.4	0.2%	0.2%
Other Territory	26.1	26.2	0.2%	0.2%
CBIC	19.4	25.1	0.1%	0.2%
Meghalaya	20.8	22.6	0.2%	0.1%
Arunachal Pradesh	10.2	13.1	0.1%	0.1%
Tripura	8.8	10.5	0.1%	0.1%
Nagaland	5.7	7.1	0.0%	0.0%
Manipur	6.2	6.7	0.0%	0.0%
Mizoram	4.2	5.0	0.0%	0.0%
Ladakh	3.3	4.8	0.0%	0.0%
Andaman and Nicobar Island	3.7	4.3	0.0%	0.0%
Lakshadweep	0.2	0.5	0.0%	0.0%
Daman and Diu	0.0	0.0	0.0%	0.0%
Grand Total	**13,249.8**	**15,232.5**	**100.0%**	**100.0%**

Source: Ministry of Finance, GST Portal, CRISIL MI&A

State Wise MSME Units

State/UT Name	Total Udyam	Micro	Small	Medium
MAHARASHTRA	4,867,851	4,750,224	105,396	12,231
TAMIL NADU	2,924,286	2,859,756	59,238	5,292
UTTAR PRADESH	2,857,941	2,791,863	61,326	4,752
RAJASTHAN	2,127,134	2,081,579	42,162	3,393
GUJARAT	2,083,180	1,992,220	82,468	8,492
KARNATAKA	1,701,504	1,651,413	45,745	4,346
MADHYA PRADESH	1,447,182	1,415,445	29,492	2,245
WEST BENGAL	1,263,178	1,224,188	35,739	3,251
BIHAR	1,220,364	1,200,403	18,947	1,014
PUNJAB	1,136,732	1,107,346	26,935	2,451
TELANGANA	1,052,770	1,022,213	27,463	3,094

ANDHRA PRADESH	994,276	967,926	24,395	1,955
HARYANA	960,735	923,396	34,044	3,295
ODISHA	906,967	891,254	14,626	1,087
DELHI	719,550	673,966	40,613	4,971
KERALA	704,762	684,507	18,800	1,455
ASSAM	584,873	574,441	9,671	761
JHARKHAND	506,906	497,423	8,828	655
JAMMU AND KASHMIR	449,833	444,330	5,154	349
CHHATTISGARH	428,244	415,119	11,855	1,270
UTTARAKHAND	292,089	285,303	6,245	541
HIMACHAL PRADESH	179,395	175,085	3,867	443
MANIPUR	78,278	77,581	659	38
TRIPURA	67,226	66,184	971	71
GOA	60,020	58,180	1,687	153
CHANDIGARH	45,238	43,074	1,960	204
PUDUCHERRY	42,829	41,760	943	126
NAGALAND	27,459	27,206	236	17
MEGHALAYA	26,389	25,838	490	61
MIZORAM	26,246	26,034	202	10
THE DADRA AND NAGAR HAVELI AND DAMAN AND DIU	21,004	19,492	1,275	237
ARUNACHAL PRADESH	15,264	14,851	378	35
ANDAMAN AND NICOBAR ISLANDS	13,688	13,402	272	14
SIKKIM	12,169	11,963	188	18
LADAKH	11,455	11,310	141	4
LAKSHADWEEP	1,041	1,040	1	0

Source: Udyam - MSME Dashboard, CRISIL MI&A (Data is as of 7th October 2024)

State Wise number of Pin codes

State	Number of pin codes
TAMIL NADU	2,036
UTTAR PRADESH	1,652
MAHARASHTRA	1,585

KERALA	1,425
KARNATAKA	1,347
ANDHRA PRADESH	1,228
WEST BENGAL	1,128
GUJARAT	1,007
RAJASTHAN	1,004
ODISHA	935
BIHAR	857
MADHYA PRADESH	770
TELANGANA	674
ASSAM	572
PUNJAB	534
HIMACHAL PRADESH	436
JHARKHAND	380
HARYANA	315
UTTARAKHAND	300
CHHATTISGARH	274
JAMMU AND KASHMIR	196
DELHI	97
GOA	88
TRIPURA	80
MEGHALAYA	68
MANIPUR	52
ARUNACHAL PRADESH	49
MIZORAM	47
NAGALAND	43
CHANDIGARH	25
ANDAMAN AND NICOBAR ISLANDS	22
PUDUCHERRY	22
SIKKIM	19
LADAKH	16
LAKSHADWEEP	9
THE DADRA AND NAGAR HAVELI AND DAMAN AND DIU	8
Total	**19,300**

Source: All India Pin Code Directory (Data as on 16th October 2024), CRISIL MI&A

2. Financial Inclusion

2.1 Financial penetration to rise with increase in awareness of financial products

Overall literacy in India is at 77.7% as per the results of NSO survey conducted from July 2017 to June 2018, which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as a combination of awareness, knowledge, skill, attitude, and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.

With increasing financial literacy, the demand for financial products, especially in smaller cities, has seen a major uptick in recent years. Going forward, CRISIL MI&A expects financial penetration to increase on account of increasing financial literacy.

Financial Inclusion on a fast path in India

According to the World Bank's Global Findex Database 2021, the global average percentage of adult population with an account opened with a bank, financial institution or mobile money provider, was approximately 78% in calendar year 2021. India's financial inclusion has improved significantly over calendar years 2014 to 2021 as adult population with bank accounts increased from 53% to 78% (Source: Global Findex Database) due to the Indian government's efforts to promote financial inclusion and the proliferation of supporting institutions.

Financial inclusion index

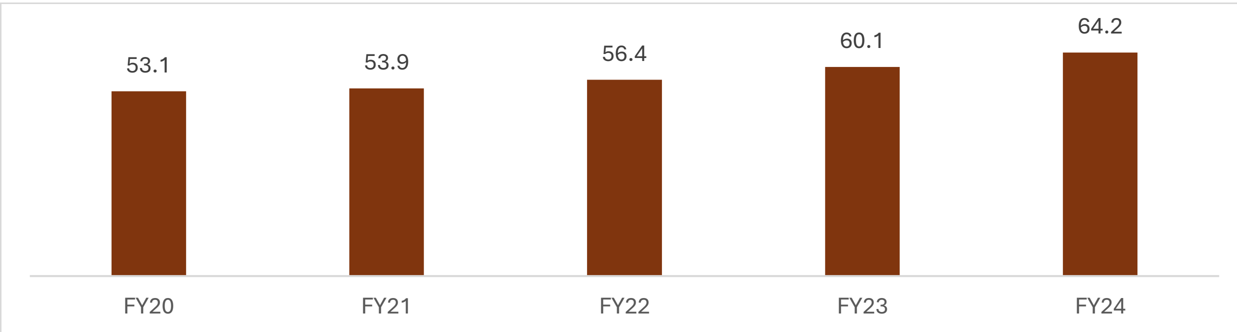
The RBI has constructed a composite financial inclusion index (FI-Index) to capture the extent of financial inclusion across the country. The FI-Index has been conceptualized as a comprehensive index incorporating details of banking, investments, insurance, postal and pension sector. The index captures information on various aspects of financial inclusion in a single value ranging between 0 to 100 where 0 represents complete financial exclusion and 100 indicates full financial inclusion.

The FI-Index comprises of three broad parameters – Access (35%), Usage (45%) and Quality (20%) with each of these consisting of various dimensions which are computed based on number of indicators.

The Index is responsive to ease of access, availability and usage of services, and quality of services, comprising in all 97 indicators. A unique feature of the Index is the Quality parameter which captures the quality aspect of financial inclusion as reflected by financial literacy, consumer protection, and inequalities and deficiencies in services.

The FI-Index has been constructed without any 'base year' and as such it reflects cumulative efforts of all stakeholders over the years towards financial inclusion. The value of FI Index for FY24 stands at 64.2 as against 60.1 in FY23, with growth witnessed across all the sub-indices.

Financial inclusion has improved over the years



Source: RBI, CRISIL MI&A Research

2.2 Role of NBFCs to achieve Financial Inclusion

While MFIs and SFBs are essential pillars of financial inclusion, NBFCs fill a critical gap by providing comprehensive financial products, catering to niche sectors like MSMEs, and extending services to the last mile. Their role in financial inclusion is complementary but equally vital, and with continued support, NBFCs can ensure that more underpenetrated populations have access to formal financial services.

- **Wider Reach and Product Diversity**
  NBFCs have a strong presence in underbanked areas, particularly in Tier 2, 3, and 4 cities. Their regional focus allows them to serve areas where traditional banks and MFIs have limited access. NBFCs offer a broader range of financial products beyond micro finance loans, including vehicle loans, gold loans, consumer finance, and housing loans. These products cater to different segments of the population that are not always served by MFIs and SFBs

- **Credit to Niche Sectors (MSMEs and Agriculture)**
  NBFCs have a strong foothold in lending to MSMEs, and agriculture-based businesses, which are crucial for the rural economy. MFIs and SFBs, while important, primarily focus on micro-loans and smaller ticket sizes, often leaving out larger credit requirements for MSMEs.

- **Customized Solutions for Diverse Needs**
  NBFCs are known for their flexibility in designing financial products, which are tailored to the specific needs of rural and semi-urban populations. This is critical in addressing the unique financial requirements of small businesses, farmers, and low-income households. NBFCs provide loans against property, gold, and other assets, which enables individuals and small businesses in rural areas to access credit even when they do not meet stringent banking criteria.

Barriers to equitable and inclusive credit growth in India

- **Low or Unsteady Income**
  Many individuals and small businesses, especially in rural areas and the informal economy, experience irregular income flows due to seasonal employment, agricultural dependence, or gig-based work. Lenders see these individuals as high-risk borrowers due to unpredictable income, making it difficult to assess their repayment capacity. As a result, many of these individuals are excluded from formal lending channels.

- **Unawareness of Financial Products**
  A significant portion of the population, particularly in rural areas, remains unaware of the financial products and services available to them. Misinformation or distrust of formal banking channels discourages many from seeking loans, especially if they've had negative experiences with high fees or complex loan conditions.

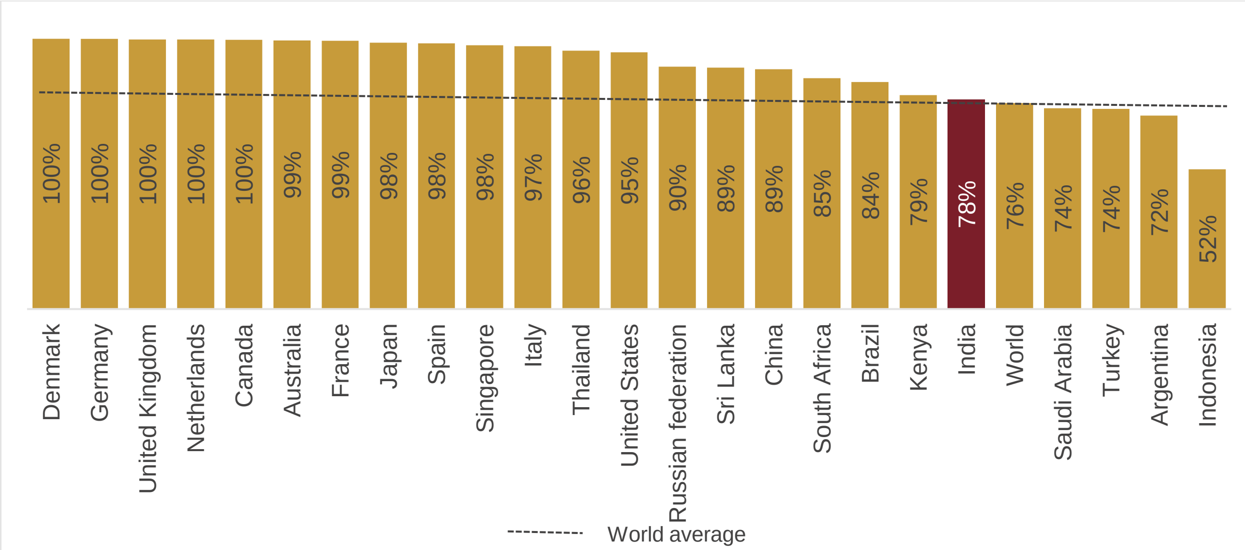
- **Unavailability of Appropriate Credit Products**
  The formal credit market often offers standardized products that do not cater to the specific needs of diverse borrower segments, particularly those in rural areas or the informal economy. Many credit products, such as fixed repayment loans or collateral-based lending, are not suitable for individuals with fluctuating incomes or no assets to pledge. Borrowers often face high interest rates or unfavorable terms, making loans inaccessible or unaffordable.

New-age NBFCs are overcoming the challenges of conventional lending

New-age NBFCs are revolutionizing the lending landscape by using technology to overcome the inefficiencies of conventional lending. Through automation, alternative data, personalized products, and secure digital platforms, they are making credit more accessible, efficient, and affordable.

Traditional lending involves lengthy credit approval processes, relying heavily on manual underwriting and evaluation, which often delays loan disbursement. New-age NBFCs use AI and machine learning algorithms to automate credit risk assessment. By analyzing vast amounts of data, including alternative data points (such as utility payments, mobile data, and social media activity), these NBFCs can quickly assess creditworthiness and approve loans within minutes or hours.

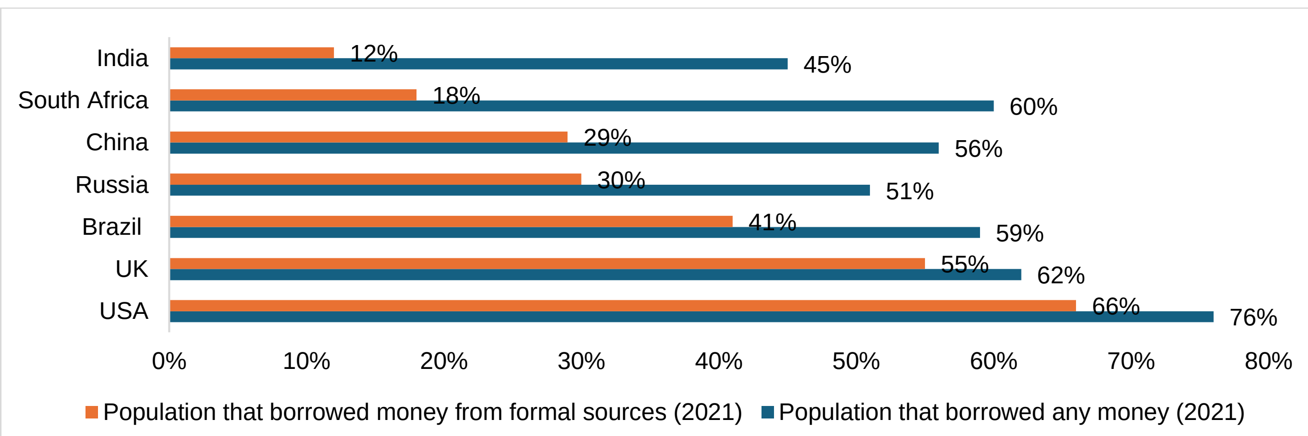
Adult population with a bank account (%): India vis-à-vis other countries



Notes: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+, Source: World Bank – The Global Findex Database 2021, CRISIL MI&A

As per the Global Findex Database 2021, ~54% of the world's 740 million unbanked adults live in only seven countries (India, Bangladesh, China, Indonesia, Egypt, Nigeria and Pakistan), of which almost 31% (230 million) are in India. This shows an immense opportunity for furtherance of financial inclusion.

Only 12% of India's population borrowed money from formal sources (CY2021)



Note: Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Data is for the population within the age group of 15+

Money borrowed from formal sources includes money borrowed from Banks, NBFCs and usage of credit card.

Source: World Bank – The Global Findex Database 2021, CRISIL MI&A

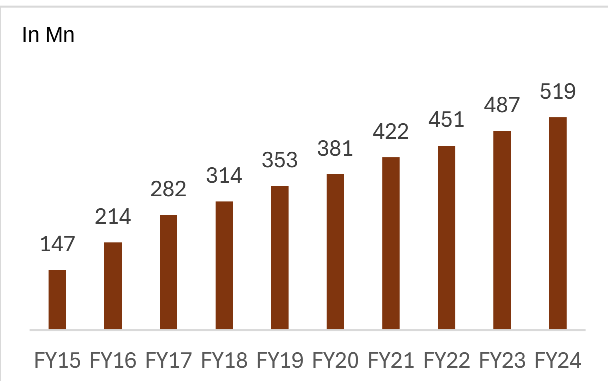
66% of the US Population borrowed money from formal sources such as Banks, NBFCs and credit card in 2021 followed by UK Population whose 55% of Population borrowed money from formal sources. Only 12% of India's population borrowed money from formal sources. This implies that a significant majority, around 88%, relied on informal sources of credit, such as friends, family, or unorganized lenders. This is the lowest among the major economies. A significant portion of the population may not have the necessary documents, such as proof of income or identity, to access formal credit.

Pradhan Mantri Jan Dhan Yojana (PMJDY)

The two key initiatives launched by the Government to promote financial inclusion are the Pradhan Mantri Jan Dhan Yojana (PMJDY) and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY). Under the PMJDY, the Government's aim is to ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJJBY is a one-year life insurance scheme that offers a life cover of Rs 0.2 million at a premium of Rs 436 per annum per member, which can be renewed every year. The Government has also launched the Pradhan Mantri Suraksha Bima Yojana (PMSBY), an accident insurance policy that offers an accidental death and full disability cover of Rs 0.2 million at a premium of Rs 20 annually. As per the Government, more than 100 million people have registered for these two social security schemes.

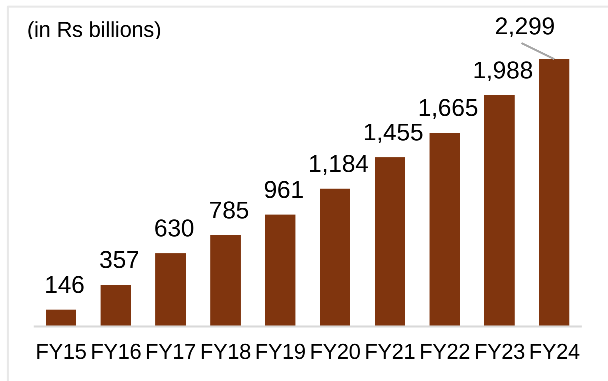
As of September 2024, 535 million PMJDY accounts had been opened, with total deposits of Rs. 2.3 trillion. (Source: Pradhan Mantri Jan-Dhan Yojana: Progress Report)

Number of PMJDY accounts



Source: PMJDY; CRISIL MI&A

Total balance in PMJDY accounts

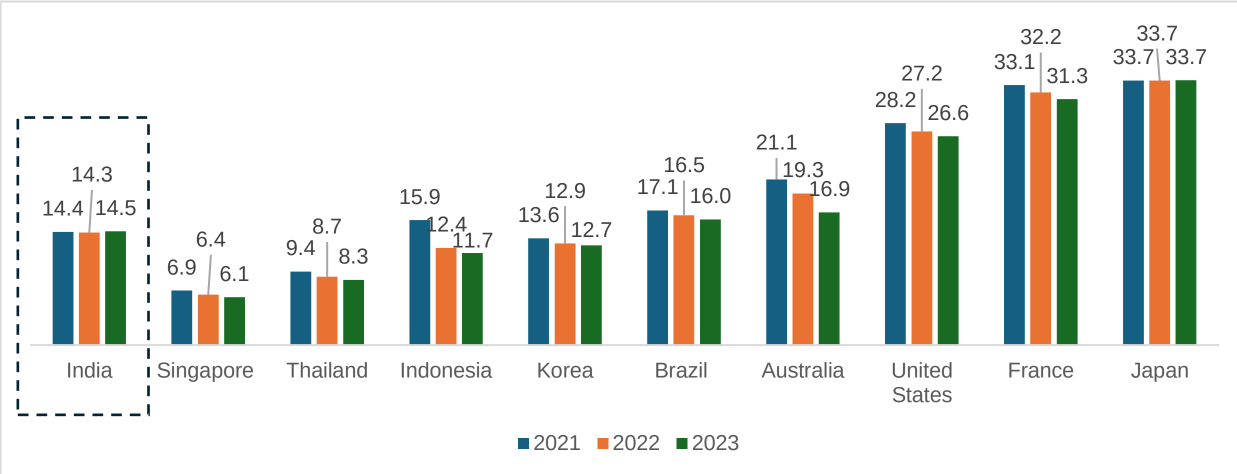


Source: PMJDY; CRISIL MI&A

Under-penetration of the Indian banking sector provides opportunities for growth

The Indian banking sector is significantly under-penetrated as observed in the current bank credit-to-GDP ratio of 98.5% for India as of the first quarter of 2024 as compared to developed economies such as China and US with bank credit to GDP ratio of 205.1% and 148.9%. The number of commercial bank branches as well as ATMs in India per 100,00 people, contrast in comparison to other countries. This provides immense opportunities for banks and other financial institutions over the long term. The number of commercial banks branches per 100,000 Adults (CY) for India were 14 in 2022.

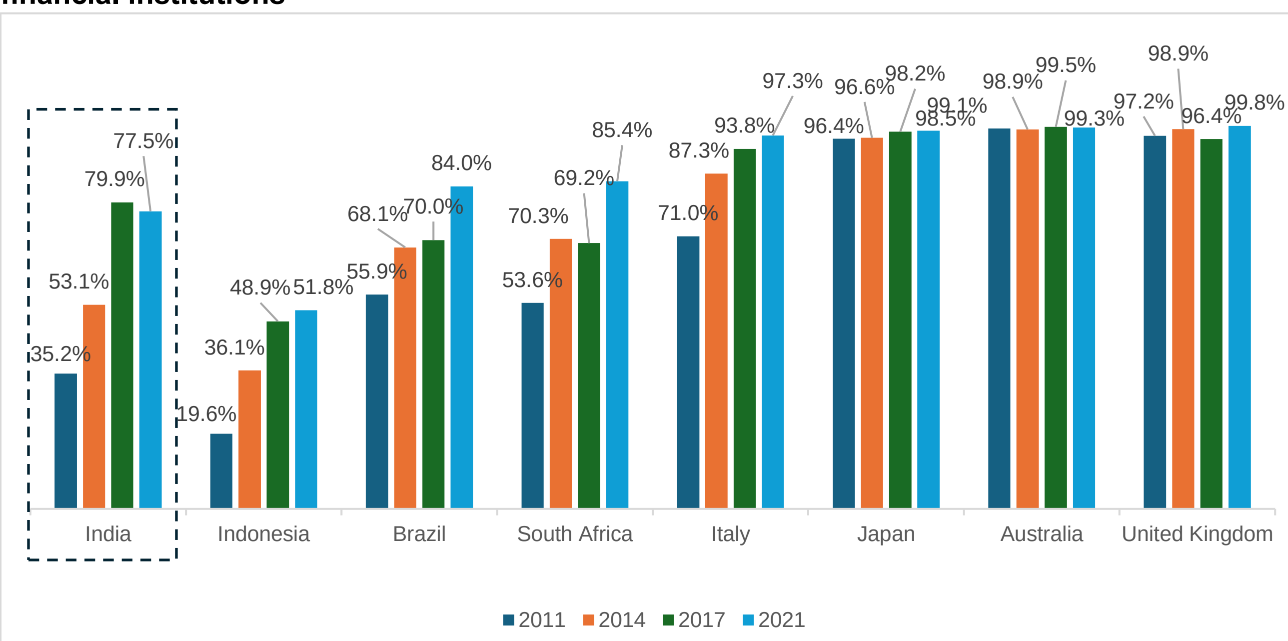
Number of Commercial Bank Branches per 100,000 Adults (CY)



Source: IMF: Financial Access Survey; CRISIL MI&A

Japan has the highest number of commercial bank branches per 100,000 Adults amounting to 34 bank branches per 100,000 Adults in 2023. In major economies the number of bank branches per 100,000 adults have remained stable due to the digitisation of banking services with customer preferring online and mobile banking over physical visits.

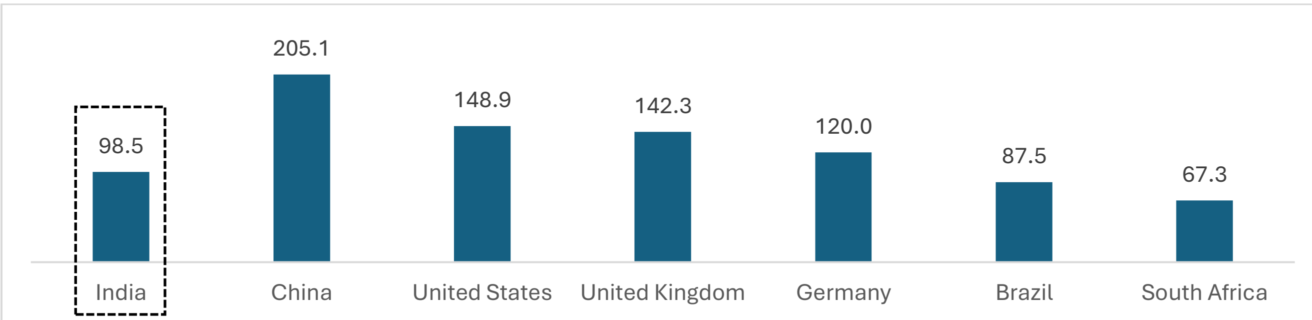
Percentage of population above 15 years having an account at bank or another type of financial institutions



Note: percentage of population above 15 yrs having an account at bank or another type of financial institutions, Source: IMF: Financial Access Survey; CRISIL MI&A

100% of UK Population above 15 years have an account at bank or another type of financial institution in 2021 followed by Australia with 99% of the population above 15 years having an account at bank or another type of financial institution. Banking is deeply ingrained in the culture, with financial products viewed as essential from a young age. Advanced digital banking systems make it easy for people to open and manage accounts even in remote areas. High employment levels and growing income stability have led to higher engagement with formal financial systems even for countries like India.

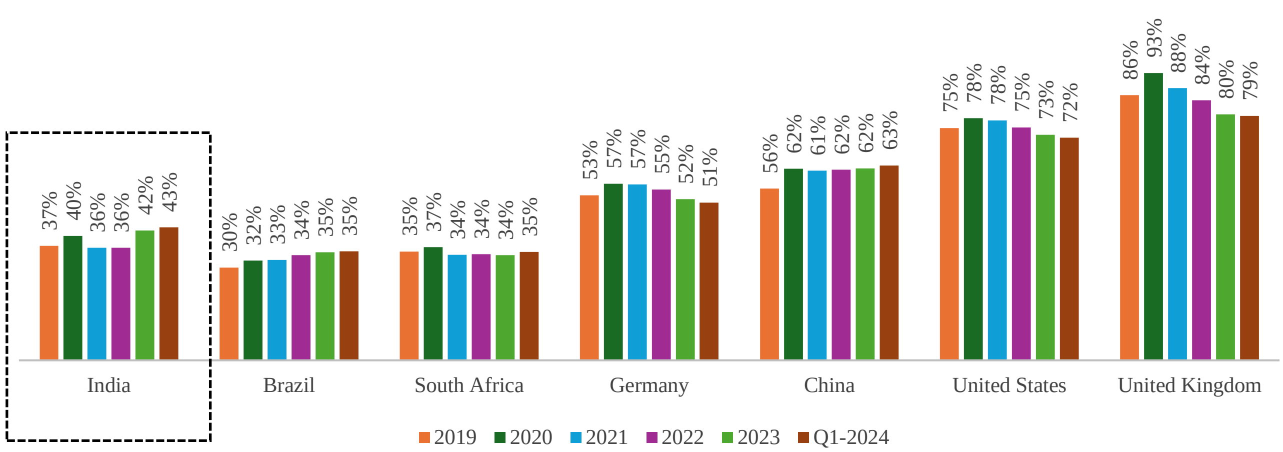
Credit to GDP ratio (%) as of the first quarter of 2024



Source: Bank of International Settlements, CRISIL MI&A

China has the highest credit to GDP ratio of 205.1% followed by United States with a ratio of 148.9%. The Indian banking sector is significantly under-penetrated as observed in the current bank credit-to-GDP ratio of 98.5% for India.

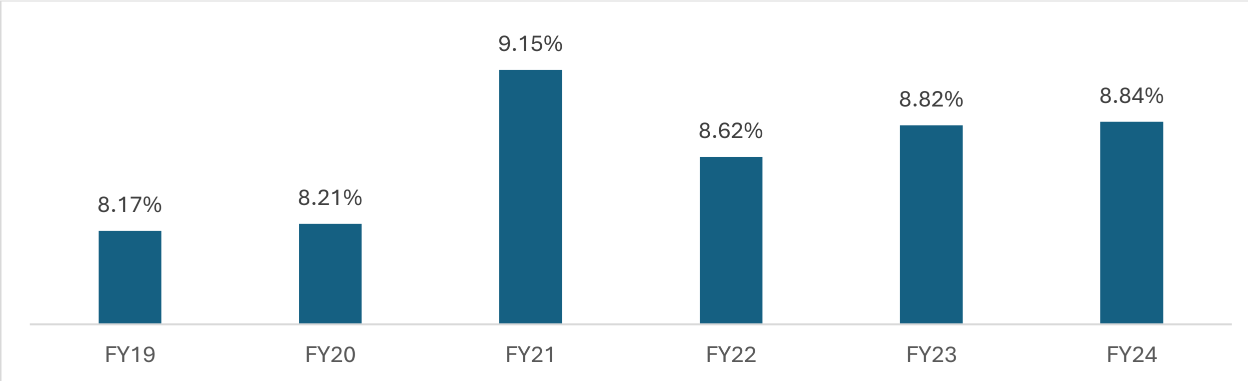
Household credit to GDP ratio of India and peer countries



Source: Bank of International Settlements, CRISIL MI&A

United Kingdom has the highest household credit to GDP ratio of 79% among the major economies as of Q1-2024 followed by United States with a ratio of 72%. India household credit to GDP ratio is 43% as of Q1-2024.

Credit Penetration in MSME



Note: Credit penetration is calculated as MSME credit portfolio value (reported to Commercial bureau) by the nominal GDP of the fiscal year. Source: CIBIL, CRISIL MI&A

MSME forms the backbone of India's economy contributing actively to the GDP and providing employment opportunities. Despite its critical role, the sector faces a persistent challenge of low credit penetration. A significant number of MSMEs lack tangible assets to offer as collateral, making it difficult for banks to assess credit worthiness. Many MSME operate informally, with inadequate financial documentation, further complicating their access to formal credit.

Rural sector supporting India growth story

India's rural segment has been a key driver of the country's consumption growth story in recent years. In the past decade, the rural segment in India has expanded at a rapid pace, driven by factors, such as rising disposable income, infrastructure development, and the proliferation of e-commerce.

According to the Economic Survey (2023-24), the government strategy has been that of an integrated and sustainable development of rural India. The government aims to fuel rural growth through decentralized planning, better access to credit, skilling of youth, enhanced livelihood opportunities, empowerment of women, social security net provision, basic housing, education, health and sanitation facilities, etc. The survey notes that a multi-pronged approach has helped raise rural incomes and improve the quality of life through different schemes, such as:

Livelihood and skill development

1. The Deendayal Antyodaya Yojana-National Rural Livelihood Mission (DAY-NRLM), which aims to enable economically weak households to access gainful self-employment and skilled wage employment opportunities, resulting in sustainable and diversified livelihood options for them.

2. Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), under which a total of 4.3 crore households availed of employment. A total of 140.21 crore person-days' employment has been generated under the Scheme (until September 5, 2024).

Women empowerment

The transformative potential of Self-Help Groups (SHGs), exemplified through their key role in the on-ground response to Covid-19, has served as the fulcrum of rural development through women empowerment. India has around 1.2 crore SHGs, 88% being all-women SHGs. Also, there has been a steady rise in Rural Female Labor Force Participation Rate (FLFPR) from 24.6% in fiscal 2018 to 36.6% in fiscal 2022 (Female Labor Utilization in India)

Housing for all

The Pradhan Mantri Awas Yojana – Gramin (PMAY-G) was launched in November 2016 with the aim of providing around 3 crore pucca houses with basic amenities to all eligible houseless households living in kutcha and dilapidated houses in rural areas. Under the scheme, landless beneficiaries are accorded the highest priority in the allotment of houses. A total of 2.94 crore houses have been sanctioned and 2.65 crore houses have been completed by Sept 5, 2024, under the scheme.

Other initiatives of the government are towards promoting smoke-free rural homes and rural infrastructure.

Additionally, e-commerce has been a significant contributor to the growth of rural areas. The e-commerce market in India has grown exponentially in recent years. This growth can be attributed to increased internet penetration, the proliferation of smartphones, and the convenience offered by online shopping.

The government has taken various steps to improve overall financial inclusion:

Direct-benefit transfer (DBT)

DBT has been instrumental in the acceleration of financial inclusion since it has helped eliminate human interface and leakages in the system, ensuring timely, accurate and quality services and fund transfers to the beneficiaries. This tool has helped in the disbursal of benefits to a wide population spread geographically through 312 government schemes, such as the Pradhan Mantri Matru Vandana Yojana (PMMVY) for women, Pradhan Mantri Ujjwala Yojana (PMUY), Krishi Unnati Yojana (KUY) or Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) for beneficiary bank accounts held by any gender. The total DBT was around Rs 6.9 trillion in fiscal 2024 (provisional figures) and Cumulative Total DBT was Rs 36.8 trillion as of March 2024.

Aadhaar card

It has played a critical role in promoting financial inclusion in India by enabling easy and efficient identification of individuals and reducing the need for physical documents. Aadhaar Card has been used for various initiatives, such as PMJDY, DBT, mobile wallets, and e-KYC, to improve financial access.

Mobile banking

The government has promoted mobile banking to make financial services accessible to people who are unable to access physical bank branches. Mobile banking has increased financial inclusion in rural areas.

Some of the mobile banking initiatives for financial inclusion are United Payments Interface (UPI), mobile wallets, Jan Dhan Yojana Mobile App, and business correspondent (BC) model.

Financial literacy programmes

The government has launched various financial literacy programmes to educate people about the benefits of financial planning and management. These programmes aim to improve financial literacy among the marginalised sections of the society and empower them to make informed financial decisions. The government and financial institutions have launched various financial literacy programmes (National Centre for Financial Education, Swabhimaan, etc.) to improve financial literacy among the general public, especially in rural areas.

Kisan Credit Card (KCC)

The KCC scheme aims at providing adequate and timely credit support to farmers for their agricultural activities at various stages of farming. According to Ministry of Finance, Department of Financial Services, total number of operative KCC accounts stood at 7.45 crores with total outstanding amount of Rs. 9.18 trillion as of September 30, 2023.

National Pension Scheme (NPS)

Regulated by the Pension Fund Regulatory and Development Authority (PFRDA), NPS is mandatory for Central government employees and voluntary for corporates and all citizens (aged 18-70 years) with matching contributions by the employer. As of fiscal 2024, National Pension System Trust reported AUM of Rs 11.4 trillion and subscriber base of 18 million.

Priority-sector lending (PSL)

PSL is an important policy tool used by the RBI to promote financial inclusion in India. The PSL requirement mandates banks to allocate a specified percentage of their lending portfolio to priority sectors, such as agriculture; micro, small and medium-sized enterprises (MSMEs); education; housing; and other weaker sections of the society. Lending to such priority sectors not only increases the credit access to underserved sectors but also lead to higher economic growth and promotes inclusive development. It also encourages banks to develop innovative products and services specifically for priority sectors. As of fiscal 2024, bank credit to PSL stood at Rs 59.1 trillion, up from Rs 50.2 trillion from fiscal 2023 (provisional amounts from the RBI's annual report).

Priority sector lending ensures credit flow to underserved segments of the population through banks. PSL also encourages bridging the gap between rural and urban credit and hence lower regional imbalances. PSL is also used by the government to ensure that credit is given to sectors which can help the country in the long term. PSL mandates banks to lend to MSMEs which ultimately adds to the overall manufacturing output of the country.

Small Saving Schemes

Sukanya Samridhi Yojana is a savings scheme designed by the government especially for girl children. Parents of a girl child can save for their education and marriage purposes through this investment scheme. The scheme was launched as a part of the Beti Bachao, Beti Padhao campaign. As of fiscal 2024, 3.8 crore registered subscribers were active as part of the scheme.

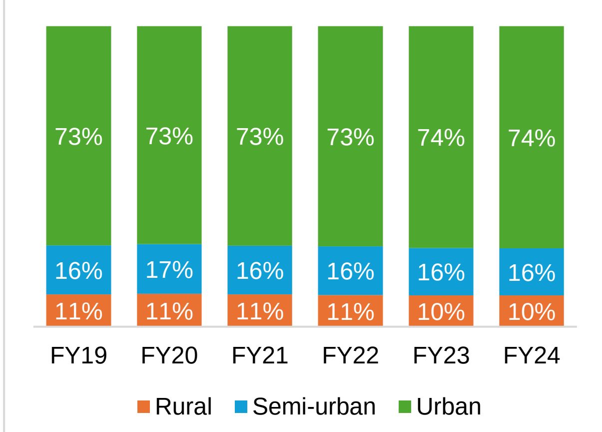
Mahila Samman Savings Certificate was launched as a part of Union Budget 2023-24 through which women of any age could open an account with a minimum deposit of Rs. 1,000 and maximum deposit of Rs. 2,00,000 provided with a facility of partial withdrawal. The interest rate for the accounts was declared at 7.5% p.a. which will be compounded quarterly. Other small saving schemes available include Kisan Vikas Patra.

Rural India accounts for about 47% of GDP, but only 10% of deposits and 8% of credit

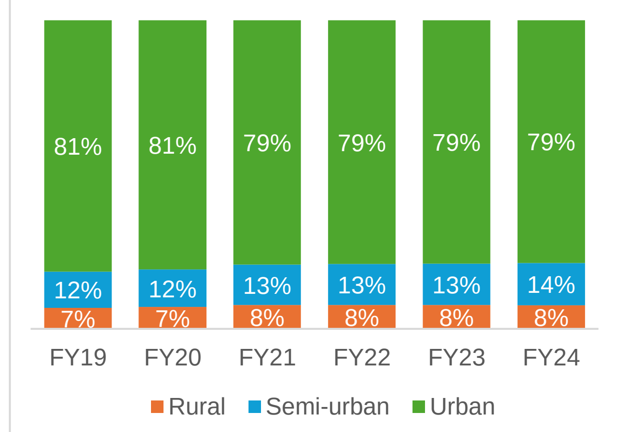
Rural India has a crucial role to play, as almost 65% of the population resides in rural areas, as per 2021 data from the Economic Survey (January 2023) and as per the Census data of 2011, there are over 6.4 lakh villages in India. About 47% of India's GDP comes from rural areas; however, their share is abysmally low at just 10% of total banking deposits and 8% of total banking credit as of March 2024. Lack of bank infrastructure, low level of financial literacy and investment habits, along with lack of formal identification, are some of the reasons for low penetration.

Share of bank credit and deposits shows low penetration in rural areas

Population group wise share of deposit



Population group wise share of credit

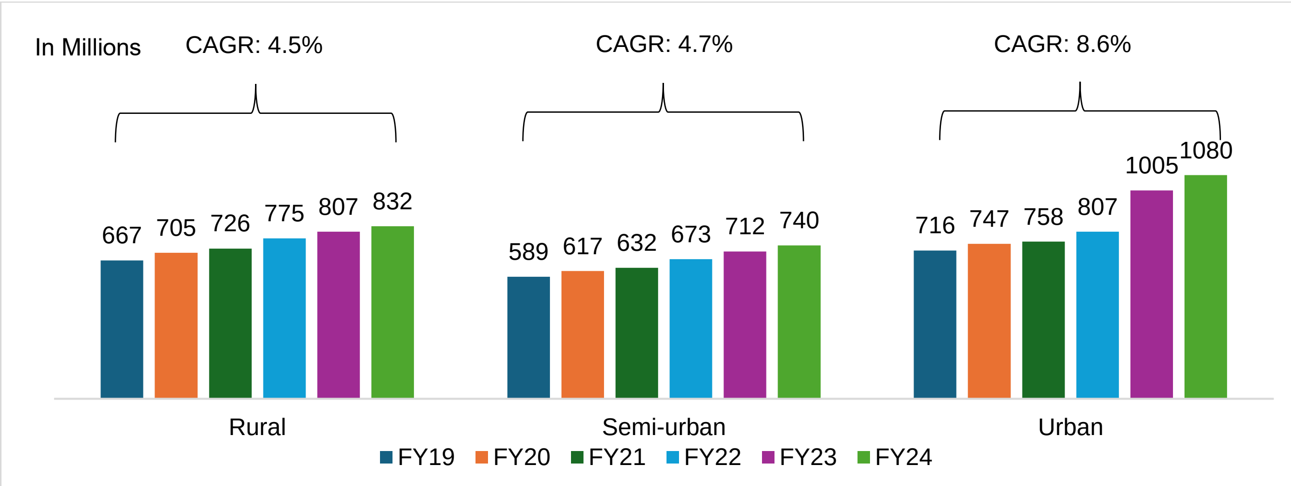


Note: Urban includes data for urban and metropolitan areas, Above data represents indicators for scheduled commercial banks in India

Source: RBI; CRISIL MI&A

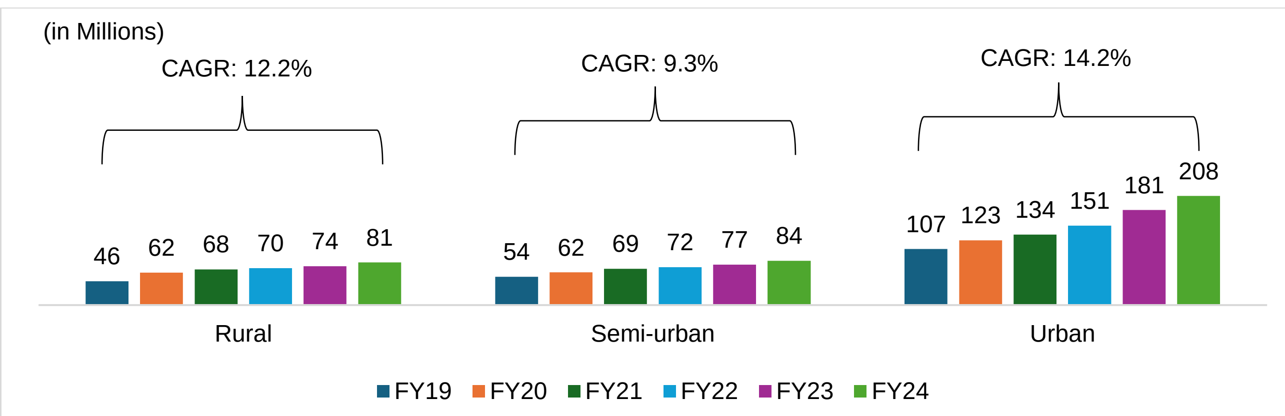
Financial inclusion is lower in rural areas than in urban areas in India. Hence, there are significant growth opportunities in this segment. Initiatives such as PMJDY and digital banking, along with increasing emphasis on financial literacy, have led to increasing financial inclusion in rural areas

Bank Deposit accounts in rural, semi-urban and urban areas



Note: Urban includes data for urban and metropolitan areas; numbers are as of the end of the fiscal year indicated. Data represents only bank deposit accounts. Above data represents indicators for scheduled commercial banks in India, Source: RBI, CRISIL MI&A

Bank Credit accounts in rural, semi-urban and urban areas



Note: Urban includes data for urban and metropolitan areas; numbers are as of the end of the fiscal year indicated. Data represents only bank credit accounts. Above data represents indicators for scheduled commercial banks in India, Source: RBI, CRISIL MI&A

Rural areas and small towns (Tier 3 and Tier 4) are becoming structurally far more resilient to shocks

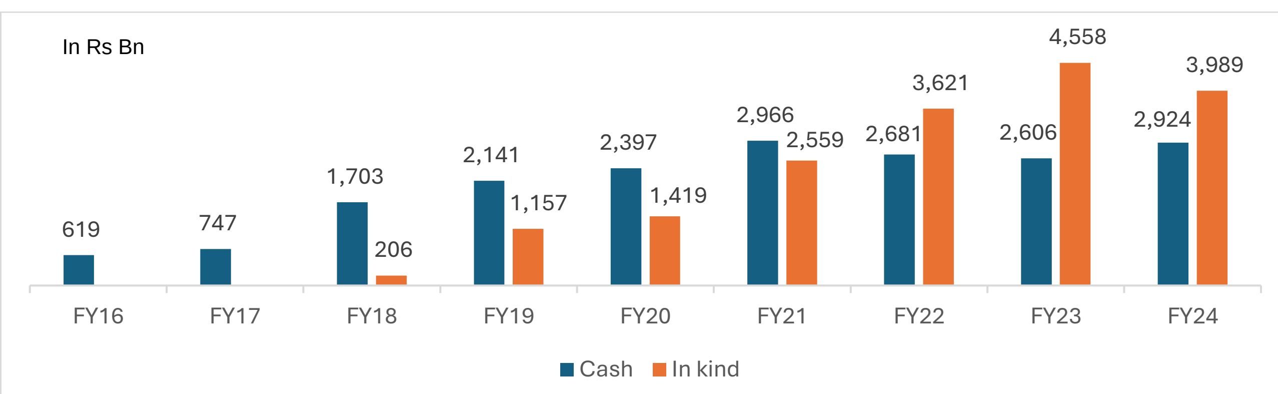
According to Census 2011, there are about 640,000 villages in India, which are inhabited by about 893 million people. The rural and semi-urban economy is far more resilient today due to increased spending under PM-Kisan scheme, Mahatma Gandhi National Rural Employment Guarantee Act, 2005 and irrigation programs. Additionally, schemes such as direct benefit transfer ("DBT"), PM Ujwala Yojana for cooking gas, PM Awas Yojana for housing, and Ayushman Bharat scheme for healthcare are supporting growth in rural and semi-urban areas. To supplement this, there has been a continuous improvement in rural and semi-urban infrastructure such as electricity and roads. These government initiatives have led to lesser leakages and higher incomes in the hands of the rural and semi-urban populace, thereby enhancing their ability and willingness to spend on discretionary products and services. The structural changes, combined with a positive macro environment, are expected to improve rural and semi-urban business prospects, provide business opportunities for the banking and financial services sector and drive the long-term growth of the economy.

The rural economy, particularly in India, is driven largely by agriculture, which remained relatively less impacted by the COVID-19 lockdowns compared to urban sectors like services and manufacturing. With farming activities continuing, rural households maintained some level of income stability, especially due to government support (e.g., PM-KISAN scheme, increased MNREGA funding).

Despite increased efforts, rural and semi-urban areas remain underpenetrated when it comes to banking and financial services. With only a fraction of the population fully integrated into the formal financial system, significant opportunities exist for expanding credit access, insurance, and digital payments. Digital Infrastructure, rising smartphone penetration and increasing internet connectivity are creating opportunities for fintech and banking players to reach previously untapped rural and semi-urban markets, especially through initiatives like PM Jan Dhan Yojana and the use of Aadhaar-enabled payment systems.

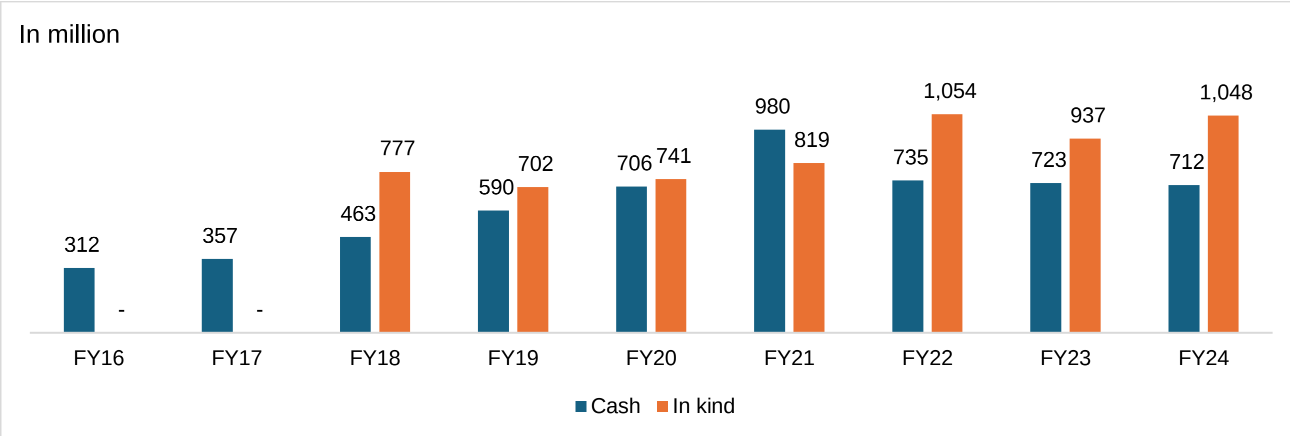
Tier 3 and Tier 4 towns have economies driven by micro, small, and medium enterprises (MSMEs), which have shown greater adaptability to disruptions. Moreover, many residents engage in entrepreneurial or informal work, providing flexibility in times of economic shocks. Smaller towns are seeing upward mobility due to factors such as improved education facilities, access to e-commerce, and better transport infrastructure, allowing for a closer integration with larger urban economies

Government schemes being delivered through digital adoption – Fund Transfer



Source: Direct benefit transfer, CRISIL MI&A

Trend in DBT Beneficiaries (Non-Unique)



Source: Direct benefit transfer, CRISIL MI&A

Digital Public infrastructure reforms by Government of India

Digitization improves the transparency and efficiency of government processes, and widespread digital transformations help governments and institutions with policy implementation and broad policy outreach. The key idea for Digital Public Infrastructure (DPI) is not the complete digitization of narrow public services but the establishment of a building block of digital modularity, which can be used modularly by both government and private players to create the specific digital infrastructure required. The India Stack is a collective name for a set of open APIs and public goods in digital form like DigiLocker, UPI, e-sign etc.

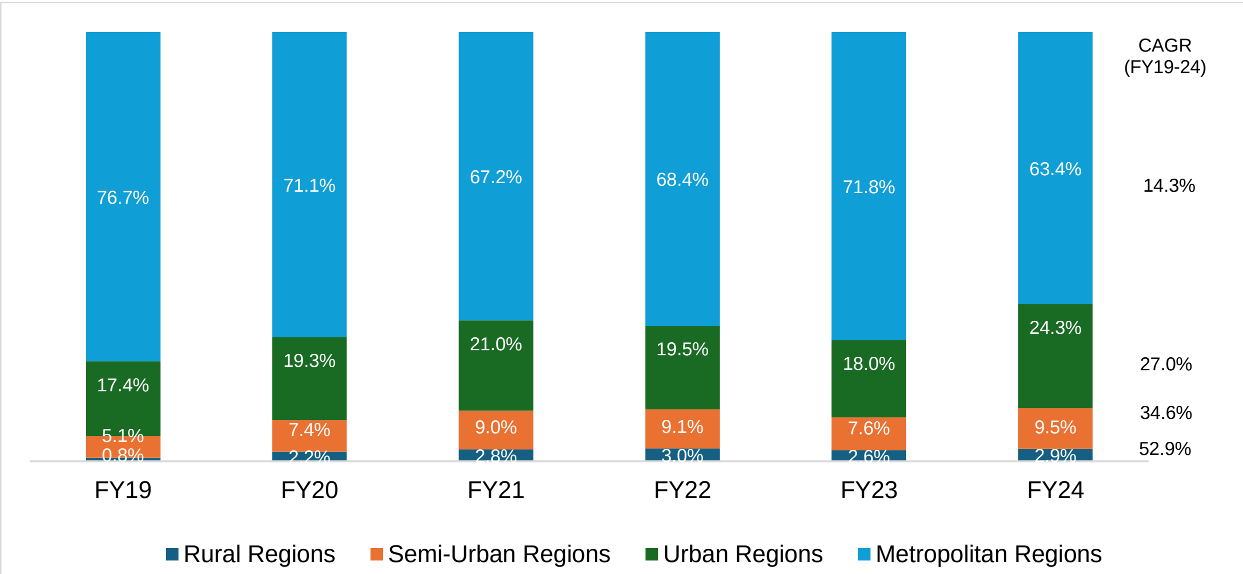
Use of generative AI and new technologies increasing productivity

Generative AI, or Gen AI, leverages extensive training on large datasets to swiftly produce diverse content forms like text and multimedia in response to prompts. Gen AI, exemplified by ChatGPT in BFSI, enables efficient, conversational banking, delivering prompt and responses, enhancing customer experiences, and saving time. Gen AI does well in fraud prevention, where it can swiftly detect potentially fraudulent activity by analysing customer behaviour patterns. This can help BFSI companies to take proactive measures to help bolster transaction security. Gen AI aids in risk analysis & synthetic data generation. This helps to offer detailed insights from intricate financial datasets which can be employed for decision making. The different uses of Gen AI now show a fraction of its potential to transform the BFSI sector.

Fintech Innovation

Fintech Innovation are a core part of India's Digital Public Infrastructure (DPI) reforms, driven by the government to foster financial inclusion, transparency and economic growth. Key initiatives like Unified Payment transfer (UPI) have revolutionized digital payments landscape, making real-time, cost-effective transactions accessible to millions. Aadhar based system for identify verification and Jan Dhan Yojana for financial inclusion are transforming India's financial ecosystem.

Share of rural and semi-urban regions in personal credit card outstanding has increased from 5.9% in FY19 to 12.4% in FY24

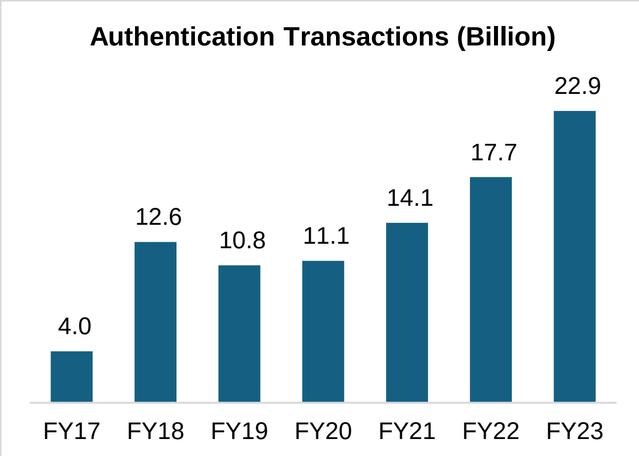


Source: RBI DBIE, CRISIL MI&A

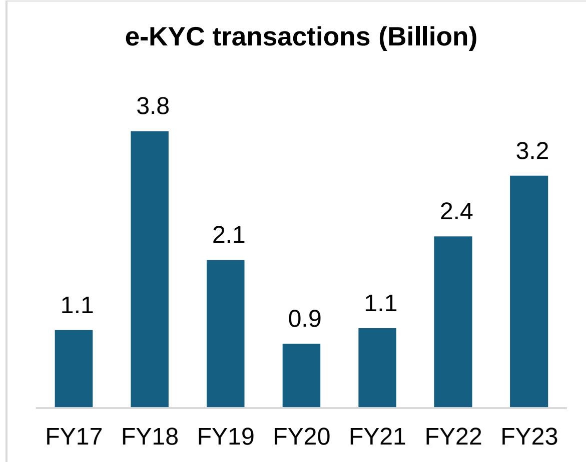
Share of rural and semi-urban regions in the total personal credit card outstanding has witnessed an increase from 5.9% in FY19 to 12.4% in FY24, primarily due to two reasons first being the rising disposable income and second the increasing discretional spending which people have displayed in the last few fiscals. Rural regions have witnessed the fastest growth in the total personal credit card outstanding growing at a CAGR of 52.9% between FY19-FY24 followed by semi-urban and urban regions which grew at a CAGR of 34.6% and 27.0% respectively during the same period. Even though metro regions still account for the highest share in overall credit card outstanding (~63%) in FY24, their share has witnessed a decline from FY19 (~77%).

Trend in the number of E-KYC transactions

The adoption and implementation of e-KYC in rural areas have transformed the financial landscape, streamlining access to various financial services. By enabling digital identity verification, e-KYC has minimized the time and costs involved in customer onboarding, facilitating easier access to banking services, credit, and government benefits for rural populations. This technology has played a crucial role in enhancing financial inclusion, integrating more individuals into the formal financial system, and improving transparency while mitigating fraud risks.



Source: UIDAI Annual report 2022-23, CRISIL MI&A



Source: UIDAI Annual report 2022-23,

States like Delhi, Maharashtra and Chandigarh, have a higher banking credit penetration compared to other states

Delhi, Maharashtra, and Chandigarh have a banking credit to GDP ratio of more than 100% as of March 2024 which indicates that banking credit penetration in the state is higher as compared to other states in India. Delhi has the highest banking credit penetration of 152% as of March 2024 followed by Chandigarh at 137%. Maharashtra has the third highest banking credit penetration in Indian States at 116%. Being predominantly urban, these regions enable banks to establish extensive branch networks and ATM facilities. People in these states exhibit higher levels of financial literacy, enabling individuals and businesses to understand and access banking credit. For most of the states, rural credit share is significantly lower than the rural population share indicating lower credit penetration. Based on the credit penetration data, there seems a huge scope for increasing bureau coverage as well in India. Further, people who don't have credit history, formal income proofs, documentation, etc. still rely on informal sources for debt which comes at a very high cost. It could provide growth opportunities for NBFCs which provide loans at reasonable rates.

State-wise banking credit penetration (Fiscal 2024)

States	GSDP - Current Prices FY24 (In Rs. Billion)	Y-o-Y growth FY23-FY24	CAGR (FY19-FY24)	Credit Penetration as on March 2024	Credit growth (FY19-FY24)	CRISIL Inclusix Score (FY2016)
Western Region						
Maharashtra	40,442.5	11%**	10%	116%	11%	62.7
Gujarat	22,034.2 *	15%**	10%^	33%^^	11%	62.4
Goa	891.3 *	10%**	6%^	29%^^	10%	88.9
Southern Region						

Tamil Nadu	27,215.7	14%	11%	55%	11%	77.2
Karnataka	25,007.3	10%	11%	45%	13%	82.1
Telangana	15,019.8	14%	12%	55%	12%	72.8
Andhra Pradesh	14,396.7	10%	11%	47%	15%	78.4
Kerala	11,461.1	12%	8%	47%	12%	90.9
Puducherry	479.0	7%	7%	41%	12%	87.7
Northern Region						
Delhi	11,077.5	9%	8%	152%	5%	86.1
Rajasthan	15,283.8	13%	11%	36%	14%	50.9
Haryana	6,340.3	8%	4%	80%	16%	67.7
Punjab	7,449.0	9%	8%	47%	9%	70.9
Jammu & Kashmir- U.T.	2,411.3	10%	9%	41%	14%	47.8
Chandigarh	549.9 *	19%**	8%^	137%^^	2%	86.7
Himachal Pradesh	2,074.3	8%	7%	24%	13%	72.3
Central Region						
Chhattisgarh	5,058.9	9%	9%	35%	15%	45.7
Madhya Pradesh	13,633.3	9%	10%	33%	13%	48.7
Uttarakhand	3,462.1	14%	8%	25%	12%	69.0
Uttar Pradesh	25,478.6	12%	10%	31%	15%	44.1
Eastern Region						
West Bengal	17,009.4	11%	9%	32%	8%	53.7
Bihar	8,544.3	14%	10%	28%	18%	38.5
Odisha	8,535.2	12%	11%	28%	16%	63.0
Jharkhand	4,610.1	10%	9%	26%	16%	48.2
Sikkim	489.4	15%	11%	13%	19%	60.2
Andaman & Nicobar Islands	116.7 *	12%**	7%^	31%^^	14%	63.9
Northeastern Region						
Assam	5,702.4	19%	13%	21%	15%	47.9
Tripura	826.2	14%	11%	16%	11%	66.2
Meghalaya	530.6	14%	11%	24%	17%	34.6
Manipur	402.4 *	15%**	10%^	26%^^	19%	32.0
Arunachal Pradesh	351.1 *	7%**	8%^	20%^^	18%	34.7
Mizoram	306.9 *	15%**	9%^	13%^^	17%	43.2
Nagaland	371.5 *	15%**	9%^	20%^^	17%	32.4

Note: 1. Credit penetration calculated as banking credit to states as of March 2024 divided by state GSDP (at current prices) as of Fiscal 2024.

2. (*) GSDP as of Fiscal 2023

3. (**) Year on year growth over Fiscal 2022

4. (^) CAGR calculated from Fiscal 2019 to Fiscal 2023

5. (^^) Credit penetration as of fiscal 2023

5. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).

Source: RBI, MOSPI, CRISIL MI&A

States with low financial penetration present a strong case for growth

Madhya Pradesh, Bihar and Uttar Pradesh have ample headroom for growth, given their low credit penetration amid sustained economic growth as a significant proportion of population in these states depend on agriculture and allied activities which traditionally have lower formal credit uptake due to the prevalence of informal lending channels. Further, low income of people and fewer industry presence in these states led to lower credit take-off. Similarly, western states such as Maharashtra and Gujarat have showcased good growth in terms of GDP, though Gujarat has relatively low credit penetration, thereby presenting huge potential. Uttar Pradesh, Bihar, Jharkhand, Assam, Meghalaya and Chhattisgarh had the lowest credit account penetration among all states in fiscal 2024. These states also exhibit lower CRISIL Inclusix scores, indicating low financial inclusion. With lower financial penetration, these states present a huge untapped market and potential for growth in the future as their state GDPs gradually increase.

2.3 Government Initiatives and Schemes

Relaxation in the threshold under SARFAESI Act from Rs. 5 million to Rs. 2 million for NBFCs

In the Union Budget 2021-22, for NBFCs with a minimum asset size of Rs. 1 billion, the minimum loan size eligible for debt recovery under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002 was proposed to be reduced from the existing level of Rs. 5 million to Rs. 2 million. The objective of this move is to improve credit discipline while continuing to protect the interest of small borrowers. This relaxation is expected to facilitate recovery from stressed books, help the NBFCs to improve their ability to recover smaller loans and strengthen their overall financial health. More importantly, it acts as a deterrent to default and enhances the enforceability of collateral for players focused on the medium ticket size LAP segment with loans of Rs. 2 million – Rs. 5 million.

Inclusion of retail and wholesale trade under MSME category

In July 2021, the Ministry of Micro, Small and Medium enterprises decided to include Retail and Wholesale trade as MSMEs for the purpose of Priority Sector Lending and they would be allowed to be registered on UDYAM Registration Portal. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government’s UDYAM portal, participate in government tenders and also avail financing options/ benefits available to the category. This move will also aid in the formalisation of India’s retail trade and enable financial support to small and mid-sized retail businesses. By widening the scope of MSME to cover wholesale as well as retail trade, this move also creates an additional opportunity for MSME lenders to increase their penetration and business.

Prime Minister’s Employment Generation Programme (PMEGP) providing margin money to MSMEs

PMEGP is a credit linked subsidy scheme to provide employment opportunities by establishing new micro enterprises in the non-farm sector where margin money is provided to MSMEs availing loan from banks to set up new enterprises. The maximum margin money provided under the scheme for setting up a new project is Rs 5 million for manufacturing sector and Rs. 2 million for service sector. Geo-tagging for the products and services of the units set up under this scheme has been initiated. This will help the enterprises with creating market linkages. During the year FY24, 122,139 companies have benefited from the scheme with margin money disbursed at Rs 20,667.6 million generating employment for around 0.7 million people.

Credit Guarantee Fund Scheme extended to cover NBFCs

One of the major reasons why MSMEs are credit-starved is the insistence by banks or financial institutions for the provision of collateral against loans. Collaterals are not easily available with such enterprises, leading to a high-risk perception and higher interest rates for these MSMEs. In order to address this issue, the government launched the Credit Guarantee Fund Scheme under the aegis of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in order to make collateral-free credit available to micro and small enterprises. In January 2017, the scheme was extended to cover systemically important NBFCs as well. Key eligibility criteria for this scheme are:

1) NBFCs should be registered with RBI and meet specified prudential norms.
2) the NBFC should have made a profit for the three preceding Fiscals at the time of enrolment.
3) the NBFC should be lending to micro and small enterprises with minimum 5 years of lending experience, minimum Rs. 1 billion of MSE loan portfolio, NPA level below 5% for MSE portfolio and average recovery ratio of 90% for preceding three Fiscals at the time of enrolment and
4) it should have long-term credit rating of at least BBB. The overall limit under the scheme has also been enhanced to Rs. 20 million.

The scheme was revamped in the year 2023 with following new features:

1) Ceiling limit of guarantee coverage raised from Rs. 20 Mn to Rs. 50 Mn
2) The annual guarantee fees was reduced from 0.75% to 0.37%
3) Increase in threshold limit from Rs. 0.5 Mn to Rs. 1 Mn for waiver of legal action

Other government initiatives addressing structural issues in the MSME market

Some of the other government and regulatory initiatives are detailed below:

- Stand-up India: It facilitates bank loans between Rs. 1 million and Rs. 10 million to at least one scheduled caste or scheduled tribe borrower and at least one-woman borrower per bank branch for setting up a greenfield enterprise.
- Make in India: Launched with an intention to make India a global manufacturing hub, which in turn will provide employment to numerous youths in India
- Mudra loans: To fulfil funding requirement of MSMEs who were earlier left out by financial institutions; credit guarantee support also offered to financiers.
- 59-minute loan: Online marketplace that provides in-principle approval to MSME loans up to Rs. 10 million in 59 minutes.
- Unified Payments Interface 2.0 (UPI 2.0): Real-time system for seamless money transfer from account
- Trade Receivables Discounting System (TreDS): Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporates and other buyers through multiple financiers.
- Factoring to support more participation from NBFCs: In an amendment to Factoring Regulation Act, 2011, the Lok Sabha passed the Factoring Regulation (Amendment) Bill in July 2021.

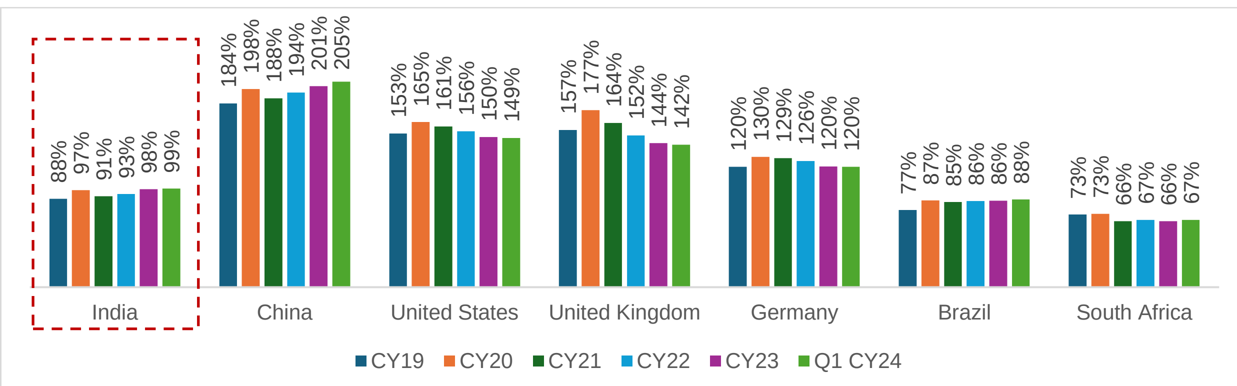
3. Overview of Credit Scenario in India

3.1 Significant retail credit gap exists in India, as compared to other nations

Overall credit to GDP ratio in India stood at 99% in Q1 CY24, which was significantly lower as compared to 142% for United Kingdom, 149% for United States and 205% for China, signalling significant room for credit penetration in the nation.

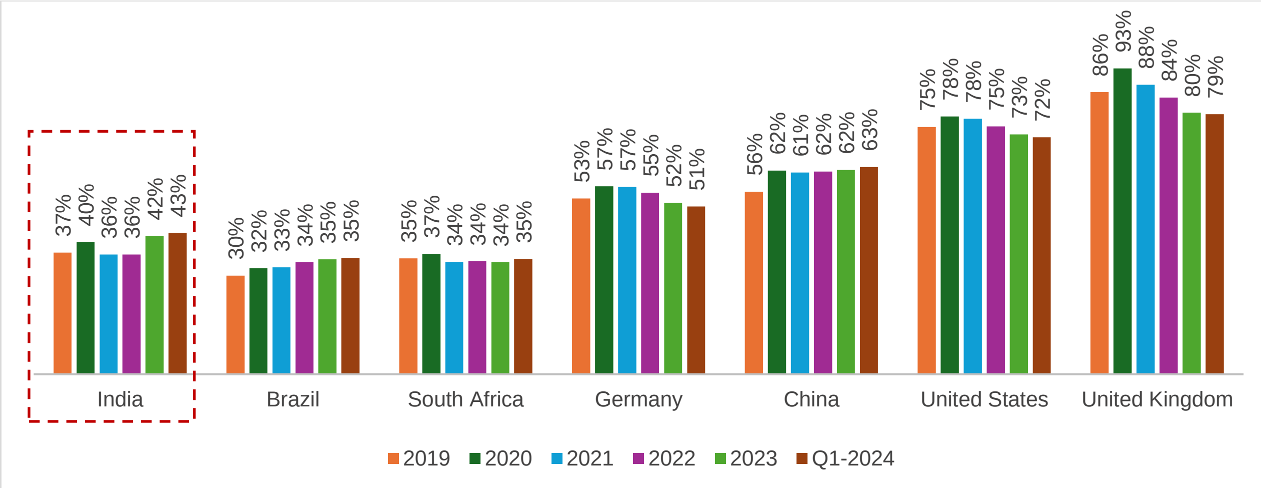
Significant retail credit gap exists in India, as evident by India's household credit to GDP ratio of 43% in Q1 CY24, as compared to 63%, 72% and 79% for China, United States and United Kingdom respectively. With rising financial awareness, government's continuous efforts for financial inclusion and rising credit accessibility to the underserved population, credit penetration in India is expected to rise. The surge in credit penetration would be led by growth in retail credit.

Credit to GDP (%) from CY19 to Q1 CY24



Source: Bank of International Settlements, CRISIL MI&A

Household credit to GDP ratio of India and peer countries (Q1 CY24)



Source: Bank of International Settlements, CRISIL MI&A

Levels of Credit penetration indicate growth opportunities for financiers

Maharashtra had reported the highest credit at Rs. 14,820.8 Bn as of FY24, Whereas Telangana had reported the highest credit penetration at 78% during the same period. People who don't have a credit history, formal income proofs, documentation, etc. still rely on informal sources for debt which comes at a very high cost. It could provide growth opportunities for NBFCs which provide loans at reasonable rates.

State-wise retail credit penetration (Fiscal 2024)

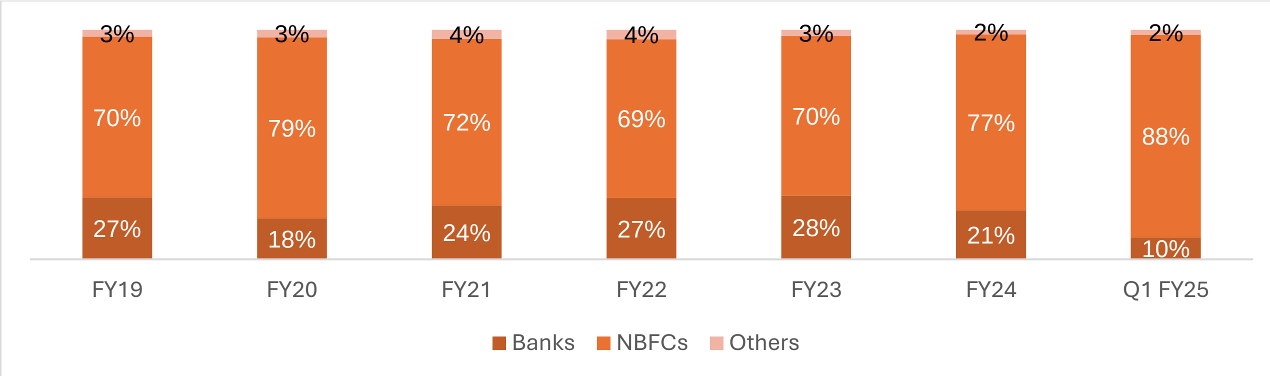
States	GSDP (In Rs. Billion)	Credit FY24 (In Rs. Billion)	Credit CAGR growth (FY19-24)	Credit Penetration (FY24)	Credit share in Rural	Credit share in Semi Urban	Credit share in Urban	Credit share in Metro
Maharashtra	24,109.0	14,820.8	15%	61%	5%	13%	15%	67%
Karnataka	14,232.3	7,817.4	17%	55%	9%	14%	16%	61%
Tamil Nadu	15,713.7	7,773.8	16%	49%	17%	36%	16%	32%
Gujarat*	14,660.0	6,429.5	17%	44%	8%	17%	18%	57%
Telangana	7,929.4	6,195.7	24%	78%	9%	15%	11%	66%
Uttar Pradesh	14,233.6	6,150.6	19%	43%	14%	17%	33%	35%
Rajasthan	8,451.2	4,314.5	20%	51%	19%	27%	22%	32%
Andhra Pradesh	8,208.9	4,161.7	21%	51%	17%	29%	34%	20%
Delhi	6,722.5	3,545.5	13%	53%	0%	0%	NA	99%
Kerala	6,351.4	3,257.5	16%	51%	3%	72%	25%	
Haryana	6,340.3	3,297.9	17%	52%	7%	18%	61%	13%
Madhya Pradesh	6,603.6	3,241.4	20%	49%	10%	29%	21%	39%
West Bengal	9,040.9	3,031.2	17%	34%	23%	12%	34%	32%
Punjab	4,958.8	2,101.9	17%	42%	13%	33%	28%	25%
Bihar	4,645.4	1,796.1	24%	39%	27%	34%	21%	18%
Odisha	5,209.1	1,440.2	21%	28%	39%	25%	36%	NA
Chhattisgarh	3,219.4	1,159.6	19%	36%	18%	23%	33%	26%
Assam	3,185.6	1,046.1	21%	33%	37%	30%	33%	NA
Jharkhand	2,850.7	891.4	19%	31%	21%	28%	24%	28%
Uttarakhand	2,133.8	727.5	18%	34%	17%	21%	62%	NA
Jammu & Kashmir	1,384.2	559.2	21%	40%	28%	34%	24%	14%
Himachal Pradesh	1,428.0	378.6	17%	27%	62%	29%	9%	NA
Chandigarh*	338.4	253.3	14%	75%	1%	1%	97%	NA
Goa*	544.4	217.7	13%	40%	28%	72%		NA
Pondicherry	267.7	127.3	15%	48%	15%	14%	71%	NA
Tripura	464.6	112.0	28%	24%	37%	23%	40%	NA
Meghalaya	283.4	94.9	20%	33%	38%	32%	30%	NA
Sikkim	249.0	61.4	19%	25%	41%	14%	46%	NA
Manipur*	222.6	109.2	23%	49%	51%	23%	26%	NA
Mizoram*	201.7	70.2	34%	35%	11%	34%	55%	NA
Arunachal Pradesh*	187.9	81.4	25%	43%	34%	66%	NA	NA
Nagaland*	201.5	85.5	25%	42%	13%	52%	35%	NA
Andaman & Nicobar Islands*	76.2	31.1	17%	41%	21%	19%	60%	NA

Note: Credit include education, housing, property, secured business, commercial vehicle, Tractor, 2W, Used car, Auto, unsecured business, general business, consumer and personal loan, Credit penetration is calculated as credit to states as of March 2024 divided by state GSDP (at constant prices) as of Fiscal 2024, (*) GSDP as of Fiscal 2023

Source: MOSPI, CIBIL, CRISIL MI&A

While Banks reduced their share in catering to new to credit (NTC) customers to 10% in Q1 FY25, NBFCs continued to cater to these new to credit customers which can be attributed to its share, which increased from 70% to 88% from FY19 to Q1 FY25.

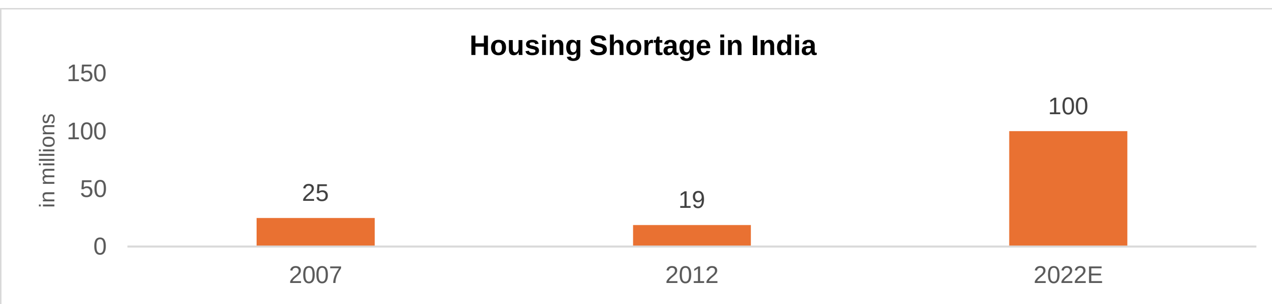
NBFCs remain the market leader in terms of volume, providing credit to new-to-credit (NTC) customers



Note: Others include Co-op Banks, SFBs and other small lenders, Credit include business loan, construction equipment loan, consumer loan, education loan, housing loan, personal loan, property loan, and vehicle loan, Market share basis number of loans disbursed, Source: CIBIL, CRISIL MI&A

Estimated shortage and requirement of ~100 million houses in 2022

The housing shortage in India has only increased since the estimates at the time of the Twelfth Five-year plan. As per the report of RBI-appointed Committee on the Development of housing finance securitization market (September 2019), the housing shortage in India was estimated to increase to 100 million units by 2022. The majority of the household shortage is for the Lower income group (LIG) and Economic weaker section (EWS) with a small proportion (5-7%) of the shortage coming from middle income group or above. Total incremental housing loans demand, if this entire shortage is to be addressed, is estimated to be in the region of Rs 50 trillion to Rs 60 trillion, as per the Committee report, indicating the immense latent potential of the market.

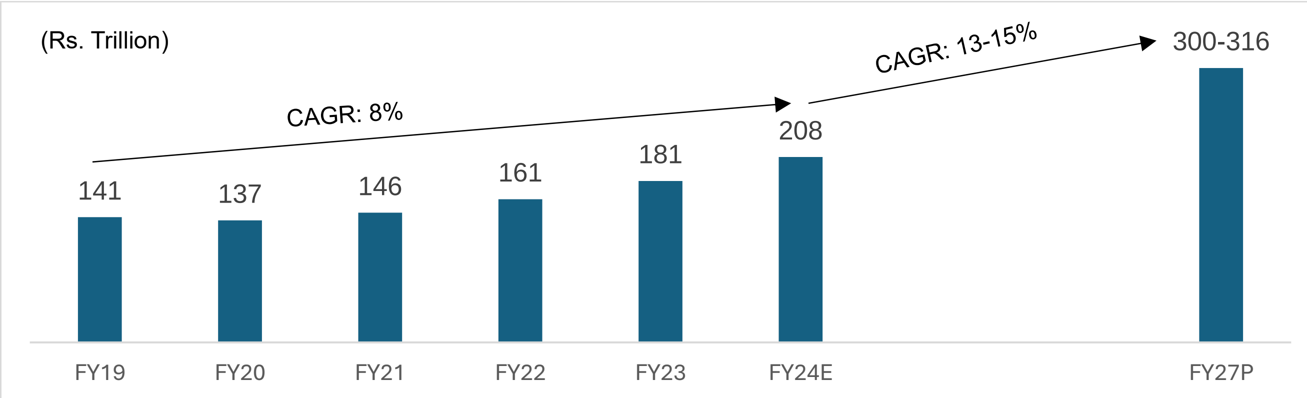


Note: E: Estimated; Source: RBI, Planning Commission, CRISIL MI&A

3.2 Overall Systemic Credit

Corporate credit determines the growth in overall credit as it accounts for nearly two-third of systemic credit. Systemic credit in India grew at a 5-year CAGR of 8% over fiscals 2019 and 2024. Retail credit continues to lead the systemic credit growth in fiscal 2024, supported by the focused approach of banks and NBFCs in increasing the retail portfolio. Going ahead, CRISIL MI&A projects systemic credit to grow at 13%-15% CAGR between FY24 and FY27.

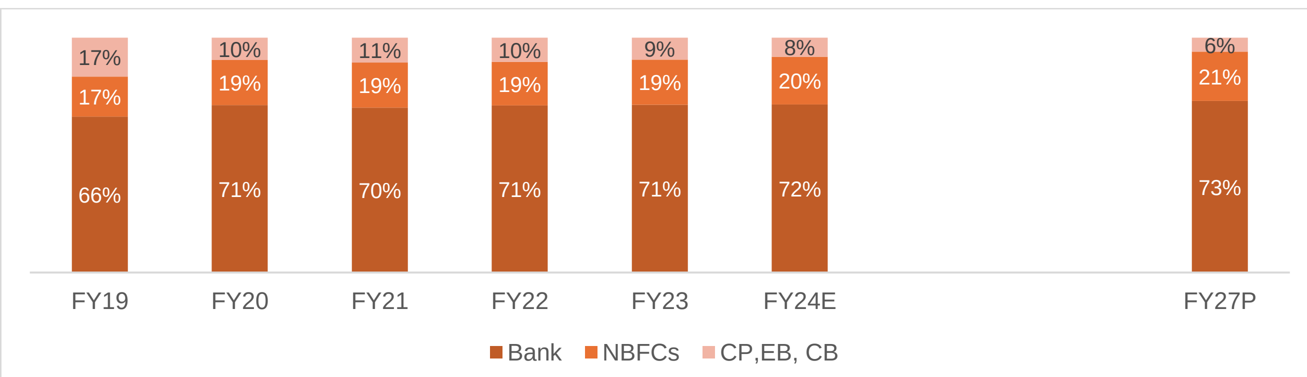
Systemic Credit to grow by 13-15% between FY24 and FY27



Note: E: Estimated, P: Projected; systemic credit includes domestic banking credit (after deduction of bank lending to NBFC), NBFC credit, commercial papers, external borrowings, corporate bonds excluding those issued by banks and NBFCs; Source: RBI, company reports, CRISIL MI&A

In terms of market share, as of FY24 NBFCs hold market share of ~20% whereas banks hold market share of ~72% and it is expected that NBFCs share in overall systemic credit to increase to 21% by FY27.

Share of NBFC Credit in overall Systemic credit to reach 21% by FY27

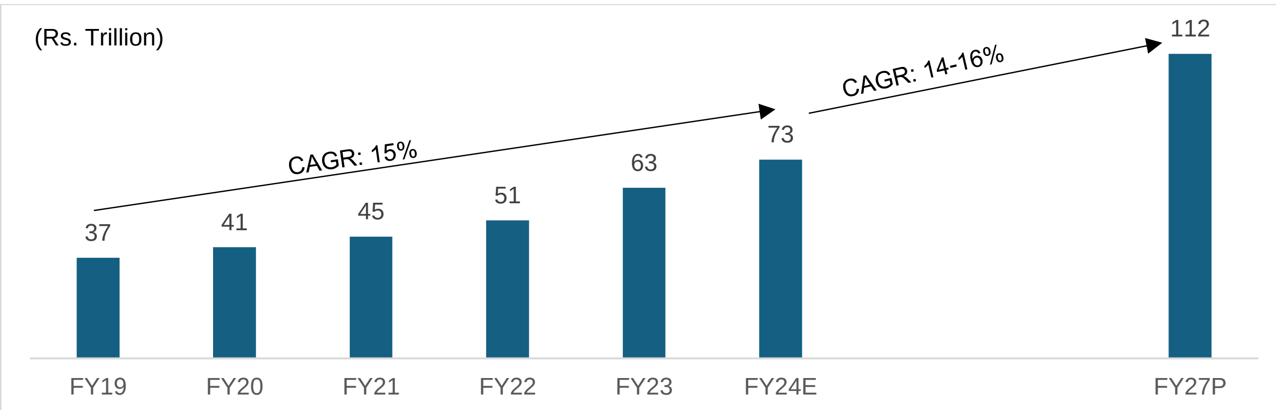


Note: E: Estimated, P: Projected; Systemic credit includes domestic banking credit, NBFC credit, commercial papers, external borrowings, corporate bonds excluding those issued by Banks and NBFC; Source: RBI, Company Reports, CRISIL MI&A

Retail credit growth is projected to grow on a strong footing, expected to witness a CAGR of 14-16% between FY24 and FY27

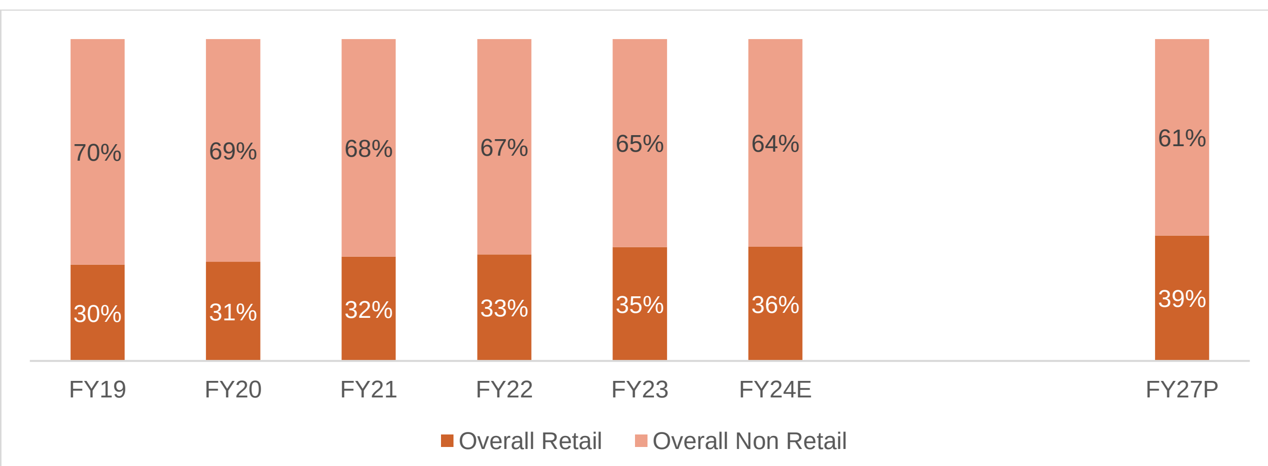
Retail credit (includes Microfinance, Housing finance, Vehicle Financing, Gold Loans, Education Loans, Consumer Durables, Personal loans, credit cards, and secured and unsecured business loans) in India stood at Rs. 73 trillion, as of FY24 which rapidly grew at a CAGR of 15% between FY19-FY24. In FY23, retail credit grew at ~24% on a year-on-year basis due to strong growth in retail book of private banks as compared to public banks. Retail credit grew at 16% in FY24 supported by steady demand in underlying assets like housing, auto and growth in personal loans, microfinancing and small business loans driven by penetration of credit to the bottom of the economic pyramid. The Indian retail credit market has grown at a strong pace over the last few years and is expected to grow further at 14-16% between FY24 and FY27, with risks evenly balanced. Moreover, the increasing demand and positive sentiments in the Indian retail credit market, presents an opportunity for both banks and NBFCs to broaden their investor base. However, RBI's risk weight circular, sustained inflation and increase in lending rates pose a downside risk to the retail credit growth.

Retail credit growth is projected to grow on a strong footing from FY24-FY27



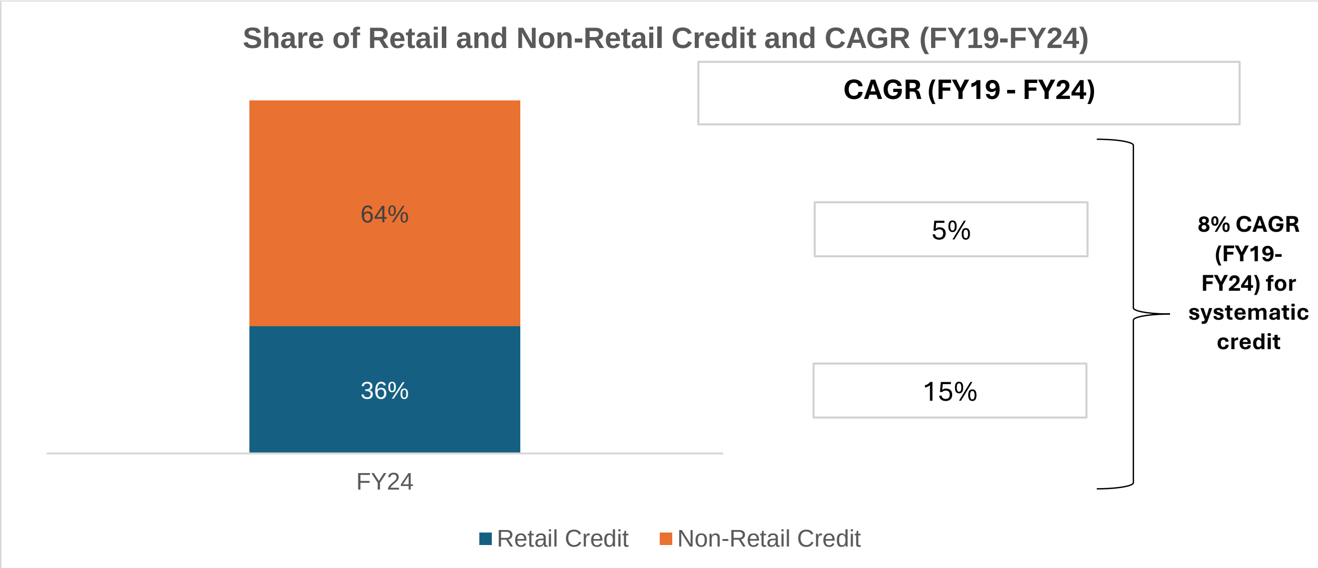
Note: E: Estimated, P: Projected, Source: RBI, CRISIL MI&A

Retail segment is expected to account for ~39% of overall systemic credit as of FY27



Note: E- Estimated, P- Projected, Source: Company Reports, RBI, CRISIL MI&A

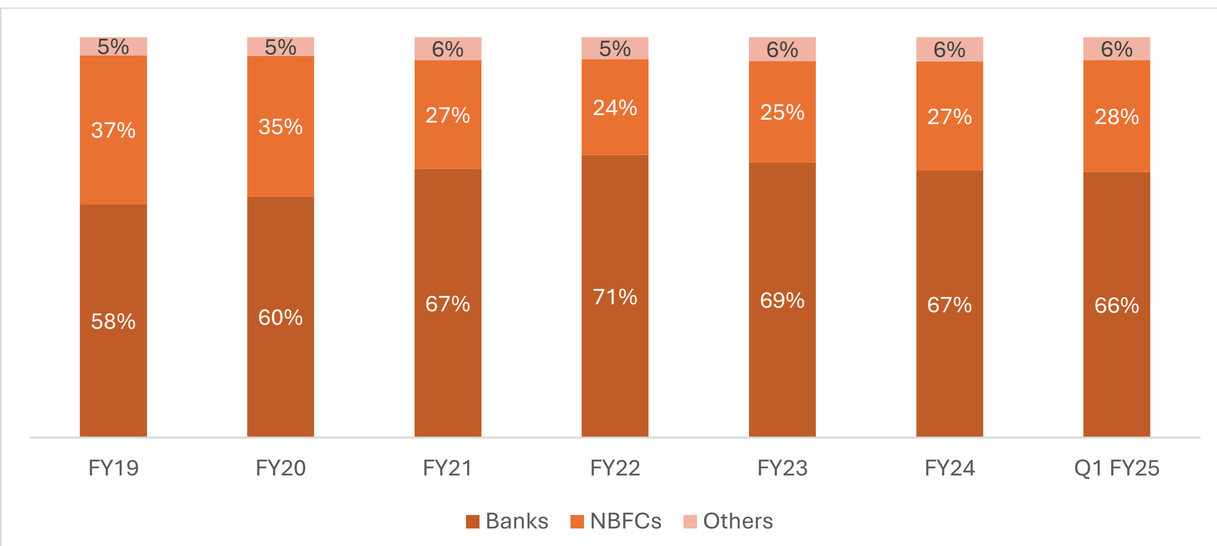
Retail and Non-Retail Credit have seen 15% and 5% CAGR between Fiscal 2019 and Fiscal 2024 respectively



Source: RBI, company reports, CRISIL MI&A

As of FY24, Banks held market share of 67% followed by NBFCs at 27% and other lenders at 6%. As of Q1 FY25, Banks held market share of 66%, followed by NBFCs at 28% and other lenders at 6%.

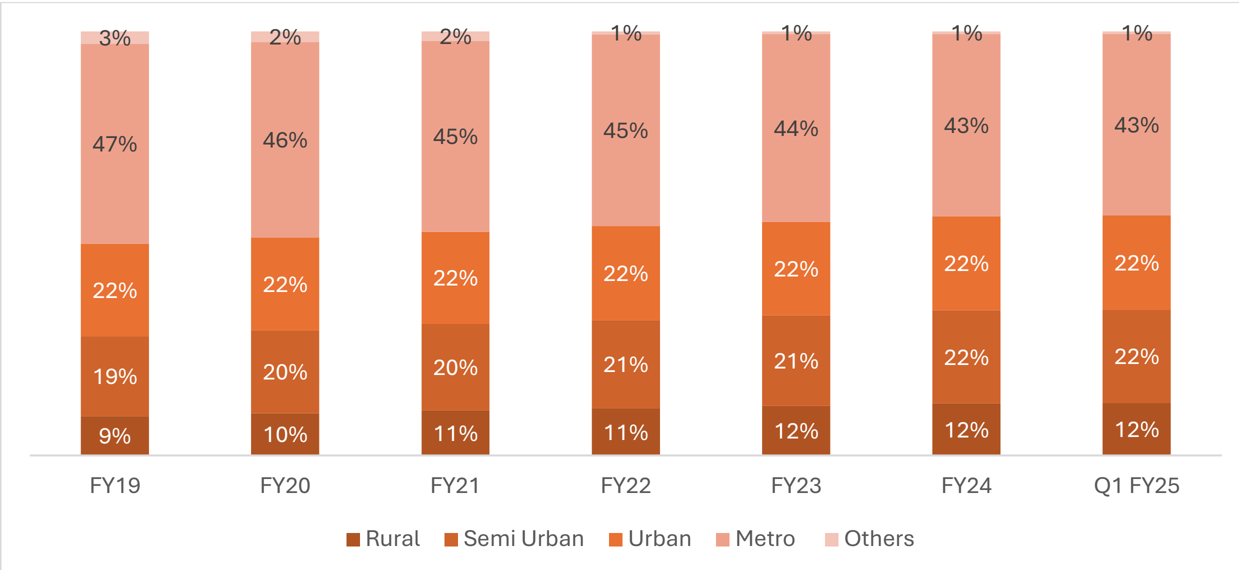
Banks continue to hold highest market share in retail credit



Note: Credit include Education, Housing, Property, secured business, commercial vehicle, Tractor, 2W, Used car, Auto, Unsecured business, general business, consumer and personal loan, Others include Co-op Banks, SFBs and other small lenders, Source: CIBIL, CRISIL MI&A

Metro cities continue to hold the largest share of retail credit, at 43% in FY24, followed by urban and semi urban at 22% each and rural at 12%. How ever in terms of growth, Rural has witnessed the highest CAGR growth at 24% during FY19 and FY24, followed by Semi Urban (21%), Urban (17%) and Metro (15%).

Rural and Semi Urban's share in credit showed the fastest growth from FY19 to FY24



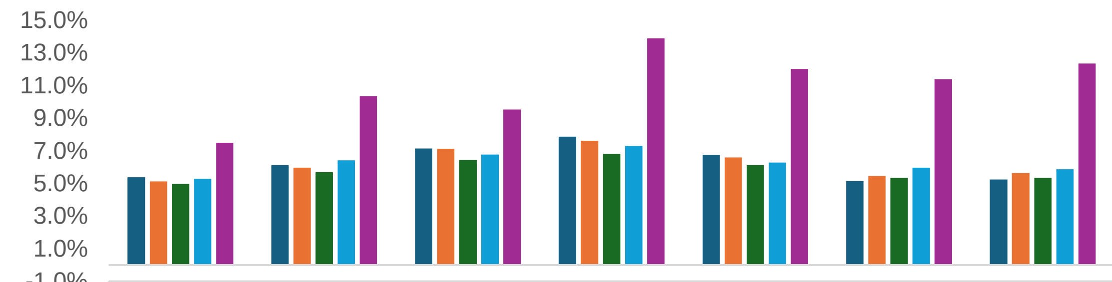
Note: Credit include Education, Housing, Property, secured business, commercial vehicle, Tractor, 2W, Used car, Auto, Unsecured business, general business, consumer and personal loan, Source: CIBIL, CRISIL MI&A

In terms of asset quality, the Metro region reported the weakest performance, with a gross non-performing asset (GNPA) ratio of 6.0% in FY24. Semi-Urban areas followed closely, with a GNPA ratio of 5.5% in FY24.

In contrast, the Rural segment demonstrated remarkable resilience, with its GNPA ratio improving from 5.4% in FY19 to 5.1% in FY24. This improvement is notable, especially when compared to the deterioration in asset quality observed in other regions.

While Rural areas showed a decline in GNPA ratio, the Semi-Urban, Urban, and Metro regions witnessed a weakening in asset quality over the same period. This suggests that the Rural segment has been more effective in managing credit risk and maintaining a healthier loan portfolio, despite the challenges inherent in serving this market.

Asset Quality Trends: Rural Shows Resilience, Metro and Semi-Urban Weaken



	FY19	FY20	FY21	FY22	FY23	FY24	Q1 FY25
Rural	5.4%	6.1%	7.1%	7.9%	6.8%	5.1%	5.2%
Semi Urban	5.1%	6.0%	7.1%	7.6%	6.6%	5.5%	5.6%
Urban	5.0%	5.7%	6.4%	6.8%	6.1%	5.3%	5.3%
Metro	5.3%	6.4%	6.8%	7.3%	6.3%	6.0%	5.9%
Others	7.5%	10.4%	9.5%	13.9%	12.0%	11.4%	12.4%

Note: Credit include Education, Housing, Property, secured business, commercial vehicle, Tractor, 2W, Used car, Auto, Unsecured business, general business, consumer and personal loan, Source: CIBIL, CRISIL MI&A

While banks have intensified their focus on premium markets, such as semi-urban, urban, and metro areas, where their market share has increased by 3%, 9%, and 13%, respectively between FY19 and FY24, NBFCs have tapped into the underserved rural market.

The rural market has traditionally been avoided by banks due to the lower ticket value loan requirements and the perceived riskier profile of borrowers. However, NBFCs have been able to successfully cater to this market by leveraging their unconventional underwriting and lending approaches. By providing last-mile connectivity and customized product offerings, NBFCs have been able to bridge the financial inclusion gap in rural areas.

NBFCs' ability to innovate and adapt to the unique needs of rural and semi-urban customers has enabled them to thrive in this underserved market. Their willingness to take on risk and invest in untraditional lending models allows them to increase their market share and provide much-needed financial services to rural communities.

NBFCs regained momentum in rural and semi urban areas, with market share increasing 5% each from FY22 to Q1FY25

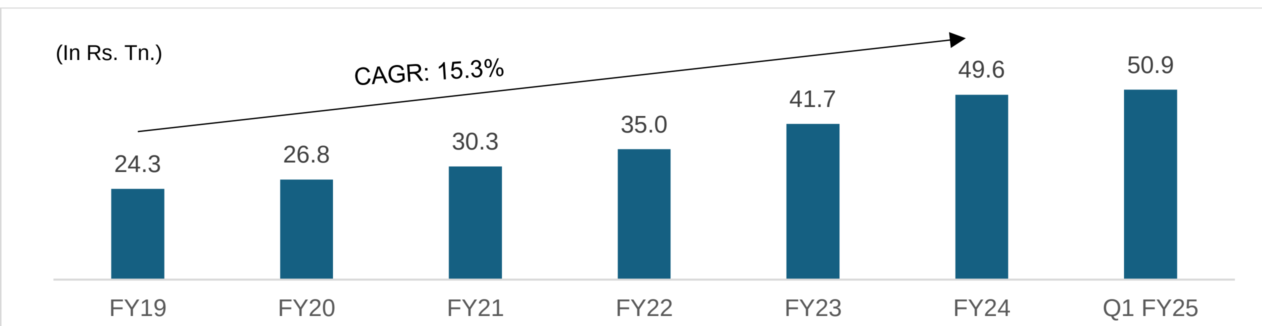
Lenders	FY19	FY20	FY21	FY22	FY23	FY24	Q1 FY25
Rural							
Banks	57%	57%	61%	64%	62%	58%	58%
NBFCs	38%	37%	32%	30%	32%	35%	35%
Others	5%	5%	6%	6%	7%	7%	7%

Semi Urban							
Banks	60%	61%	65%	68%	65%	63%	62%
NBFCs	35%	34%	28%	25%	27%	30%	30%
Others	4%	5%	7%	7%	8%	8%	7%
Urban							
Banks	62%	63%	70%	74%	72%	71%	70%
NBFCs	35%	33%	25%	22%	22%	24%	24%
Others	3%	4%	5%	5%	5%	5%	5%
Metro							
Banks	56%	59%	68%	72%	70%	69%	69%
NBFCs	39%	36%	27%	23%	24%	25%	26%
Others	5%	5%	5%	5%	6%	6%	5%

Note: Credit include Education, Housing, Property, secured business, commercial vehicle, Tractor, 2W, Used car, Auto, Unsecured business, general business, consumer and personal loan, Others include Co-op Banks, SFBs and other small lenders, Source: CIBIL, CRISIL MI&A

Secured retail loan witnessed growth at a 15% CAGR between FY19 and FY24

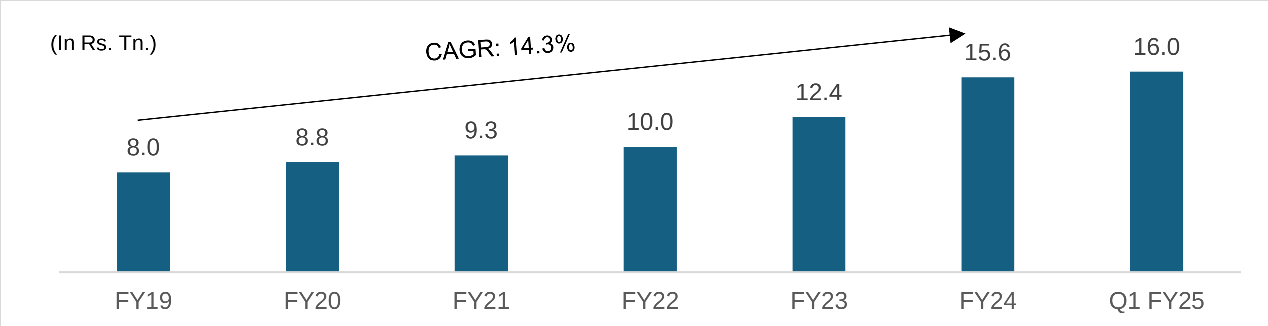
As of FY24, secured retail loans reached 49.6 trillion and 50.9 trillion in Q1 of FY25. It is growing at a CAGR of 15% from FY19 to FY24.



Note: Secured retail loan includes education loan, housing loan, property loan, and secured property business loan, Source: CIBIL, CRISIL MI&A

Secured hypothecation retail loan grew at a CAGR of 14% between FY19 and FY24

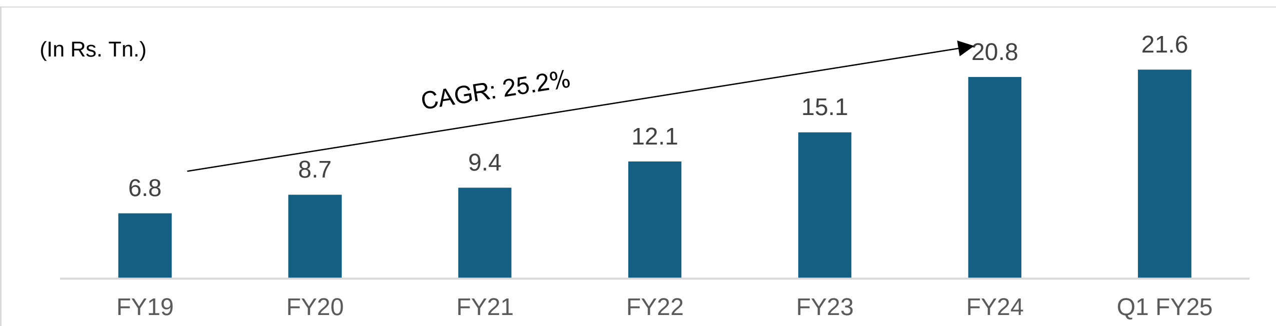
As of FY24, secured hypothecation loans reached 15.6 trillion and 16 trillion in Q1 of FY25. It exhibited CAGR of 14% from FY19 to FY24.



Note: Secured Hypothecation retail loan include secured business loans; Commercial vehicle loan, Tractor loan, 2-Wheeler loan, used car loan, and auto loan, Source: CIBIL, CRISIL MI&A

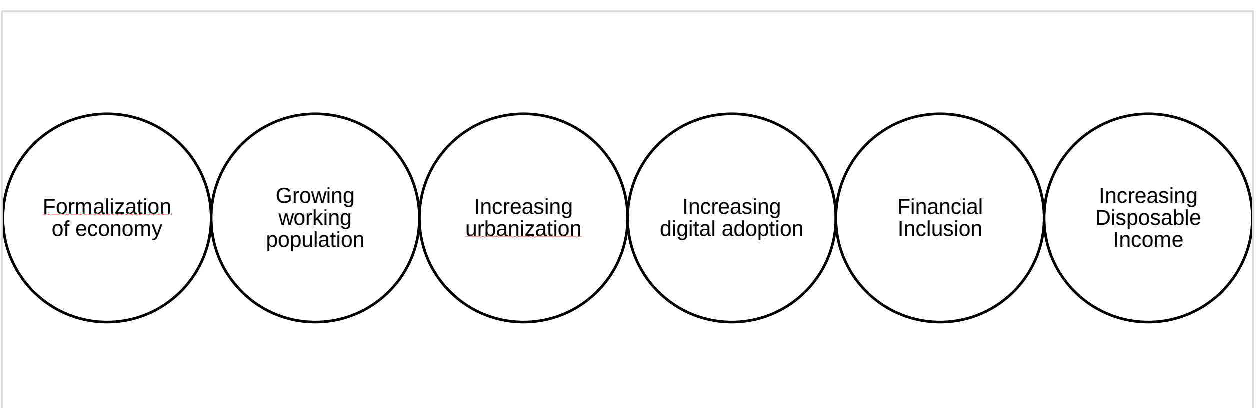
Unsecured retail loan reported 25% CAGR between FY19 and FY24

As of FY24, unsecured retail loans reached 20.8 trillion and 21.6 trillion in Q1 of FY25. It reported CAGR of 25% from FY19 to FY24. A significant driver of this growth has been the personal loan category, which experienced a substantial increase of 25% during the same period, serving as a key catalyst behind the segment's expansion.



Note: Unsecured retail loan includes unsecured business loan, general business loan, consumer loan, and personal loan, Source: CIBIL, CRISIL MI&A

3.3 Factors that will support retail credit growth



Source: CRISIL MI&A

Impact of digitization on retail credit

Higher mobile penetration, improved connectivity, and faster and cheaper data, supported by Aadhaar and bank account penetration have led India to shift from being a cash-dominated economy to a digital one. Technology has played an important role in taking the financial sector to the next level of growth, by helping to surmount challenges stemming from India's vast geography, which makes physical footprints in smaller locations commercially unviable.

In the financial space, the underwriting process can be improved by leveraging all available data efficiently. Lenders are increasingly using their web platforms and creating apps to register, score, approve and disburse loans to their customers. For lenders, digitization has enabled them to make informed decision making through business insight generation and data visualization. Moreover, it has improved lead generation for lenders with faster onboarding of customers, comprehensive loan servicing, and fraud detection. For customers, it has become easier to gather information about different lenders with the help of digitization and compare them.

Furthermore, the India Stack, a set of APIs and tools that enable the building of digital platforms for various services, has been a game-changer in the retail credit sector. The India Stack includes Aadhaar (for identity verification), e-KYC (for paperless Know Your Customer processes), eSign (for digitally signing documents), and the Unified Payments Interface (UPI) for seamless and instant fund transfers. All of these components have been seamlessly integrated into the lending ecosystem, traditional lending players have also integrated these components in their loan processes which had made it easier for lenders to streamline their operations and offer a seamless experience to borrowers. Looking ahead, the digitization of retail credit in India is expected to continue evolving

3.4 Non-retail credit growth drivers

PM Gati Shakti: PM Gati Shakti is aimed at building next generation infrastructure, which improves the ease of living as well as ease of doing business. Multi-modal connectivity will provide integrated and seamless connectivity for the movement of people, goods and services from one mode of transport to another. It will facilitate last-mile connectivity of infrastructure and reduce travel time for people. Developments in infrastructure and connectivity are expected to support developments in the real estate segment in the medium term.

Infrastructure Debt Fund (IDF): Providing an additional funding source for infrastructure projects, infrastructure debt funds (IDFs) have tapped private capital pools over the past three years. IDFs essentially act as vehicles for refinancing the existing debt of infrastructure companies, thereby creating headroom for banks to lend to fresh infrastructure projects. IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, especially insurance and pension funds, can invest through units and bonds issued by IDFs.

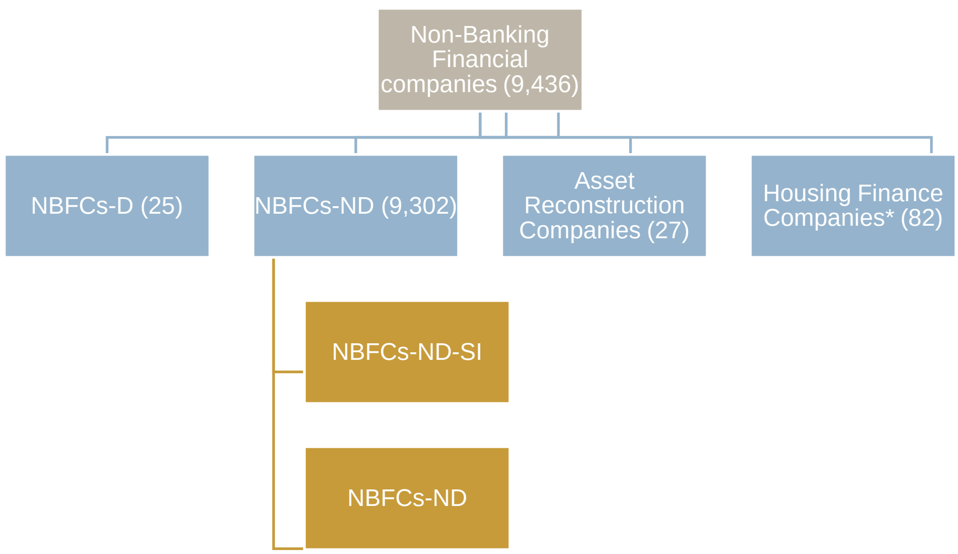
Introduction of tax-free bonds: Given the long-term nature of infrastructure projects and their importance to the economy, these projects have been funded primarily by the government through budgetary allocations. Apart from the government, banks and NBFCs have been other large financiers, meeting over a third of the sector's funding needs. NBFCs typically depend on market borrowings, particularly the bond market, to meet their funding requirements, with bond issuances accounting for over three-fourths of their funding mix. The introduction of tax-free bonds by the government has made it easier for these companies to raise funds from the market in recent years.

4. NBFC Credit Landscape

4.1 Classification of NBFCs

NBFCs are classified based on liabilities into two broad categories: a) deposit-taking; and b) non-deposit-taking. Deposit-taking NBFCs are subject to requirements of capital adequacy, liquid assets maintenance, exposure norms, etc. Further, in 2015, non-deposit-taking NBFCs with an asset size of Rs 5 billion and above were labelled as 'systemically important non-deposit taking NBFCs' ("NBFC–ND–SI") and separate prudential regulations were made applicable to them.

Classification of NBFCs based on liabilities



*Note: Figures in brackets represent the number of entities registered with the RBI as of March 2024. *Number of HFCs is as of June 2024*

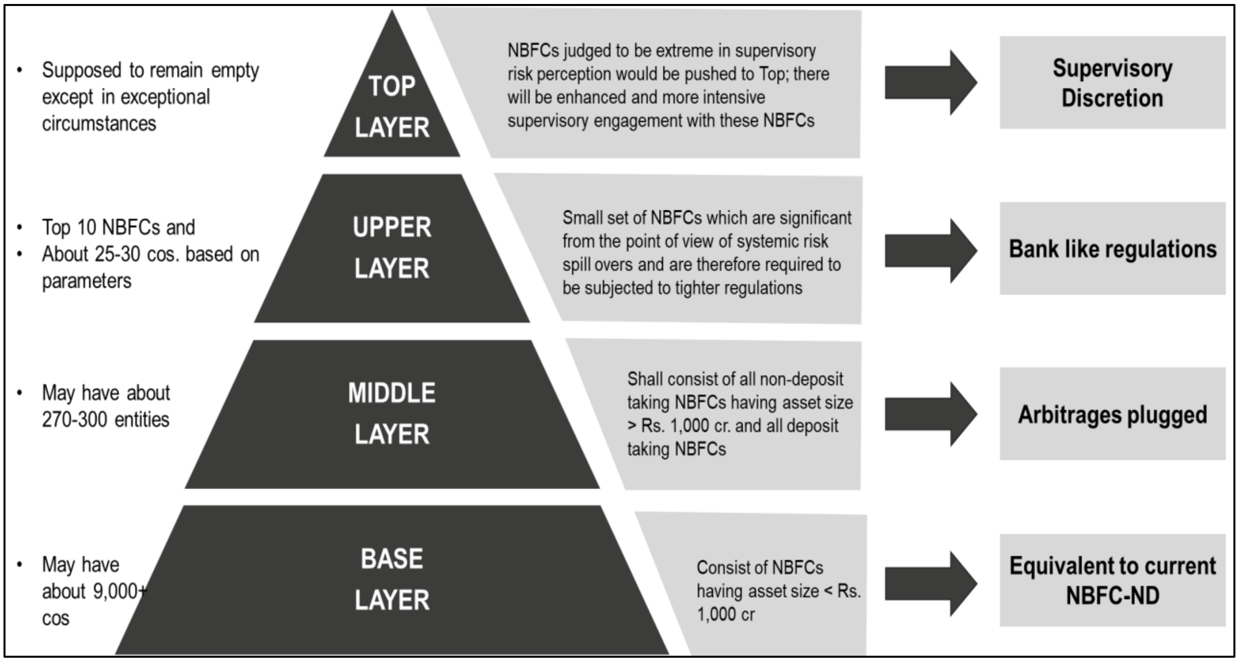
Source: RBI, CRISIL MI&A

4.2 Regulations impacting NBFCs and key changes over the last few years

Scale based Regulatory Framework for NBFCs

In January 2021, the RBI had proposed a tighter regulatory framework for NBFCs by creating a four-tier structure with a progressive increase in regulation intensity in a discussion paper titled 'Revised Regulatory Framework for NBFCs - A Scale-based Approach'. Based on the inputs received, in October 2021, the RBI put in place a revised regulatory framework for NBFCs, which is in effect from October 2022.

As per the RBI's Scale-Based Regulation for NBFCs framework, the regulatory and supervisory framework of NBFCs should be based on a four-layered structure depending on their size, activity, and perceived riskiness: base, middle, upper, and top layers.



Source: RBI, CRISIL MI&A

Regulatory distinction between banks and NBFCs

	NBFC – ND –SI	NBFC – D	Banks (Basel-III)
Minimum net owned funds	Rs 20 million	Rs 20 million	N.A.
Capital adequacy	15.0%	15.0%	11.5%
Tier I capital	10.0%	10.0%	9.5%
Stage III assets	90 days#	90 days#	90 days
Cash reserve ratio (CRR)	N.A.	N.A.	4.50%
Statutory liquidity ratio (SLR)	N.A.	15.0%$	18.00%
Priority sector	N.A.	N.A.	40% of Adjusted net bank credit
SARFAESI eligibility	Yes*	Yes*	Yes
Exposure norms (% of NOF)	Single borrower: 15% (+10% for IFC)	Single borrower: 15%	Single borrower: 15% (+5% for infrastructure projects)
	Group of borrowers: 25% (+15% for IFC)	Group of borrowers: 25%	Group of borrowers: 30% (+10% for infrastructure projects)

Note: NA = Not applicable

**The Ministry of Finance, in its union budget for 2021, proposed that the SARFAESI threshold be reduced from ₹5 million to ₹2 million, # Discretion with the audit committee of NBFCs to defer stage 3 classification beyond 90+dpd, $ as per RBI regulations, NBFC-D, shall invest in India in unencumbered approved securities valued at the price not exceeding the current market price of such securities an amount which shall, at the close of business or any day, not be less than 15% of the "public deposit". Source: RBI, CRISIL MI&A*

The RBI has taken a balanced view, and instead of going for a one-size-fits-all approach, it has opted for differential regulations based on the size and systemic importance of an NBFC. Furthermore, the importance of NBFCs in providing credit to underserved customers has been recognised. The RBI has not proposed imposition of CRR and SLR on NBFCs, is a relief to NBFCs.

Net owned fund

The RBI has specified Rs. 10 Cr as net owned fund required for below mentioned categories of NBFCs to commence or carry on the business of non-banking financial institution from October 01, 2022. Provided that mentioned NBFCs having net owned fund of less than ten crore rupees, shall achieve the NOF of Rs 10 crore as per the following.

Net Fund Owned Requirement		
NBFCs	**By 31st Mar 2025**	**By 31st Mar 2027**
NBFC-ICC	Rs. 5 Cr.	Rs. 10 Cr.
NBFC-MFI	Rs. 7 Cr.	Rs. 10 Cr.
NBFC-MFI in Northeastern region	Rs. 5 Cr.	Rs. 10 Cr.
NBFC-Factor	Rs. 7 Cr.	Rs. 10 Cr.

Source: RBI, CRISIL MI&A

RBI tightens provisioning norms on Standard assets for NBFC Upper Layer

On June 6th, 2022, the RBI released a circular aligning provisioning for standard assets by NBFCs in the upper layer as per RBIs scale-based regulations with that prevalent with the banks, which was effective from October 1, 2022. The impact of the norms is unlikely to be material as most large NBFCs already maintain Stage 1 and Stage 2 provisioning, which is comfortably higher than the required levels. The below table shows the provisioning that NBFC-ULs are required to maintain in respect of standard assets for the funded amount outstanding:

Provisioning norms for standard assets for NBFC-ULs

Category of Assets	Rate of Provision
Individual housing loans and Small and Micro Enterprises	0.25%
Housing loans extended at teaser rates	2.00%, which will decrease to 0.40% after 1 year from the date on which the rates are reset at higher rates (if account remains standard)
Advances to Commercial Real Estate – Residential Housing (CRE - RH) sector	0.75%
Advances to Commercial Real Estate (other than CRE -RH) sector	1.00%
Restructured Advances	As stipulated in the applicable prudential norms for restructuring of advances
All other loans and advances not included above, including loans to Medium Enterprises	0.40%

Note: NBFC-UL includes non-banking financial companies and housing finance companies; Source: RBI, CRISIL MI&A

RBI issues Master Direction on Scale Based Regulation of NBFCs, 2023

The RBI published the Master Direction on Scale Based regulation (SBR) of NBFCs to bring an end to the basic categorization of systemically important and non-systemically important NBFCs, while the classification based on acceptance of public deposits and specialisation continues to be in force. In addition, considering the systemic importance, the SBR Master Directions has enhanced the corporate governance in middle layer and upper layer NBFCs. For instance, NBFCs that are part of a common Group or are floated by a common set of promoters shall not be viewed on a standalone basis. The total assets of all the NBFCs in a Group shall be consolidated to determine the threshold for their classification in the Middle Layer.

Activity-based classification

As per the RBI circular dated February 22, 2019, the RBI has merged the three categories of NBFCs viz. asset finance companies (AFC), loan companies (LCs) and investment companies (ICs) into a new category called NBFC - Investment and Credit Company (NBFC-ICC):

- Investment and credit company – (NBFC-ICC): An NBFC-ICC means any company that is a financial institution carrying on as its principal business – asset finance – that is providing of finance by making loans or advances or otherwise for any activity other than its own and acquisition of securities; and is not any other category of NBFCs
- Infrastructure finance company (IFC): An IFC is a NBFC that deploys at least 75% of its total assets in infrastructure loans and has minimum net-owned funds of Rs 300 crore, with a minimum credit rating of 'A' or equivalent and a 15% CRAR.
- Systemically important core investment company (CIC-ND-SI): A CIC-ND-SI is an NBFC in the business of acquisition of shares and securities and satisfying the following conditions:
    - Holds not less than 90% of its total assets in the form of investments in equity shares, preference shares, debt, or loans in group companies.
    - Investments in equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies

that constitute not less than 60% of its total assets.

  - Does not trade in its investments in shares, debt, or loans in group companies except through block sales for dilution or disinvestment
  - Does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI Act, 1934, except investments in bank deposits, money-market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies
  - Asset size is Rs 500 crore or above
  - Accepts public funds

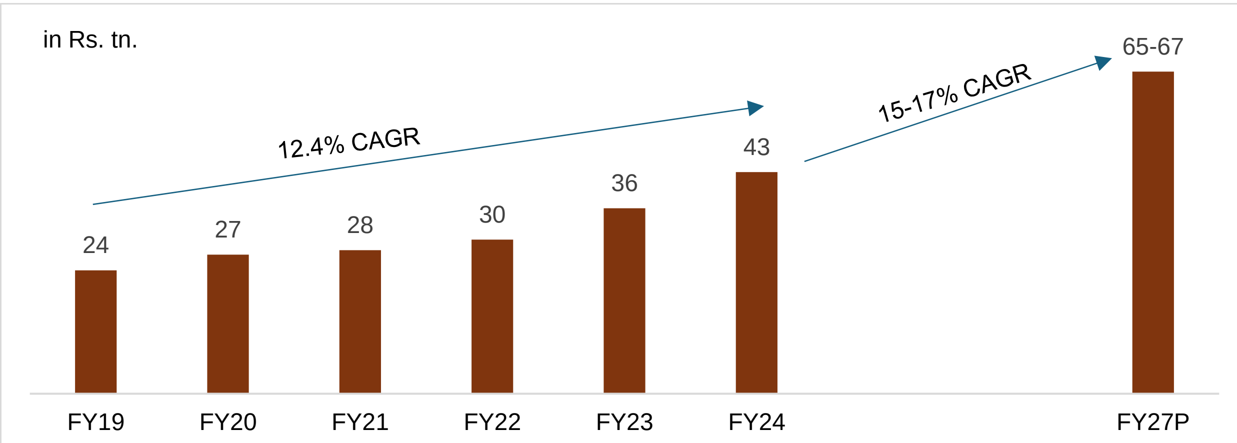
- Infrastructure debt fund (IDF-NBFC): An IDF-NBFC is a company registered as an NBFC to facilitate the flow of long-term debt into infrastructure projects. It raises resources through issue of rupee or dollar-denominated bonds with a minimum five-year maturity. Only IFCs can sponsor IDF-NBFCs
- Micro-finance institution (NBFC-MFI): An NBFC-MFI is a non-deposit-taking NBFC with not less than 75% of its assets in qualifying assets, which satisfy the following criteria:
  - The NBFC-MFI can disburse loans to borrowers with a household annual income not exceeding Rs 3,00,000 for all rural, urban, and semi-urban households
  - Loan tenure to not be less than 24 months for a loan amount in excess of Rs 30,000 with prepayment without penalty
  - Fixed obligation to income ratio (repayment) capped at 50%
  - Loan to be extended without collateral
  - Loan is repayable on weekly, fortnightly, or monthly instalments as per the borrower's choice
- Factors (NBFC-Factors): An NBFC-Factor is a non-deposit-taking NBFC engaged in the principal business of factoring. Financial assets in the factoring business should constitute at least 50% of its total assets and income derived from factoring business should not be less than 50% of its gross income.
- Mortgage guarantee companies (MGC): An MGC is a financial institution for which at least 90% of the business turnover is mortgage-guarantee business or at least 90% of the gross income is from mortgage-guarantee business and whose net-owned funds is Rs 100 crore.
- Non-operative financial holding company (NOFHC): An NOFHC is a financial institution through which promoter / promoter groups will be permitted to set up a new bank. A wholly owned NOFHC will hold the bank as well as all other financial services companies regulated by the RBI or other.

NBFC Credit is expected to grow faster than overall systemic credit between FY24 and FY27, witnessing a CAGR of 15-17%

The credit growth of NBFCs which has trended above India's GDP growth historically, is expected to continue to rise at a faster pace. NBFCs have shown remarkable resilience and gained importance in the financial sector ecosystem, during fiscals 2019 to 2024, NBFC credit is estimated to have witnessed a growth at CAGR ~12%. Rapid revival in the economy is expected to drive consumer demand in Fiscal 2025, leading to healthy growth in NBFCs.

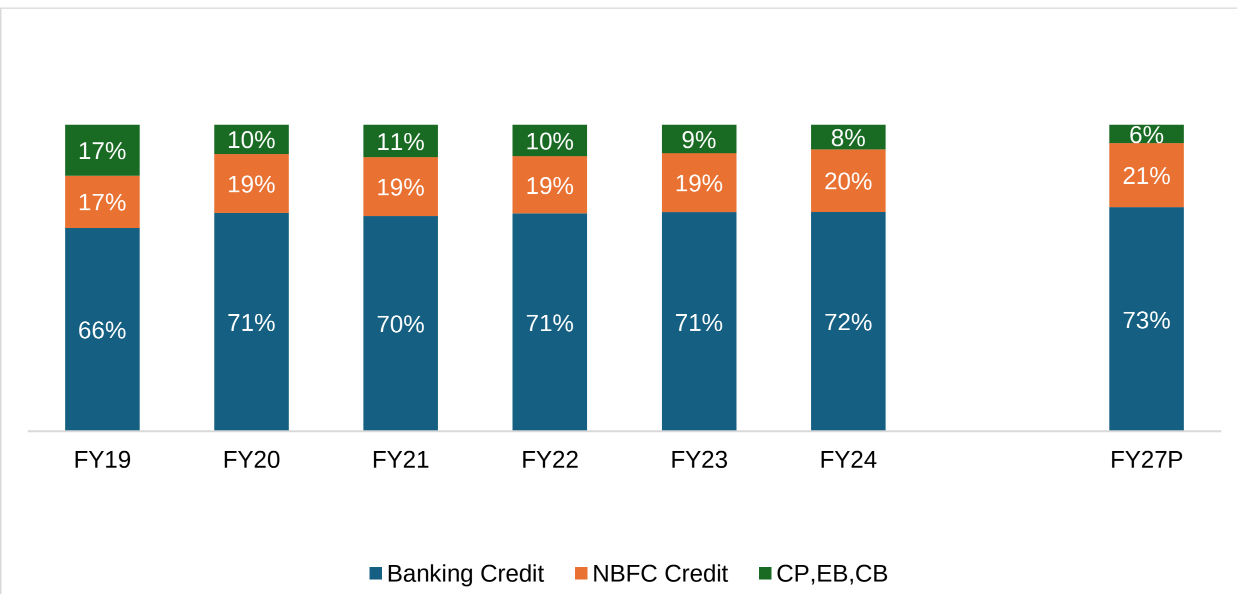
Going forward, CRISIL MI&A expects NBFC credit to grow at 15-17% between FY24 and FY27, driven by growth in retail segment, and MSME loans in the wholesale segment continuing to be the primary drivers.

NBFC Credit is expected to grow at a CAGR of 15-17% between FY24 and FY27



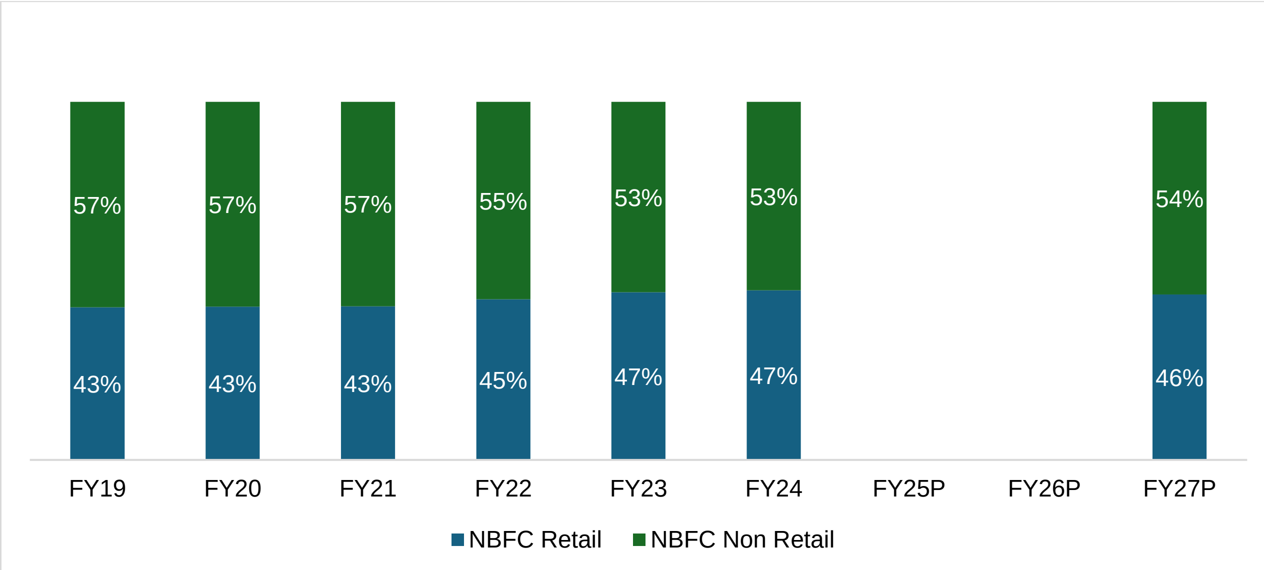
Note: P = Projected, Source: RBI, Company reports, CRISIL MI&A

Share of NBFC credit in overall systemic credit is projected to reach 21% in FY27



Note: P: Projected; Systemic credit includes domestic banking credit, NBFC credit, commercial papers (CP), external borrowings (EB), corporate bonds (CB) excluding those issued by Banks and NBFC; Source: RBI, Company Reports, CRISIL MI&A

NBFC Retail and NBFC Non- Retail



Note: P = Projected, Source: RBI, Company reports, CRISIL MI&A

NBFC's share in systemic credit is estimated to have increased from 17% in Fiscal 2019 to 20% in Fiscal 2024. Overall, consolidation in certain corporate groups and other corporate activities indicate buoyancy in the NBFC space and expectations of healthy credit growth.

CRISIL MI&A believes that NBFCs will remain a force to reckon within the Indian credit landscape, given their inherent strength of providing last-mile funding and catering to customer segments not conventionally targeted by the Banks. Going forward, NBFCs are expected to continue to gain market share over banks due to their ability to provide flexible lending solutions and tailored services, focused approach to tap under-served and niche customer segments, ability to penetrate deeper into geographies, leveraging technology to reimagine the lending process, strong origination skills and shorter turnaround time.

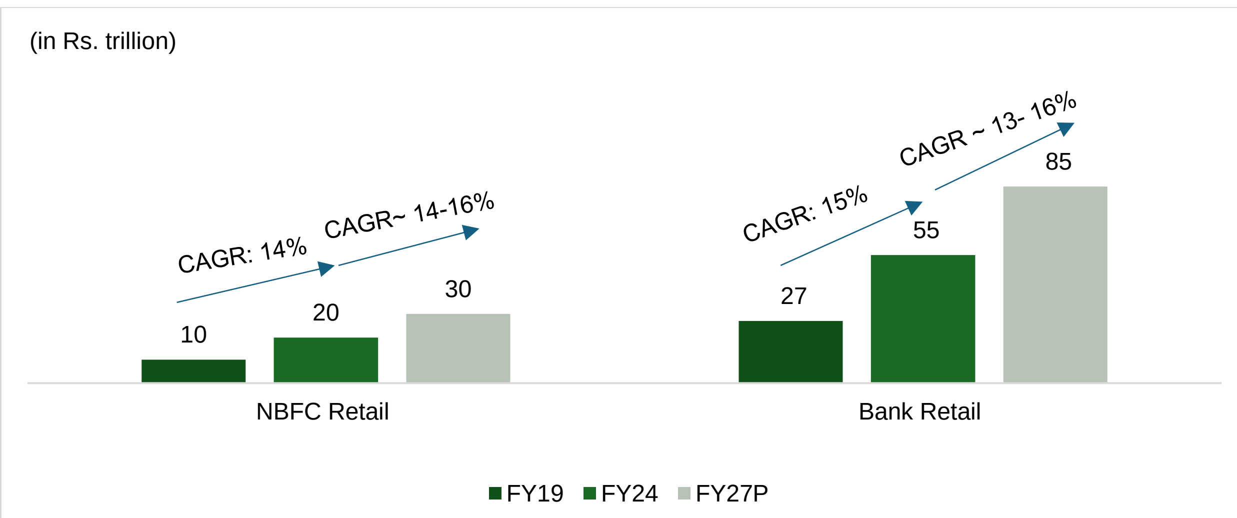
4.3 NBFCs are driving financial inclusion

While banks are the primary institutions for banking in India, retail loan portfolio forms only 34% of the overall banking credit as of Fiscal 2024. Other focus areas for banks are wholesale lending to large corporates, credit to services sector and agriculture sector. Lower presence of banks in the retail space has created an opportunity for NBFCs to penetrate the segment which has also led to greater financial inclusion as NBFCs also cater to riskier customer profiles with lower income. Compared to that of banks, NBFC credit to retail segment forms more than 47% as of Fiscal 2024 of its portfolio indicating larger focus on retail customers. Rural and semi-urban areas, presents vast market opportunity for NBFCs. NBFCs have played a major role in meeting this need, complementing banks and other financial institutions. NBFCs help fill gaps in the availability of financial services with respect to products as well as customer and geographic segments. A strong linkage at the grassroots level makes them a critical cog in the financial machine. They cater to the unbanked and underbanked masses in rural and semi-urban India and lend to the informal sector and people without credit histories, thereby enabling the government and regulators to realize the mission of financial inclusion. MSME often lack easy access to formal credit from banks due to limited credit history, insufficient collateral or lack of financial documentation. NBFCs bridge the gap by offering customized solutions. NBFCs stronger presence in rural and semi-urban areas where MSMEs are prominent help them to serve the under-penetrated segments driving financial inclusion

The NBFC sector has, over the years, evolved considerably in terms of size, operations, technological sophistication, and entry into newer areas of financial services and products. The number of NBFCs as well as the size of the sector has grown significantly, with a number of players with heterogeneous business models starting operations. The increasing penetration of neo-banking, digital authentication, and mobile phone usage as well as mobile internet has resulted in the democratisation of financial services, particularly credit. Overall NBFC credit during fiscals 2019 to 2024, is estimated to have witnessed a CAGR of ~12% which was majorly led by retail segment which is estimated to have witnessed a CAGR of ~14%, while NBFC non-retail credit is estimated to have witnessed a growth of ~9% during the same time period.

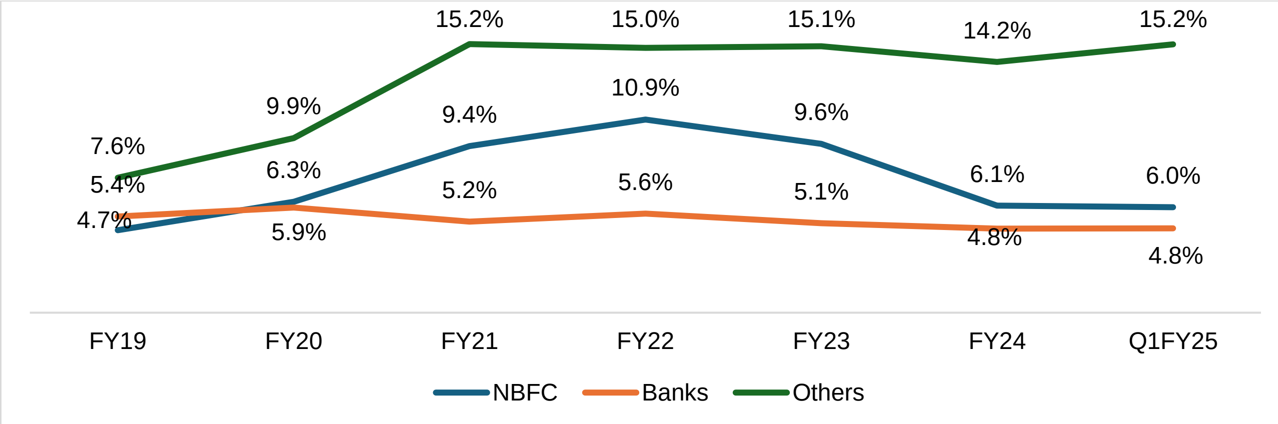
Going forward, growth in the NBFC retail segment is expected at 14-16% from Fiscal 2024 to Fiscal 2027 which will support overall NBFC credit growth, with continued focus on the retail segment.

NBFC Retail Credit is expected to grow at a CAGR of 14-16% between FY24 and FY27



Note: P = Projected; Retail credit above includes housing finance, vehicle finance, microfinance, gold loans, construction equipment finance, consumer durable finance and education loans; Source: Company reports, RBI, CRISIL MI&A

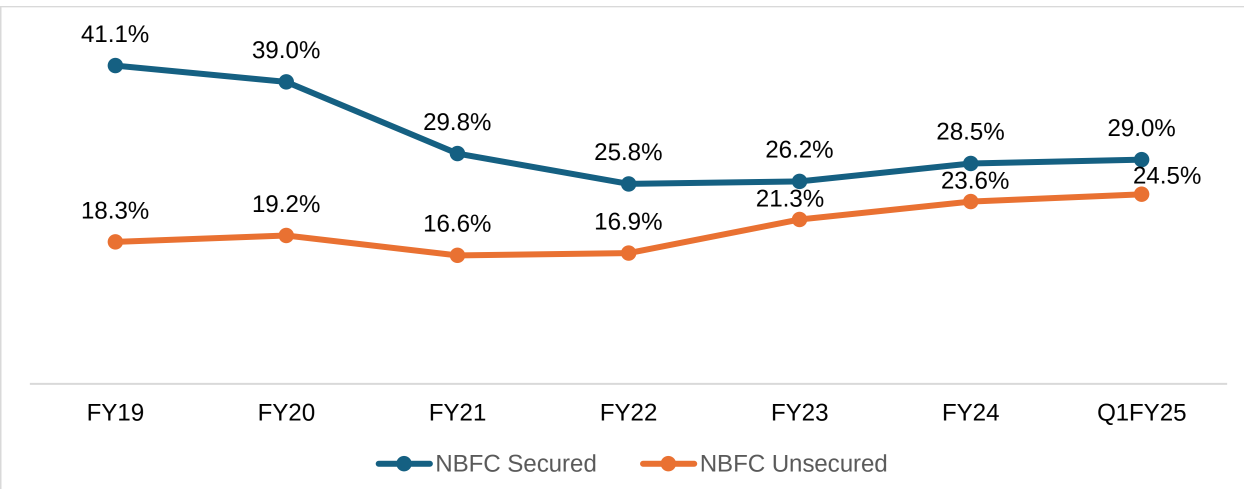
GNPA (90+ DPD) Trend for NBFCs, Banks and Others



Source: CIBIL, CRISIL MI&A

Note: Asset class considered were Auto loan, Business loan general, Business loan secured, business loan unsecured, commercial vehicle loan, consumer loan, education loan, housing loan, personal loan, property loan, tractor loan, two-wheeler loan, used car loan

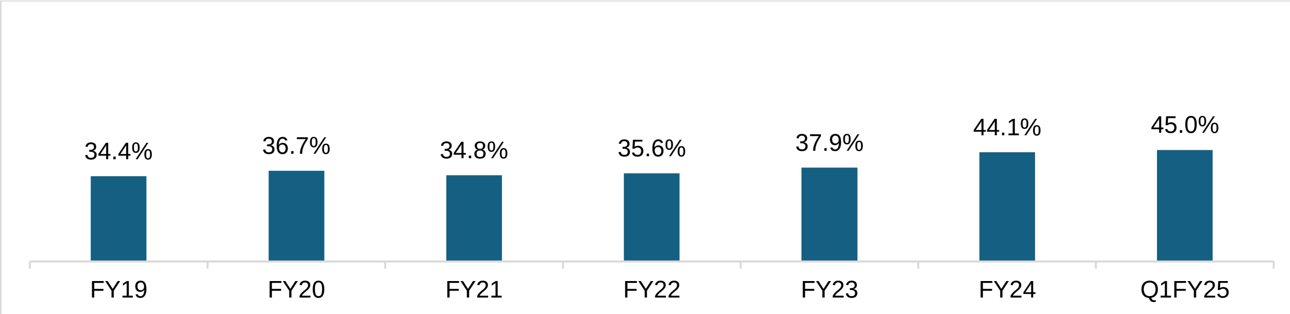
Share of NBFCs in Secured and Unsecured credit asset classes



Note: For computation of share of NBFC Secured, loans considered were Auto loan, Business loan secured, commercial vehicle loans, education loan, housing loan, loan against property, tractor loan, two-wheeler loan and used car loan. For computation of share of NBFC Unsecured loans, loans considered were business loan general, business loan unsecured, consumer loan and personal loan.

Source: CIBIL, CRISIL MI&A

NBFCs' share in small ticket (upto Rs 0.5 million) loans

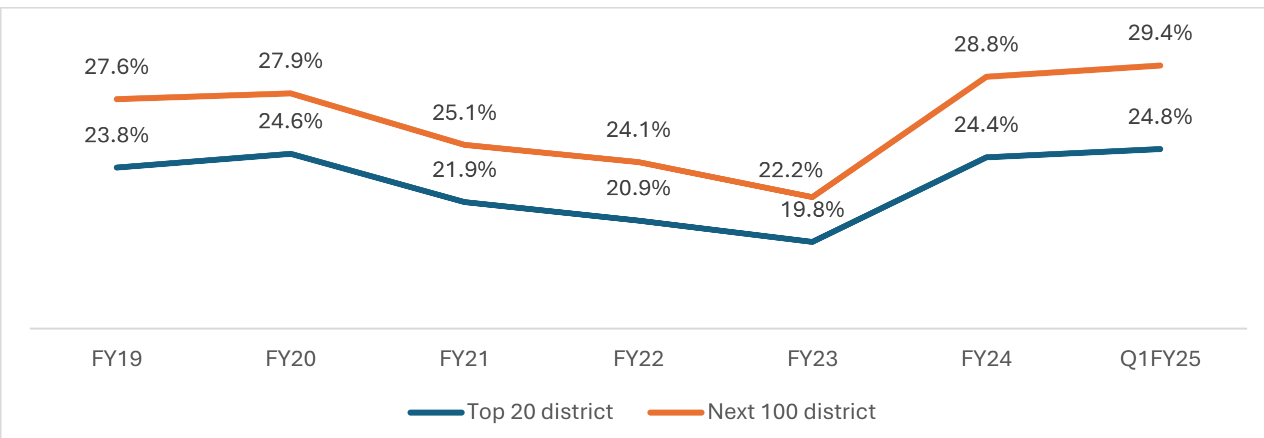


Note: Asset class considered were Auto loan, Business loan general, Business loan secured, business loan unsecured, commercial vehicle loan, consumer loan, education loan, housing loan, personal loan, property loan, tractor loan, two-wheeler loan, used car loan

Source: CIBIL, CRISIL MI&A

NBFC Share in small ticket loans (upto 0.5 million) has increased from 34.4% in FY19 to 45.0% in Q1FY25. NBFCs have a significant presence in tier 2 and tier 3 cities as well as rural areas where traditional banking penetration is lower which makes them favourable for small ticket loans specifically in smaller cities and districts.

NBFCs' share of lending in small ticket loans (Upto Rs 0.5 million) in top 20 districts and in next 100 districts

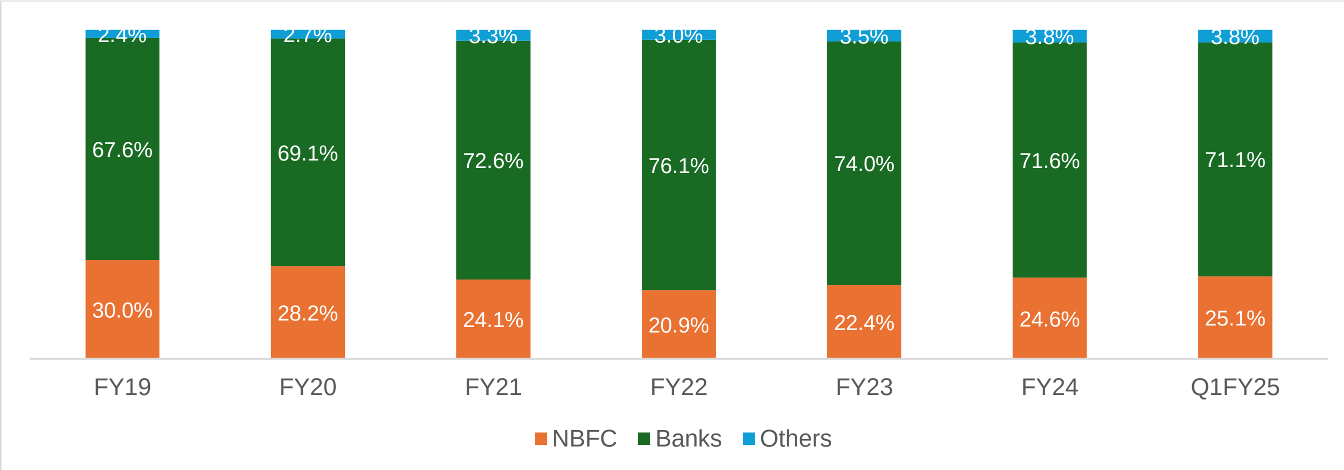


Note: Top 20 and next 100 districts are considered based on portfolio outstanding of Auto loan, Business loan general, Business loan secured, business loan unsecured, commercial vehicle loan, consumer loan, education loan, housing loan, personal loan, property loan, tractor loan, two-wheeler loan, used car loan

Source: CIBIL, CRISIL MI&A

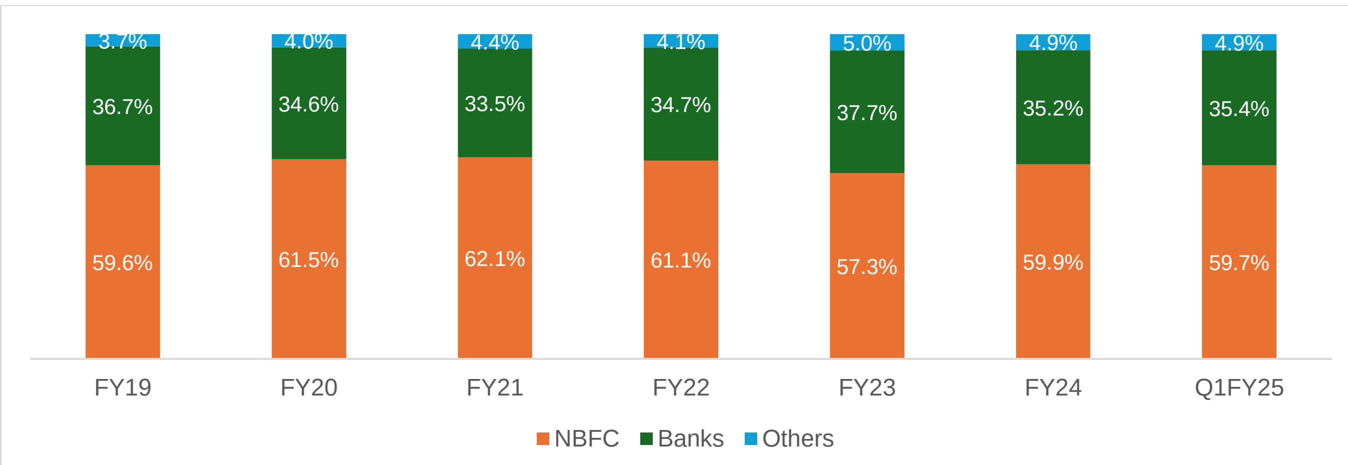
Share of NBFCs across select asset classes

Auto loans



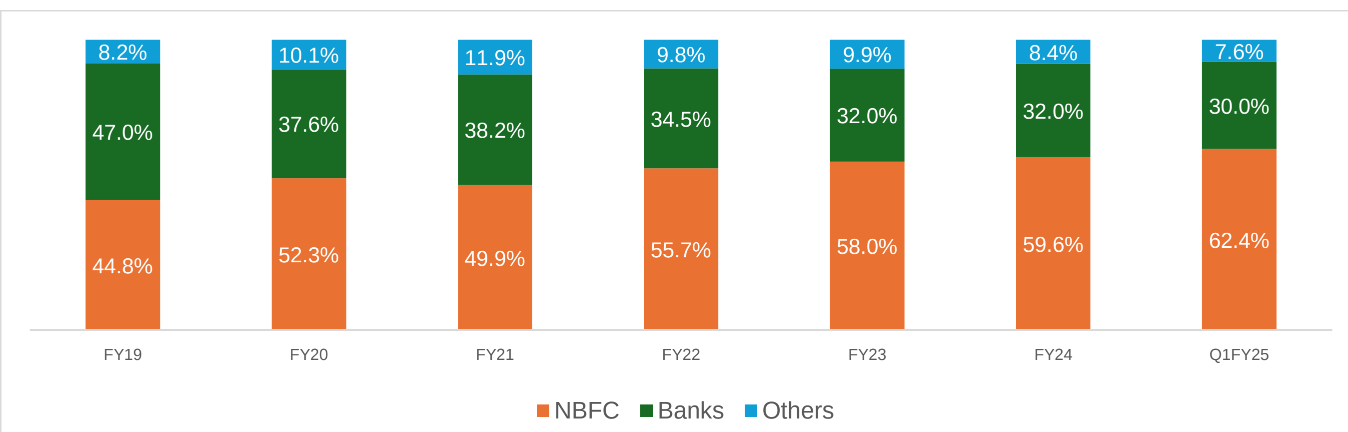
Source: CIBIL, CRISIL MI&A

Commercial vehicle loans



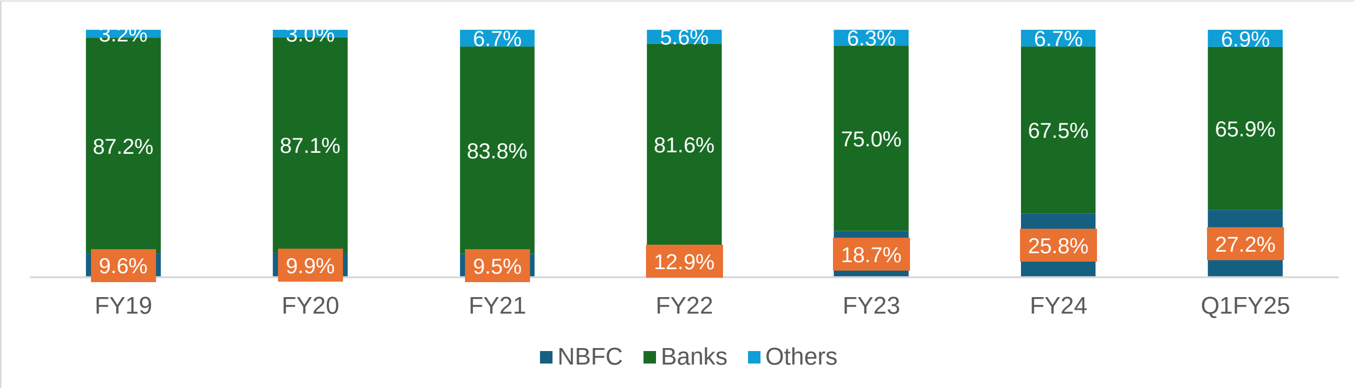
Source: CIBIL, CRISIL MI&A

Consumer loans



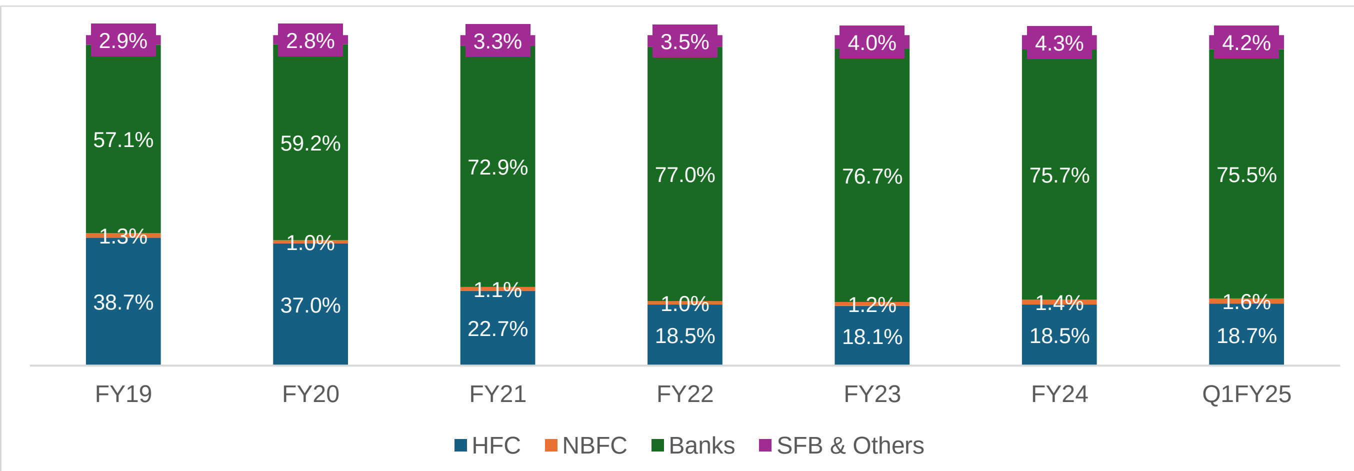
Source: CIBIL, CRISIL MI&A

Education loan



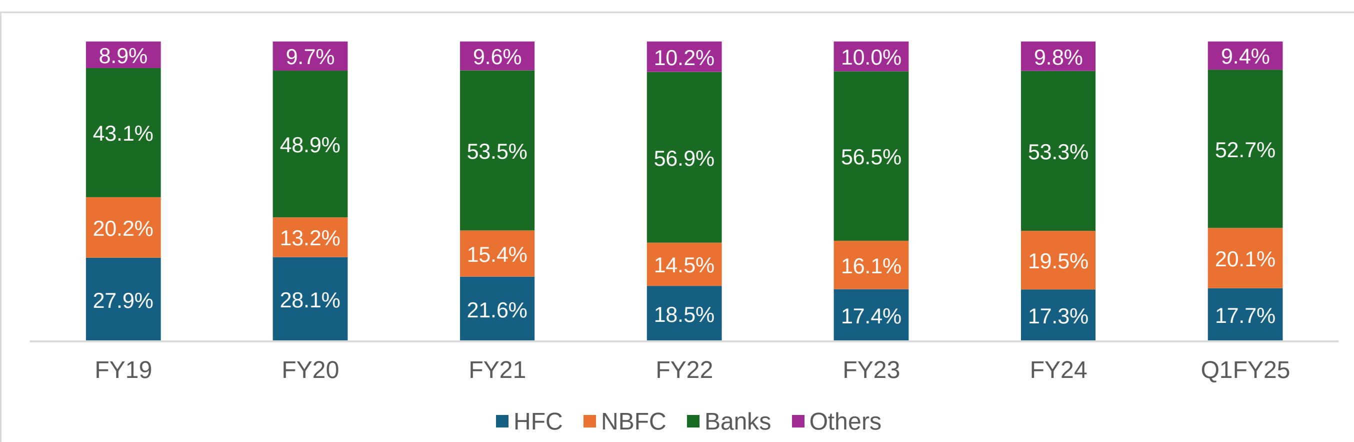
Source: CIBIL, CRISIL MI&A

Housing loan



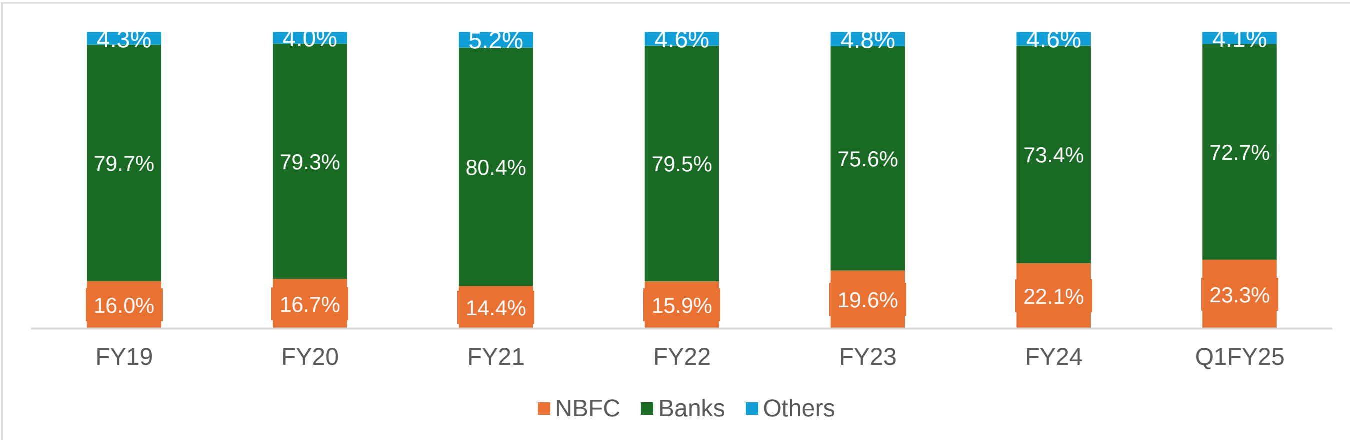
Source: CIBIL, CRISIL MI&A

Loan against property



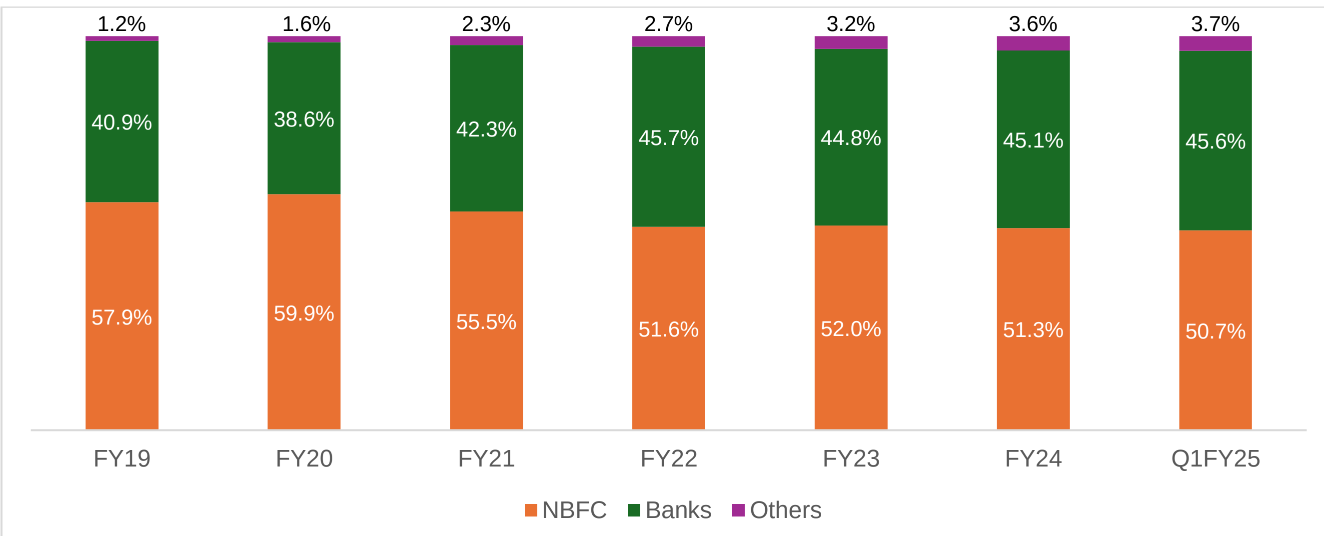
Source: CIBIL, CRISIL MI&A

Personal loan



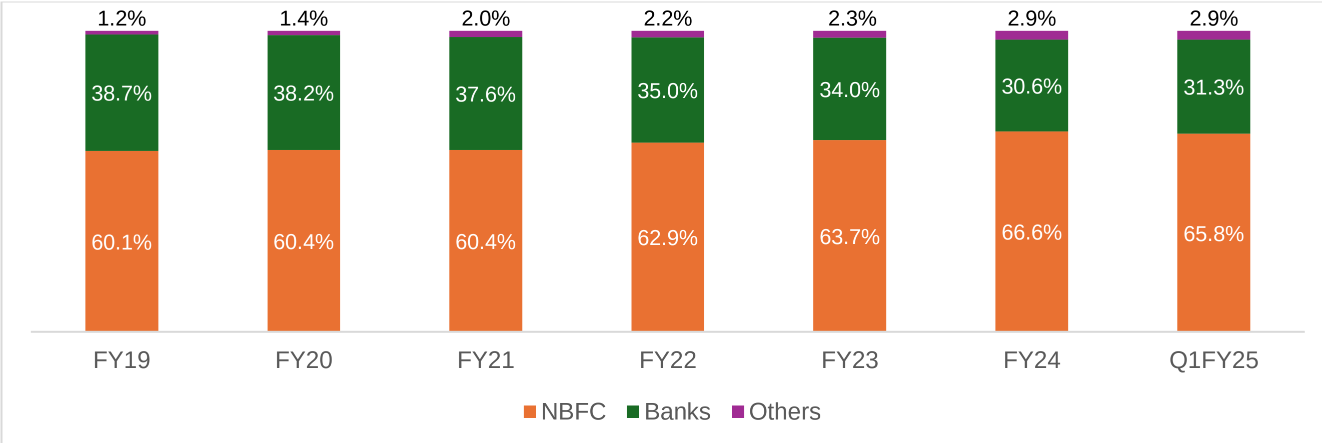
Source: CIBIL, CRISIL MI&A

Tractor loan



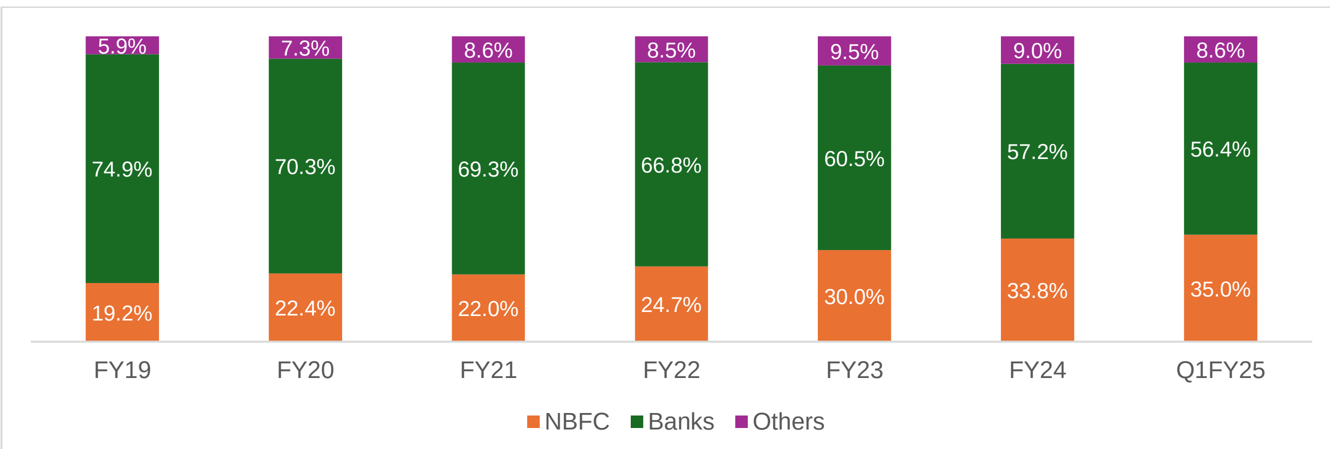
Source: CIBIL, CRISIL MI&A

Two-wheeler loan



Source: CIBIL, CRISIL MI&A

Used car loan



Source: CIBIL, CRISIL MI&A

4.4 Loan segments driving NBFC growth

NBFCs in India have demonstrated remarkable growth, driven by an increased focus on diversified loan segments catering to both individual and business needs. NBFCs have strategically expanded their portfolios across various segments, including auto loans, commercial vehicle loans, education loans, housing loans, personal loans, loans against property, tractor loans, two-wheeler loans, used car loans, and general as well as secured and unsecured business loans.

NBFC non retail segment consists of secured MSME, Hypothecation MSME and unsecured MSME loans. This portfolio is growing at a moderate CAGR between 8.4% to 11.8% between FY19 and FY24. In NBFC retail the secured business loan segment stands out as the fastest-growing segment, with a CAGR of 54.8%. This surge can be attributed to the rising need for capital among MSMEs and an increased willingness among NBFCs to fund businesses that provide collateral. Unsecured business loans have witnessed a 28.7% CAGR benefitting from a huge credit gap and, underscoring NBFCs' role in addressing the financing gap for enterprises lacking sufficient assets for collateral. In the individual-focused segments, education loans have seen a robust 41.4% CAGR, highlighting the increasing priority given to higher education and skill development in the country. The personal loan segment, with a CAGR of 34.7%, reflects a strong preference for quick and flexible financing options among consumers. This growth is driven by the need for funds for personal consumption, lifestyle needs, and emergency expenses, supported by the ease of access and minimal documentation provided by NBFCs.

NBFC - Segment Wise Credit (portfolio outstanding) across asset class

Segment (Rs Tn)	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25	CAGR FY19-24
Secured MSME	3.1	3.9	4.1	4.7	4.4	5.1	5.8	10.4%
Unsecured MSME	1.6	1.6	1.9	2.3	2.7	2.8	3.1	11.8%
Hypothecation MSME	0.8	0.8	0.8	0.9	1.0	1.2	1.2	8.4%
Vehicle Finance	3.4	3.9	3.9	4.0	4.9	6.6	6.8	14.0%
Personal Loans	0.7	1.0	1.0	1.4	4.5	3.1	3.3	34.7%
LAP	2.3	2.1	2.2	2.2	2.8	3.8	4.0	10.4%
Business loan – Unsecured	0.4	0.5	0.4	0.4	0.8	1.3	1.4	28.7%
Business loan - Secured	0.1	0.1	0.2	0.2	0.4	0.7	0.8	54.8%
Housing Loan	7.4	7.8	5.4	5.1	5.9	7.0	7.3	-1.0%
Consumer Loan	0.2	0.2	0.2	0.3	0.4	0.5	0.6	24.5%
Education Loan	0.1	0.1	0.1	0.1	0.2	0.4	0.5	41.4%

Note: Vehicle Finance includes auto loan, commercial vehicle loan, tractor loan, two-wheeler loan and used car loan. CRISIL has classified overall MSME loans into three categories – Secured MSME loans, Unsecured MSME loans and MSME Hypothecation loans. The credit portfolio and other related data of MSME loans which are reported to commercial bureau are considered while providing analysis.

Further, CRISIL considers Loan against Property (LAP) as also secured MSME loans as majority of the loans in this category is obtained by MSMEs for commercial use. The data pertaining to LAP which are reported to Consumer bureau are considered while providing analysis.

Business loans considered in this section are business loans – secured, business loans – unsecured and business loans – general which are reported to consumer bureau. For the analysis, CRISIL has considered Business loan – unsecured and business loan – general as unsecured business loans.

Source: CIBIL, CRISIL MI&A

4.5 Borrowing Mix of NBFCs

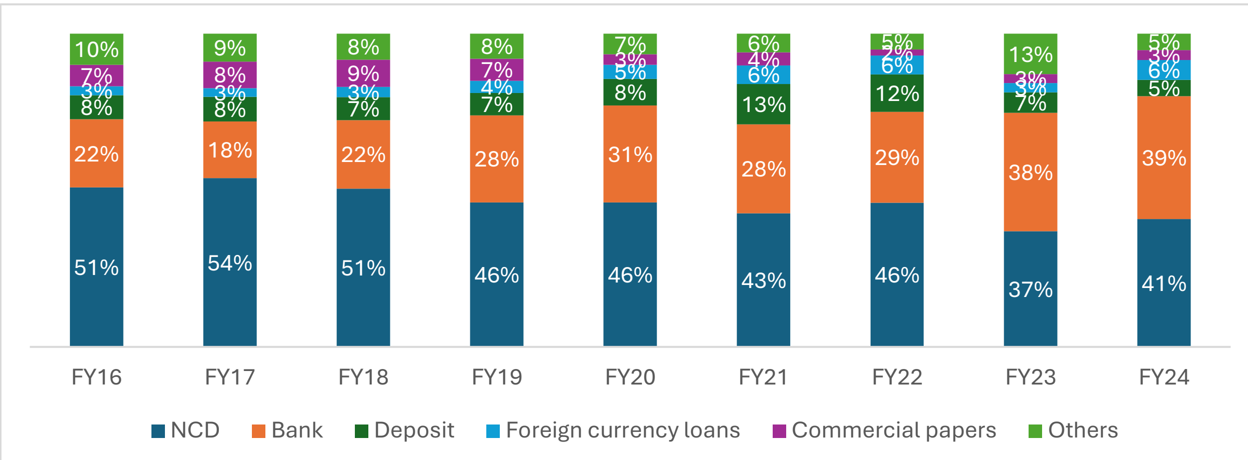
Bank borrowings continue to gain share in borrowing mix of NBFCs; expected to undergo moderation in near to medium term

In FY24, NBFCs' borrowings from NCDs witnessed high growth resulting in an increase in share to 41% of total funding up from 37% at the end of FY23. Share of bank's lending to NBFCs have almost doubled during last 10 years.

Joint efforts of the government and private sector have significantly influenced the growth of India's capital markets, driven in part by a focus on financial inclusion. This could lead to diversified sources of borrowings for NBFCs.

Going forward, CRISIL MI&A believes that funding access would gradually improve for NBFCs who are able to demonstrate strong performance. Reliance on bank funding is expected to remain at 38% as of Fiscal 2025, while it is expected to moderate in the near term with impact of RBI circular on risk weight and further transmission of rate hikes accelerated by deficit liquidity in the banking system.

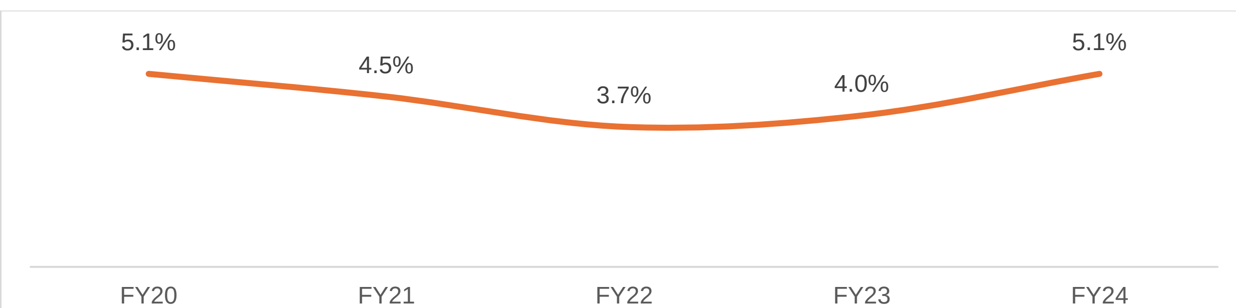
Bank borrowings expected to remain primary source of funds for the NBFCs, apart from NCDs



Note: Based on sample set of NBFCs accounting for more than 80% of overall borrowings of NBFCs as of March 2023; For FY23, NCD includes Debt Securities and NCDs, Bank includes Banks and National Housing Bank, and Others include Related Parties, Foreign Institutions, External Commercial Borrowings, and other sources

Source: Company reports, CRISIL MI&A

Cost of funds for banks stood at ~5.1% as of FY24

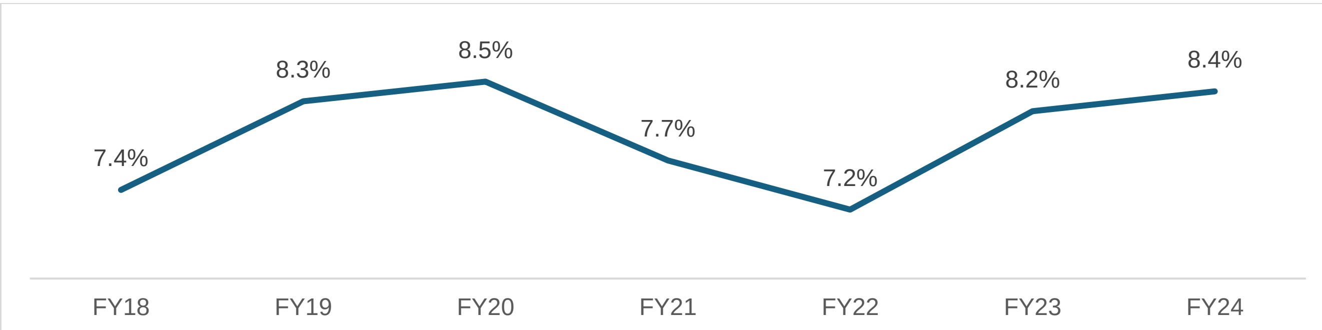


Source: Company Reports, CRISIL MI&A

NBFC borrowing cost increased in fiscal 2024

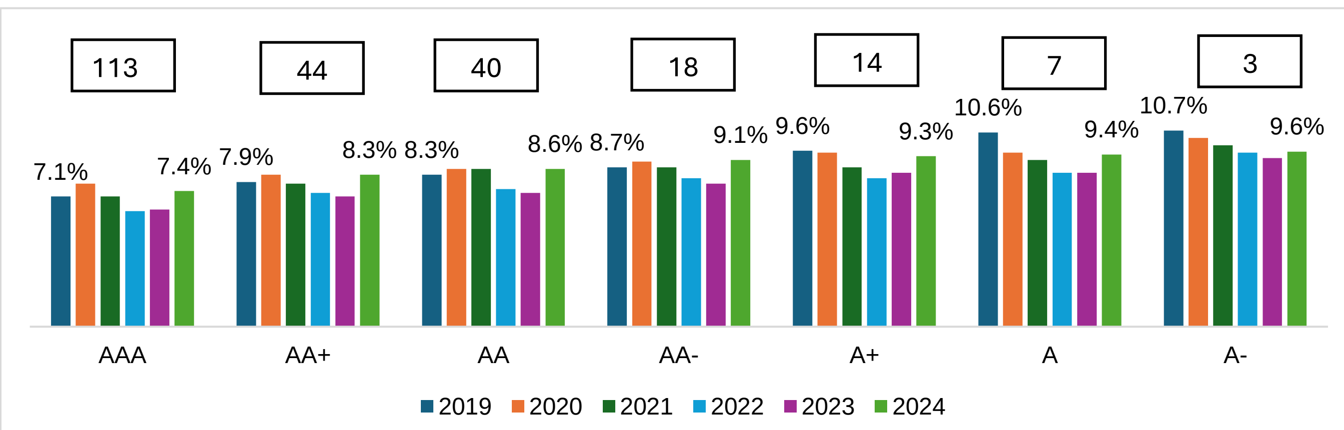
On account of increased unsecured lending in recent times by NBFCs, the RBI introduced a circular on risk weights, which acts as a deterrent to the growth of unsecured loans. As per the circular, the risk weights of all consumer loans (extended by both banks and NBFCs) were increased; the consumer credit exposure for banks and NBFCs will attract a risk weight of 125% from 100% earlier, excluding housing, vehicle, education and gold loans. Additionally, the risk weights for exposure of banks to NBFCs where the extant risk weight of the NBFC is below 100% was also increased. An increase in the cost of funds for NBFCs could drive the demand for securitisation and co-lending. NBFCs will also need to maintain adequate capital buffers.

Borrowing cost for NBFCs increased in fiscal 2024



Note: Data represents cost of borrowing of players, which cumulatively accounts for 85% of overall NBFC AUM; Source: Company reports, CRISIL MI&A

Average cost of borrowings for companies issuing bonds in the last five fiscals



Note: The box represents the number of NBFCs that full under different rating bands. Source: CRISIL MI&A

Average cost of borrowing for companies primarily increases with deterioration in credit rating. Average cost of borrowings for AAA rating category NBFCs was in the range of 6-7% between FY19 and FY24, whereas average cost of borrowings for A- rating category NBFCs was in the range of 9-10% between FY19 and FY24.

Alternatively, NBFCs have also started exploring several other sources of funds through securitization, there are generally two types of securitization structures, direct assignment (DA) and pass-through certificate (PTC), the common feature of these two types of transactions is that they both involve pooling of loans and selling them to a counterparty, therefore transferring credit risk. CRISIL MI&A expects, securitisation will continue to remain an important tool for NBFCs to mobilise liquidity. While volumes are expected to evolve significantly in FY25 with a rebound in both economic and credit growth, the overall pace of recovery in the transactions will be a function of extent in improvement in economic activities.

Opportunities for NBFCs to diversify source of funds

Partnership based lending (PBL), or Co-lending model (CLM) refers to an arrangement between two parties wherein one of the parties agrees to take over a larger proportion of the loan (usually 80% in PBL and 100% in case of loans originated by business correspondents (BCs)) originated by another party on its books, with the originator taking on the remaining (usually 20% in PBL) on its books. The collections and all the other activities pertaining to the loan are generally done by the originator. Mid and large sized NBFCs and a few banks have been undertaking lending through PBL for the last 3-4 years by leveraging on the distribution, customer segment understanding and/or digital sourcing capabilities of smaller NBFCs and fintech's. The focus in the case of banks is largely to meet their PSL target, while mid and large sized NBFCs aim at earning higher risk-adjusted yields through partnership-based lending. This model allows smaller NBFCs and fintech's to cater to a larger customer base with lesser capital by leveraging the larger balance sheet of their partners.

Various models available with banks to engage with NBFCs to meet the PSL targets

Criteria	Priority Sector Lending Certificates (PSLC)	Securitisation	Business Correspondent (BC)	Lending to NBFCs/MFIs/HFCs	Co-Lending
Bank exposure and risks	No operational and underwriting risks are involved, as the underlying asset, along with the risks and rewards, is held by the issuer	It requires an understanding of the market and the instrument, as there is a transfer of underlying receivables, including risks and rewards	It enables banks to take exposure across multiple regions and explore newer geographies	It enables banks to reach last-mile borrowers through NBFCs	It enables banks to take exposure with partner NBFCs
Mark-to-Market and Capital Requirement	No mark-to-market ("MTM") and capital requirement	MTM and capital requirement	No MTM, but requires capital	No MTM, but requires capital	No MTM, but requires capital
Impact on Bank book Size	No impact on the	Helps banks increase their book sizes	Helps banks increase their book sizes	Helps banks increase their book sizes	Helps banks increase their book sizes

	banks' book sizes				
Life Cycle	Has a life cycle only for a particular financial year	It involves large ticket size and have a longer life cycle of around 3-4 years	Involves tie ups with BCs like NBFCs to manage business for longer run	Involves direct lending to NBFCs and has a life cycle depending on loans disbursed by the NBFCs / MFIs / HFCs to the ultimate borrower/s as on the reporting date	Involves partnership with NBFCs for Co-lending for PSL and non-PSL loans
Risk	Involves no credit risk	Credit enhancement is available in case of Pass-through certificates ("PTCs")	Involves a hurdle rate or initial loss-sharing	Risk taken is on NBFCs/MFIs/HFCs	Involves an agreement in which a partner must maintain minimum 20% of the loan on their book
Yields	Yields are not relevant	Yields are relatively lower, as originators bargain with various banks for better pricing	Yields are comparatively higher	Yields are comparatively higher	Yields are comparativel y higher
Classificatio n of Assets	A clear classificatio n of assets for buyers	Risk of RBI questioning the classification of assets	Risk of RBI questioning the classification of assets	Detailed RBI guidelines available for classification	Policy to be guided by the RBI guidelines
Challenges	Availability of certificates can be an issue	Application of GST (18%) could be a dampener, as it increases the cost, thus impacting volume	Difficult for both parties to exit, as it can impact the overall portfolio	Periodic information sharing from NBFCs / Bank lending to NBFCs (other than MFIs) and HFCs are subjected to a cap of 5% of average PSL achievement of the four quarters of the previous financial year.	Difficult for both parties to exit, as a master agreement shall be formed with the partner

Source: CRISIL MI&A

Credit cost for NBFCs moderately declined in Fiscal 2024, with improvement seen in profitability

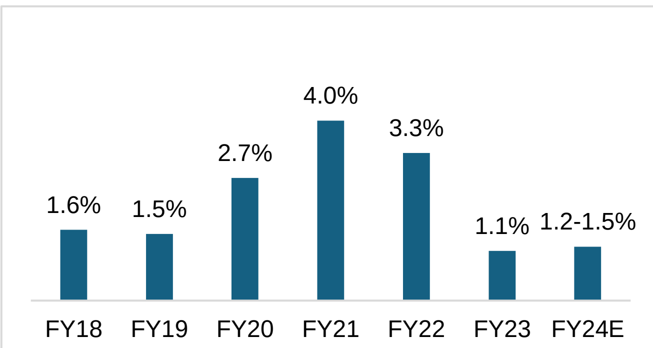
Overall yield for the retail segments increased in fiscal 2023 due to the interest rates hikes. However, the amount of pass-on has been distinct across all segments on account of level of competition, nature of asset class and segmental credit demand. Accordingly, a stable or modest increase in RoA was seen across all segments in Fiscal 2024.

In Fiscal 2023, decline in credit costs due to improved collections and lower slippages supported improvement in profitability aided by higher yields. The MFI segment, which typically has more pricing power, was able to improve its NIM. Similarly, the housing segment also improved its NIM owing to the floating nature of its loan book where it was able to pass on the increase in rates to its customers faster. However, competition from banks and subdued credit demand resulted in NIM compression for the gold segment.

In Fiscal 2024, credit cost is estimated to have moderately declined on account of improved collections and lower asset quality stress translating to moderate increase in RoA. In the near term, the impact of RBI circular on risk weights on cost of funds, thereby NIM and RoA will be a key monitorable.

Key ratios of NBFCs

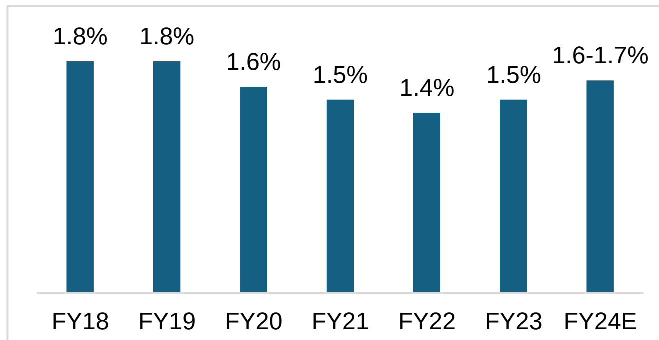
Credit costs for NBFCs moderately declined in Fiscal 2024



Note: E: Estimated

Source: CRISIL MI&A

RoA moderately increased in Fiscal 2024 for NBFCs



Note: E = Estimated

Source: CRISIL MI&A

ROA Tree for NBFCs across asset classes

Asset Class	Financial Metric	FY22	FY23	FY24E and FY25P
MSME Loans	Interest income to average assets	14.5%	15.5%	15.5-16%
	Interest expense to average assets	5.6%	5.7%	5.8-6.2%
	Credit Cost	1.2%	1.3%	1.3-1.5%
	Opex	4.2%	3.6%	3.4-3.6%
	ROA	3.3%	3.7%	3.6-3.9%

Auto Loans	Interest income to average assets	12.0%	12.4%	13.2-13.4%
	Interest expense to average assets	6.0%	5.8%	6.9-7.1%
	Credit Cost	2.5%	1.8%	1.6-1.8%
	Opex	1.6%	2.5%	2.0-2.2%
	ROA	1.9%	2.3%	2.4-2.6%
Housing Loans	Interest income to average assets	8.7%	9.2%	9.5-9.7%
	Interest expense to average assets	5.7%	5.9%	6.2-6.4%
	Credit Cost	0.6%	0.5%	0.3-0.5%
	Opex	0.9%	0.9%	0.8-1.0%
	ROA	1.5%	1.9%	1.9-2.1%
Affordable Housing Loans	Interest income to average assets	9.9%	10.3%	10.8-11.0%
	Interest expense to average assets	5.4%	5.4%	5.8-6.0%
	Credit Cost	0.7%	0.4%	0.2-0.4%
	Opex	1.5%	1.7%	1.7-1.9%
	ROA	2.3%	2.8%	2.8-3.0%
Personal Loans	Interest income to average assets	16.4%	16.8%	16.6-17.0%
	Interest expense to average assets	6.5%	6.7%	6.6-6.8%
	Credit Cost	3.6%	3.2%	2.8-3.2%
	Opex	4.5%	4.4%	4.2-4.4%
	ROA	3.6%	3.2%	2.8-3.2%

Source: CRISIL MI&A, Company Documents, Note: Ratios on average total assets

Personal loans have the highest interest income to average assets ratio of 16.8% in FY23 compared to 15.5% for MSME loans. MSME loans have the highest Return on Assets (ROA) OF 3.7% in FY23 compared 3.2% for personal loans. ROA for housing loans is lowest in FY23 with a ratio of 1.9% in FY23. MSME loans have the second lowest interest expense to average assets with a ratio of 5.7% in FY23. Affordable housing loans have the lowest credit cost of 0.4% in FY23 compared to MSME loans with a credit cost of 1.3% in FY23. Housing loans have the lowest operating expenses of 0.9% in FY23 compared to MSME loans with an operating expenses of 3.6% in FY23.

Profitability of NBFC Players present in the Unsecured Business Loan Segment

NBFCs in the Unsecured Business Loan segment operate with yield in the range of 23-25%, on average. With average cost of funds being in the range of 12-13%, net interest margins (NIMs) for this segment are in the range of 12-14%. CRISIL MI&A estimates the profitability in this segment to have increased in Fiscal 2024 owing to improving credit costs and increase in interest yields. Going forward, profitability to improve on the back of growth in loan book and increasing operating efficiency.

Competitive Scenario in the Unsecured Business Loan Segment

Parameter	FY22	FY23	FY24
Yield on advances	25.7%	24.4%	24.6%
Cost of Borrowings	12.4%	12.2%	12.2%
Net Interest Margins	12.5%	14.2%	16.9%
Return on Assets	-3.2%	2.4%	2.9%
ROE	-11.8%	9.5%	11.7%

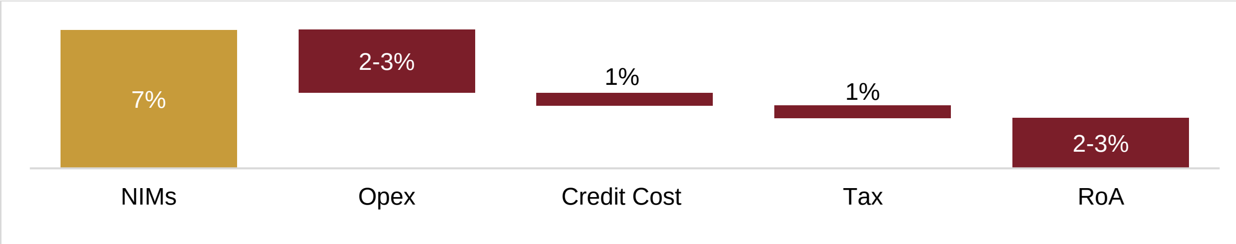
Sources: Company Reports, CRISIL MI&A

NBFCs operating in the Unsecured Business Loan Segment have been able to command higher margins (~16.9%) due to higher yield on advances (24.6%), with cost of borrowings at ~12.2%. leasing to return on assets at 2.9% for FY24, rising from 2.4% in FY23, their return on equity stood at 11.7% in FY24, rising from 9.5% in FY23.

NBFC/HFCs Profitability in LAP (secured business loans) improved in Fiscal 2024

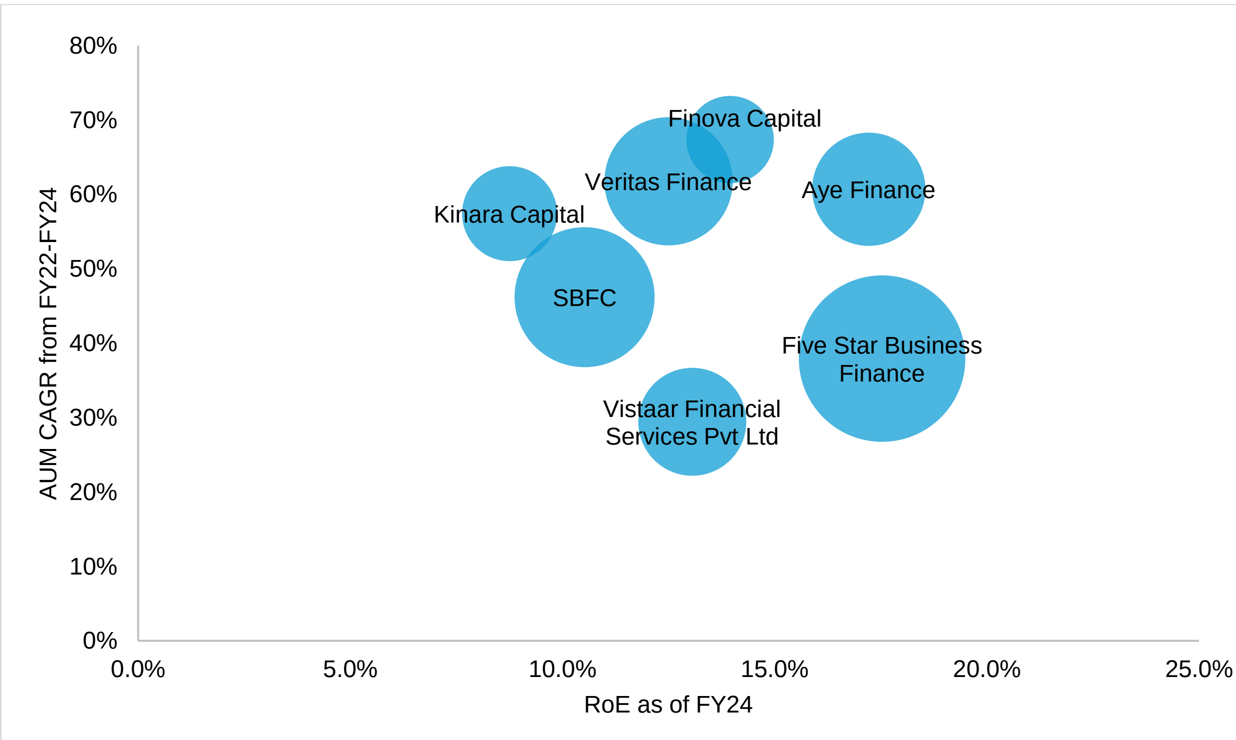
NBFCs in LAP segment operate with yield in the range of 15-16%, on an average. With average cost of funds being in the range of 9-10%, net interest margins (NIMs) for this segment are in the range of 5-7%. CRISIL MI&A estimates the profitability in this segment to have increased in Fiscal 2024 owing to improving credit costs and improved asset quality.

Profitability of LAP financing NBFCs (FY2024)



Source: CRISIL MI&A; Profitability estimated for FY24

Comparison of various players based on MSME portfolio size, portfolio growth (Fiscal 2022- Fiscal 2024) and RoE (Fiscal 2024)



Note: Size of the bubble denotes relative size of the MSME loan portfolio as of March 2024, Source: Company Reports, CRISIL MI&A

5. MSME Credit in India

5.1 Overview of MSME Sector in India

As per the MSME Development Act 2007, Micro enterprises are classified as enterprises with investment in plant and machinery or equipment not more than Rs. 10 million and annual turnover not more than Rs. 50 million. Small enterprises are enterprises with investment in plant and machinery or equipment not more than Rs. 100 million and annual turnover not more than Rs. 500 million. While medium enterprises are classified as enterprises with investment in plant and machinery or equipment not more than Rs. 500 million and annual turnover not more than Rs. 2500 million.

India has over 63.4 million MSMEs, of which 63 million MSMEs are classified as micro enterprises as per NSO survey conducted in 2016-17 and mentioned in the Ministry of MSME annual report. The estimated number of MSMEs in India is around 70 million as of FY22. MSMEs complement large corporates as suppliers or directly cater to end users. The MSME sector contributes to India's socio-economic development by providing huge employment opportunities in rural and backward areas, reducing regional imbalances, and assuring equitable distribution of national wealth and income. MSMEs in India contribute approximately 29.20% to the national GDP and faces a substantial unmet credit demand estimated at Rs 103.00 trillion. The Government expects that MSMEs' contribution to GDP to increase from 29.2% in Fiscal 2022 to 40-50% by Fiscal 2030. Further, as of June 2024, the total employment recorded on the Udyam registration portal (since inception 1st July, 2020, to 11th November, 2024) is 229.7 million.

MSME segment accounts for ~29% of Indian GDP

Rs trillion	Total MSME GVA	Growth (%)	Total GVA	Share of MSME in GVA (%)	All India GDP	Share of MSME in All India GDP (in %)	Number of MSMEs (in millions) *
FY16	41	11.0%	126	32.3%	138	29.7%	63.4
FY17	45	10.9%	140	32.2%	154	29.2%	65.5
FY18	51	13.0%	155	32.8%	171	29.8%	66.5
FY19	57	12.9%	172	33.5%	190	30.0%	68.5
FY20	61^	7.6%	184	33.4%	201	30.5%	NA
FY21	54^	-12.0%	182	29.7%	198	27.2%	NA
FY22	69^	27.1%	214	32.0%	235	29.2%	70.0
FY23	81^	8%	246	30.1%	269	NA	NA

Note: (*) – Estimated, All India GDP as of current prices, (^) Calculated numbers, Source: MSME Ministry Annual reports, Role of MSME Sector in India- Ministry of Micro, Small & Medium Enterprises, Source:https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1946375, CRISIL MI&A

As of 11th November 2024, micro enterprises accounted 97.4% of total registered MSMEs in India. Small and medium enterprises accounted for 2.4% and 0.2%, respectively of the total registered MSMEs. Maharashtra, Tamil Nadu and Uttar Pradesh account for the highest number of registered MSMEs in the country, with Maharashtra accounting for 16%, followed by Tamil Nadu and Uttar Pradesh accounting for 10% each.

In terms of constitution, close to 94% of the entities in the MSME universe in India are estimated to be sole proprietorship firms, wherein a small business undertaking is run and managed by the business owner and the business, and the owner can virtually not be separated.

Behavioural shift in MSMEs

Due to various initiatives and schemes by the Government, MSMEs have witnessed a behavioural shift which is expected to help them in gaining more access to credit. Few examples of behavioural shifts are:

Formalization of MSMEs - Around 38% of total estimated number of MSMEs in India are registered under Udyam System

There has been a large push for formalization of MSMEs in recent years with a ~5357% increase in the number of MSMEs registered on the Udyam portal (similar government portals) from Fiscal 2016 to Fiscal 2024. As of 11th November 2024, close to 30.8 million MSMEs (~44% of estimated number of total MSMEs in India) are registered on Udyam. Udyam certificate will be required by MSMEs for taking benefit of any scheme of the Central government. The Udyam portal is also integrated with the Government e-Marketplace ("GeM") and the Trade Receivables and Discounting System ("TReDS") so that enterprises can participate in government procurement and have a mechanism for discounting their bills.

Year-wise and MSME category-wise registration of MSMEs

Year / Category	FY17	FY18	FY19	FY20	FY21*	FY22^	FY23$	FY24	FY25^^
Micro	21,47,908	13,44,612	18,70,932	22,48,730	35,95,577	49,75,082	1,26,17,959	2,62,34,956	3,01,53,648
Small	2,16,558	1,66,259	2,41,187	3,02,299	4,00,525	1,72,432	4,35,885	7,08,216	7,27,208
Medium	8,592	6,584	9,426	11,229	35,541	11,294	39,854	67,481	68,660
Total	23,73,058	15,17,455	21,21,545	25,62,258	40,31,643	51,58,808	130,93,698	270,10,590	3,10,05,936

*Note: * Based on UAN and Udyam registrations, ^Based on Udyam registrations, $ Based on Udyam registrations as on December 2022 as stated in the MSME Annual Report 2022-23; ^^ as of 18th November 2024. Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), Udyam Registrations, CRISIL MI&A*

Top 10 State-wise Udyam registration of MSMEs

The top 5 states together accounted for approximately 50% of the total number of MSMEs registered on Udyam as of 18th November 2024.

State	Cumulative MSME Registration	Share in overall MSME registration
Maharashtra	50,22,257	16%
Tamil Nadu	30,15,056	10%
Uttar Pradesh	29,70,583	10%
Rajasthan	21,98,512	7%
Gujarat	21,41,265	7%
Karnataka	17,70,523	6%

Madhya Pradesh	15,10,178	5%
West Bengal	13,12,630	4%
Bihar	12,68,087	4%
Punjab	11,69,100	4%

Note: (*) Based on Cumulative MSME registration as of 18th November 2024(https://dashboard.msme.gov.in/Udyam_Statewise.aspx)
Source: Udyam Registrations, CRISIL MI&A

5.2 MSME Credit Gap

High risk perception and prohibitive cost of delivering services physically have constrained formal lending to MSMEs. The emerging self-employed individuals and micro, small and medium enterprise segment is largely unaddressed by lending institutions in India.

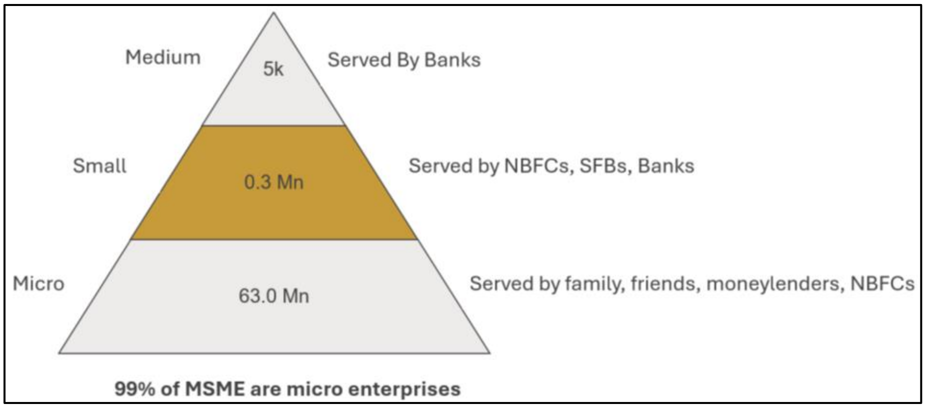
An IFC report titled Financing India's MSMEs (November 2018) estimated the MSME credit demand at Rs. 69.3 trillion in FY17, and the MSME credit gap *(defined as the gap between the demand for funds amongst MSMEs and the supply from formal financiers)* was estimated at Rs. 58.4 trillion.

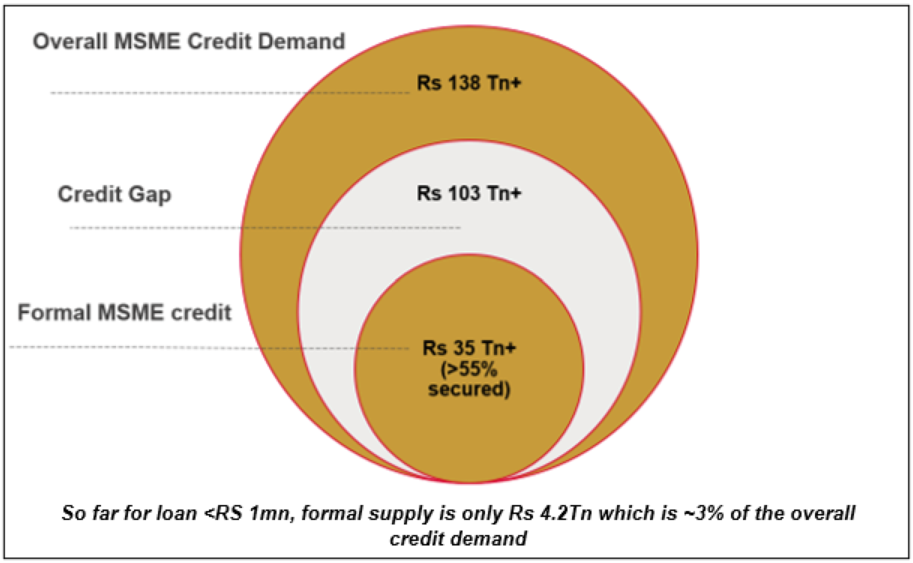
The addressable credit demand was at Rs. 36.7 trillion after removing demand from new MSMEs, commercially unviable MSMEs and micro MSMEs that do not seek formal financing as these types of MSMEs voluntarily go for informal source of credit including moneylenders, chit funds and personal sources from friends and relatives. The interest rate for these sources generally ranges between 36-60% per annum.

The credit gap is estimated to have further widened over the last 4 years due to slower economic growth in FY20, followed by the COVID-19 pandemic in FY21. In FY21, the nationwide lockdown to contain the spread of the COVID-19 pandemic disrupted economic activity, hurt demand, impacted working capital needs and supply chain along with future investments and expansions.

As of FY24, the MSME credit demand is estimated to be around Rs. 138 trillion, of which around 25.00% of demand is met through formal financing. Assuming an increase of around 10% annually in the demand for credit and the availability of credit from formal sources, CRISIL MI&A estimates the credit gap to have increased to Rs. 103.00 trillion as of FY24.

CRISIL MI&A estimates the total addressable credit demand at Rs. 67.5 trillion out of which current formal financing stands at around Rs. 35 trillion taking the total potentially addressable MSME credit gap to Rs. 32.5 trillion which needs to be met by Financial Institutions. CRISIL MI&A expects total addressable credit demand to have increased on account of favourable government policies and increased lenders' focus with tailored products and technological advancements. Technology and use of various data sources are helping lenders analyse cash flow for NTC (New to Credit) MSME customers faster and bring many MSMEs into the formal financing network. Further, this demand is expected to grow as the Government expects MSMEs' contribution to GDP to increase in the coming years.





Source: UDYAM, CIBIL, CRISIL MI&A

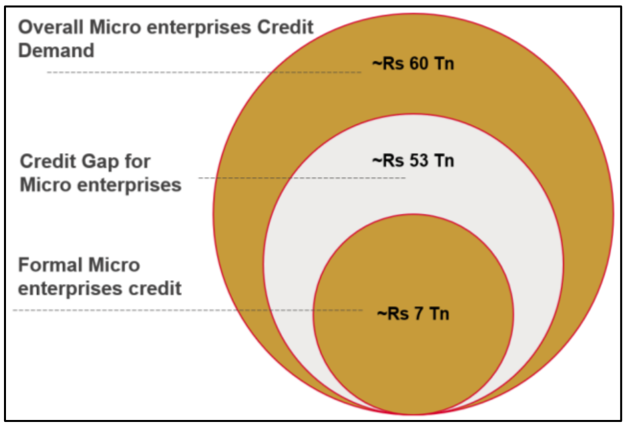
Credit gap for Micro Businesses is estimated to have increased to around Rs. 53 trillion as of fiscal 2024

In India, as per UDYAM registrations, more than 97.13% of MSMEs are classified as micro enterprises, highlighting a substantial total addressable market ("**TAM**") for financial services. These micro enterprises are credit starved and have limited access to formal credit and constitute only around 18.16% of formal credit availability. They typically need small business loans with a ticket size of less than Rs 0.5 million.

Further, while a large proportion of this TAM might own a property (in the form of their home or business premises), most of these micro enterprises require a hypothecation loan below Rs 0.5 million, while some of them would be willing to mortgage their property for a larger ticket size business loan ranging between Rs 0.30 million to Rs 1.00 million.

Additionally, women owned MSMEs account for 39.60% of total MSMEs (as per UDYAM registrations as of November 2024). Despite their significant contributions to the economy, women-owned micro enterprises often encounter systemic barriers, with limited access to capital being a major constraint. The large unaddressed target market can provide a large opportunity to NBFCs having pan-India presence to be among the fastest growing MSME lenders.

The aforesaid IFC report of November 2018 reported the credit demand for micro businesses at Rs. 30.4 trillion in FY17 with credit gap for micro businesses estimated to be around Rs. 27 trillion. As of fiscal 2024, the credit demand for micro business is estimated to have increased to Rs. 59.00 – Rs 60.00 trillion. Considering the credit demand for micro businesses to be more than availability of formal financing, the credit gap for micro businesses is estimated to have increased to Rs. 53.00-55.00 trillion as of fiscal 2024.

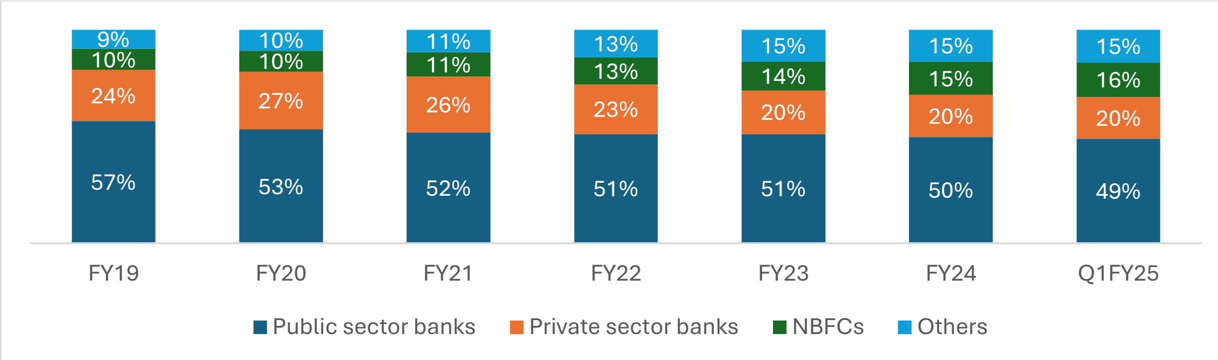


Source: UDYAM, CIBIL, CRISIL MI&A

Sources of finance for MSMEs with credit requirements of Rs 0.1 million to Rs. 0.5 million

Banks have remained the major source of finance for MSMEs with credit requirements of Rs. 0.1 million to 0.5 million. However, the share of NBFCs has increased from 9.88% in fiscal 2019 to 15.45% in fiscal 2024 whereas public sector banks and private sector banks have witnessed decline in their share. Going forward, the share of NBFCs in MSME credit with ticket size of Rs. 0.1 million to Rs. 0.5 million is expected to rise further as NBFCs have been intensifying their focus on the segment.

Share of NBFCs in MSME credit (Ticket size between Rs. 0.1 Mn – Rs. 0.5 Mn) increased to 16% in Q1FY25



Source: TransUnion CIBIL, CRISIL MI&A

5.3 Overview of overall MSME credit in India

Modes of funding for MSMEs

MSMEs need credit for various purposes including term loan for expansion of business and working capital for daily operational activities. These credit needs are being fulfilled by banks and NBFCs (including Fintech companies).

Additionally, there are several schemes by the Government and institutions like NABARD and SIDBI which are offered to MSMEs for supporting them in their businesses. Such schemes support MSMEs by facilitating collateral free loans, subsidies on term loans for setting-up and/or expanding the business, promotion of innovation, marketing assistance, technology enhancements, etc.

Banks and NBFCs offer various credit products based on the need of MSMEs. Such products include Loan against property, Supply chain financing, Inventory funding, Unsecured business loans, etc.

- **Loan against property**: It is a secured business loans which is disbursed by financial institutions against the mortgage of property. The property act as collateral / security and therefore the financial institution charges comparatively lesser interest rates than unsecured loans.
- **Secured Hypothecation**: These loans are backed by collateral in the form of movable/working assets such as inventory, machinery, vehicle or accounts receivables, which remains in the possession of the borrower but are hypothecated to the lender.
- **Inventory funding:** Inventory acts as one of the most important factors for running business smoothly. Inventory financing facilitate MSMEs to buy adequate inventories which could act as collateral for the loan. It helps MSMEs in maintaining optimal stock levels without impacting their cash flows.
- **Supply chain finance (SCF):** SCF consists of financing MSMEs against invoices and receivables as intermittent collaterals. It includes providing cash to suppliers against receivables from buyers.
- **Unsecured Retail:** These loans rely on the creditworthiness of borrower, business cash flow, alternative data rather than physical asset as security. These are typically used for working capital,

expansion, and operational needs. These loans have shorter approval times, higher interest rates, and are offered in smaller amounts compared to secured loans.

Note: *CRISIL has classified overall MSME loans into three categories – Secured MSME loans, Unsecured MSME loans and MSME Hypothecation loans. The credit portfolio and other related data of MSME loans which are reported to commercial bureau are considered while providing analysis.*
Further, CRISIL considers Loan against Property (LAP) as also secured MSME loans as majority of the loans in this category is obtained by MSMEs for commercial use. The data pertaining to LAP which are reported to Consumer bureau are considered while providing analysis.

Formal Source of Funding being preferred by borrowers

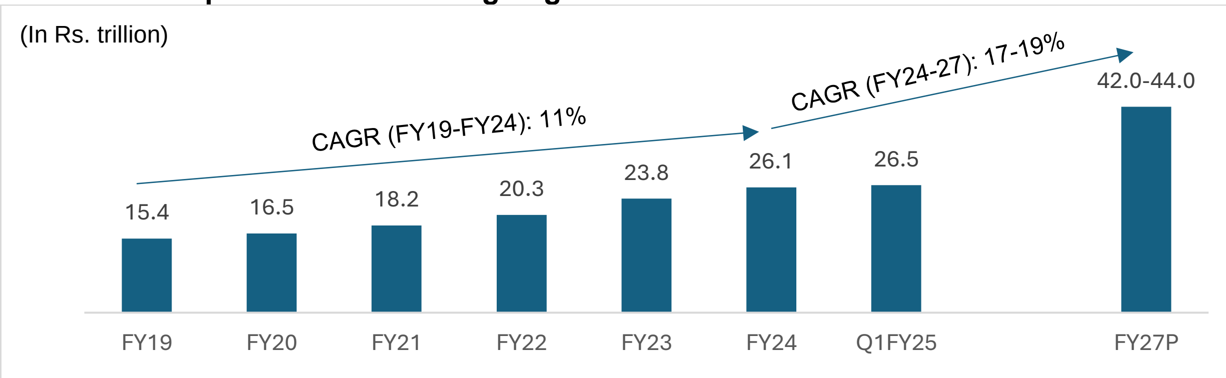
Formal financial institutions such as banks and non-banking financial companies (NBFCs) generally offer lower interest rates than informal lenders, making formal credit more affordable for MSMEs. Formal loans often come with longer repayment periods, which eases the cash flow burden on MSMEs and allows them to allocate resources to business expansion and other needs. Formal loans are regulated by government bodies, ensuring transparency, fairness, and adherence to structured processes, which builds trust among MSMEs. Borrowing from formal sources contributes to the borrower’s credit history, which is crucial for accessing future financing at better terms. A good credit score opens opportunities for larger loans or credit lines. Many formal financial institutions are tied to government schemes like the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and Priority Sector Lending (PSL), which offer benefits such as reduced collateral requirements or subsidized interest rates. Hence, MSME prefer formal source of funding rather than informal source.

Overall MSME Credit Outstanding

CRISIL MI&A estimates the total size of MSME lending market across ticket sizes and various player groups (banks, NBFCs, small finance banks, and other formal lenders) to be around Rs 26 trillion as of March 2024 and Rs 27 trillion as of June 2024. This market size includes loans taken by MSMEs across various constitution types (sole proprietorships, partnership firms, private and public limited companies, and co-operatives) and the ticket size spectrum, and includes loans extended in the name of the firm/entity/company as well as the individuals in case of micro enterprises or entrepreneurs.

The two pandemic waves were particularly tough for the MSMEs on account of no or fewer economic activities. The pandemic led frequent lockdowns and restrictions interrupted supply chains, demand and hence profitability of the MSMEs. During fiscal 2023, the Indian economy normalised, with industrialisation and urbanisation picking up pace. As a result, revenue increased to 20% for corporate India, while SMEs revenue grew 11%. In line with the overall growth, aggregate MSME credit grew 17% in fiscal 2023. In Fiscal 2024, overall MSME credit grew by 10% on the back of higher credit demand from MSME’s, higher focus of lenders on the asset class leading to higher disbursements.

Overall MSME portfolio outstanding to grow at 17-19% CAGR between FY24 and FY27

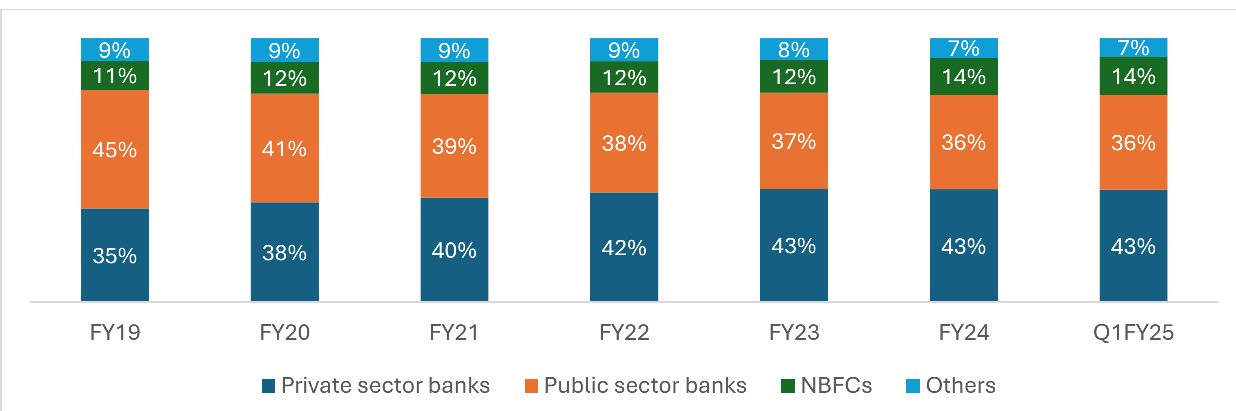


Source: TransUnion CIBIL, CRISIL MI&A

Private sector banks and NBFCs have grown their market share in overall MSME portfolio

As of Q1FY25, private sector banks have the largest share in overall MSME portfolio at 43% whereas public sector banks have 36% share. The share of NBFCs in overall MSME portfolio has increased from 11% as of fiscal 2019 to 14% as of Q1FY25. Overall, banks remain the major source of MSME financing with a share of 79% as of Q1FY25. Going forward, NBFCs are expected to drive the growth of MSME lending and increase its share in overall MSME credit, with banks following closely.

Private and public sector banks have a cumulative share of 79% in overall MSME credit as of Q1FY25



Source: TransUnion CIBIL, CRISIL MI&A

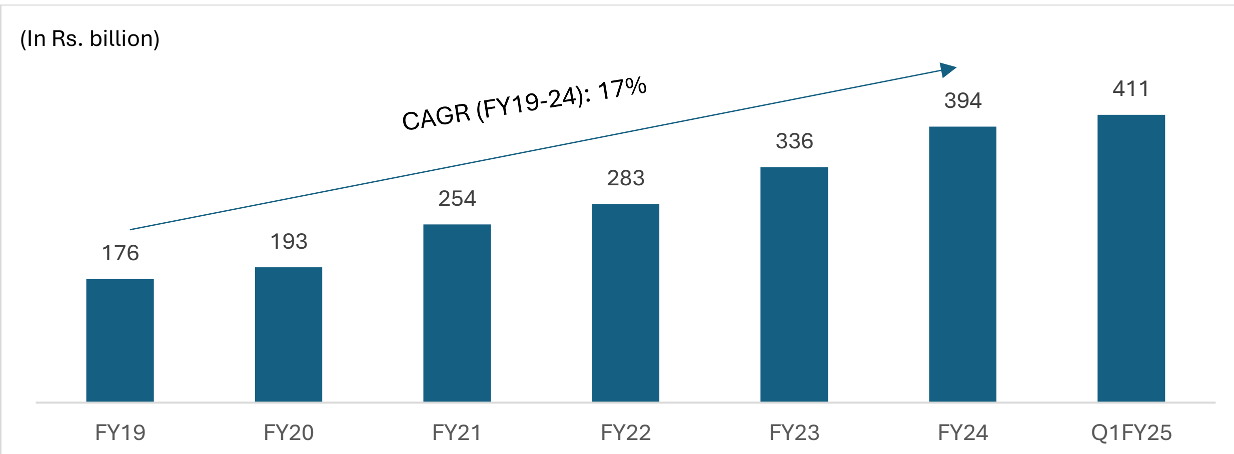
MSME credit for NBFCs with smaller ticket size of less than Rs. 1.0 Mn reached Rs. 411 billion as of Q1FY25

The majority of micro scale businesses require loans with a ticket size of less than Rs 1.0 million representing 11% of overall MSME credit outstanding (reported to Commercial bureau), highlighting a significant gap in addressing the needs of this segment.

Despite the large demand, only a very limited number of organized NBFCs or banks serve these customers. Barriers to entry in this market include high operational costs for servicing small-ticket loans, nuanced underwriting owing to limited or no available credit histories of borrowers, limited availability of data for underwriting and stringent regulatory requirements, which make it challenging for new entrants to effectively cater to this underserved segment. These discrepancies present a significant opportunity for financial institutions to address the unmet needs of this sector.

MSME loans for NBFCs with ticket size less than Rs. 1.0 million witnessed robust CAGR of 17% between fiscal 2019 and 2024 and reached Rs. 411 billion as of Q1FY25. The growth was on account of NBFCs shifting their focus more towards smaller ticket size MSME loans. Going forward, NBFCs are expected to continue driving the growth of smaller ticket size MSME credit.

MSME loans for NBFCs having ticket size less than Rs. 1.0 million grew at a CAGR of 17% between fiscals 2019 and 2024

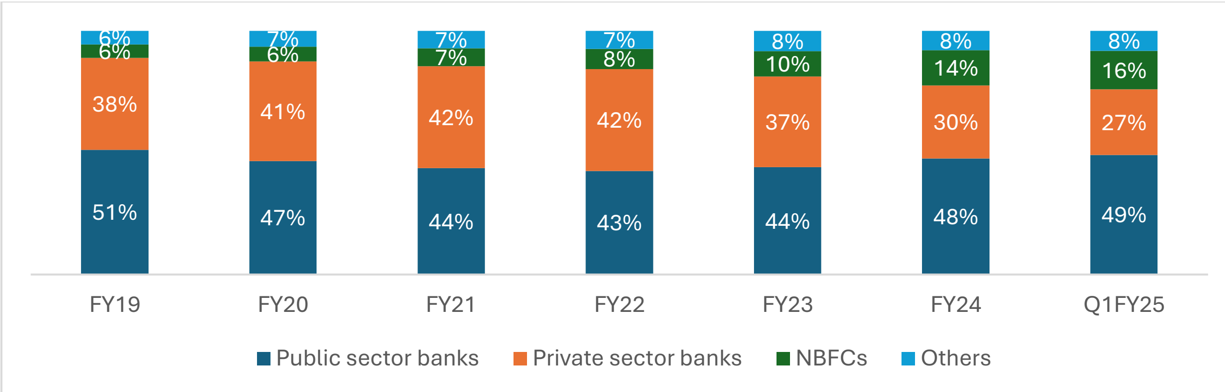


Source: TransUnion CIBIL, CRISIL MI&A

NBFCs' share witnessed a rise in MSME loans portfolio of ticket size less than Rs. 1.0 million

The share of banks in MSME loans portfolio of ticket size less than Rs. 1.0 million declined from 89% as of fiscal 2019 to 76% as of Q1FY25 as private sector banks shifted their focus towards larger ticket size MSME loans. However, this has led to more opportunities opening for NBFCs in small ticket size MSME loans with market share of NBFCs in MSME loans portfolio of ticket size less than Rs. 1.0 million increasing from 6% as of fiscal 2019 to 16% as of Q1FY25.

Share of NBFCs in MSME loans (Ticket size less than Rs. 1.0 million) increased to 16% as of Q1FY25



Source: TransUnion CIBIL, CRISIL MI&A

Semi-urban and rural region have cumulative market share of 29% in overall MSME credit as of Q1FY25 (In Rs. Billion)

The cumulative market share of semi-urban and rural region in overall MSME credit has increased from 25% as of fiscal 2019 to 29% as of Q1FY25.

Region-wise MSME credit in various ticket sizes as of Q1FY25

Region	< 0.5 million	0.5 million to 1 million	1.0 million to 1.5 million	1.5 million to 2.5 million	> 2.5 million	Total
Metro	488	339	335	671	9,700	**11,534**
Urban	280	276	249	417	5,204	**6,425**
Semi-Urban	293	355	273	411	3,915	**5,248**
Rural	154	220	145	197	1,614	**2,328**
Not reported	103	82	56	73	691	**1,007**
Total	**1,319**	**1,272**	**1,058**	**1,769**	**21,124**	**26,542**

Note: Above figures are in Rs. Billion as of Q1FY25

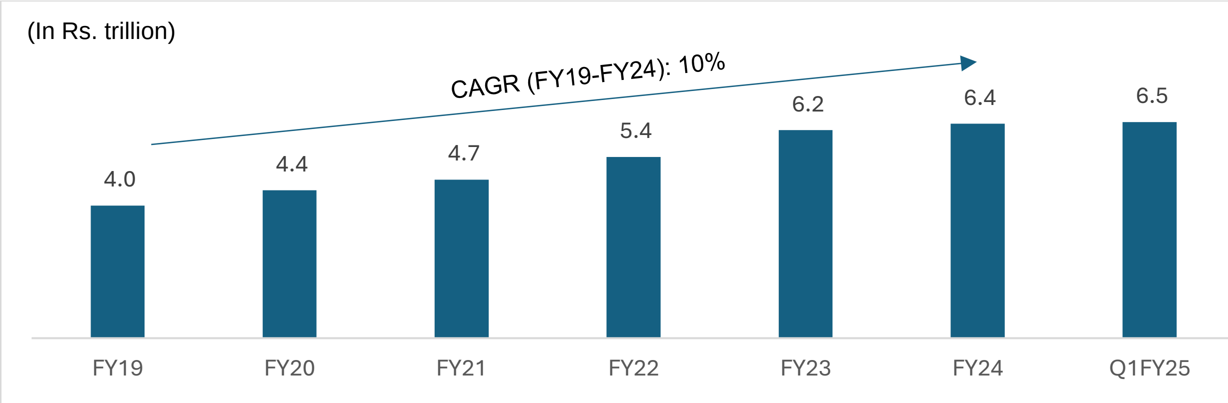
Source: TransUnion CIBIL, CRISIL MI&A

5.4 Secured MSME loans

Secured MSME loans (Commercial) reached Rs. 6.4 trillion as of Q1FY25

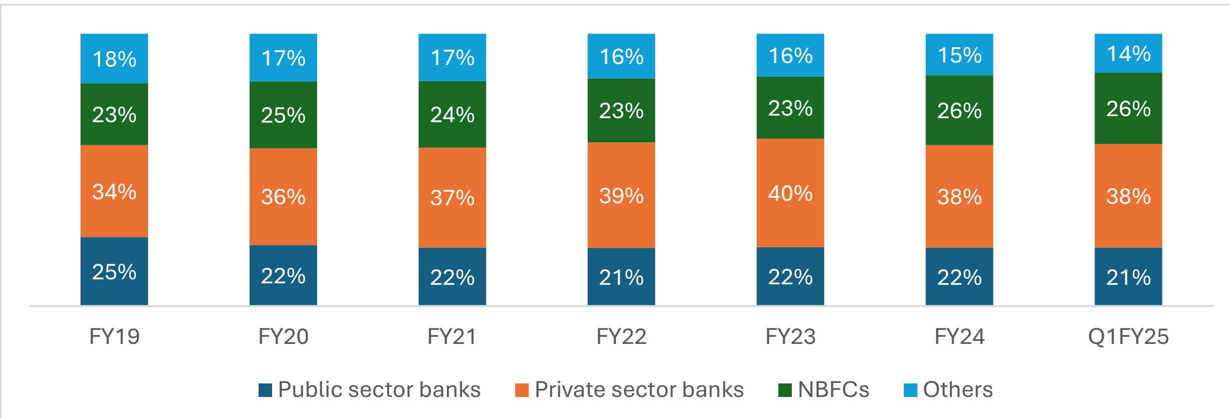
Secured MSME loans portfolio increased from Rs. 4.0 trillion as of fiscal 2019 to Rs. 6.4 trillion as of fiscal 2024 thereby reporting a CAGR of 10% during the same period. As of Q1FY25, Secured MSME loans portfolio has reached Rs. 6.5 trillion. The growth in Overall Secured MSME loans portfolio was driven by growth in loan term loans and property loans.

Secured MSME loans grew at CAGR of 10% between fiscals 2019 and 2024



Note: Above data includes secured MSME loans reported by lenders to the commercial bureau.
Source: TransUnion CIBIL, CRISIL MI&A

NBFCs' share in Secured MSME Credit (Commercial) has increased to 26% as of Q1FY25



Note: Above data includes secured MSME loans reported by lenders to the commercial bureau.
Source: TransUnion CIBIL, CRISIL MI&A

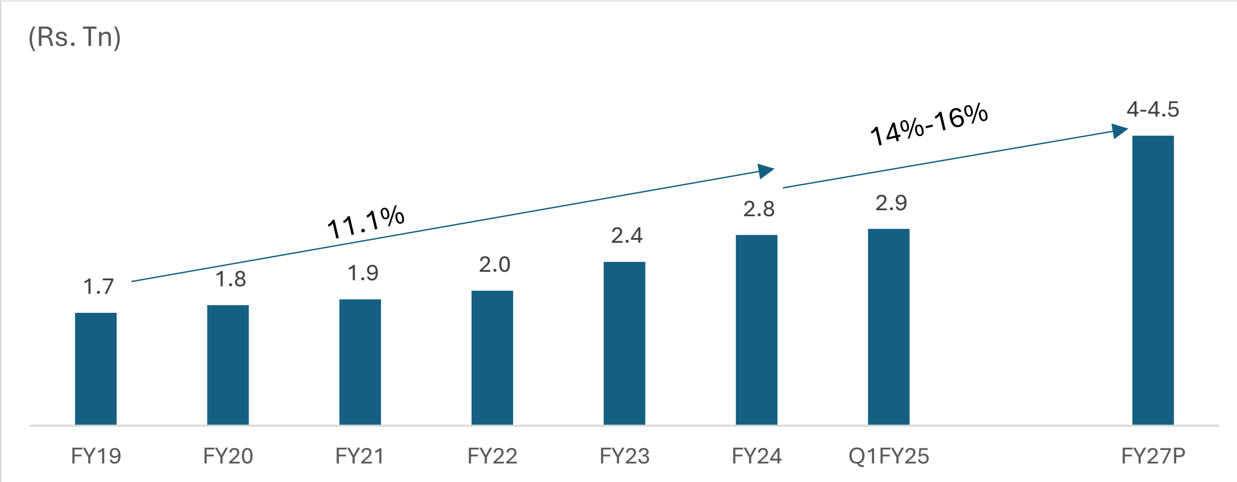
Private Sector Banks and NBFCs have lowest GNPA% in Secured MSME Credit (Commercial) as of Q1FY25

Row Labels	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
Public Sector Banks	19%	20%	19%	19%	17%	15%	16%
Private Sector Banks	4%	4%	4%	4%	4%	4%	3%
NBFCs	4%	7%	9%	10%	7%	5%	5%
Others	21%	21%	21%	22%	20%	19%	21%
Industry	**11%**	**11%**	**12%**	**11%**	**10%**	**9%**	**9%**

Note: Above data includes secured MSME loans reported by lenders to the commercial bureau.
Source: TransUnion CIBIL, CRISIL MI&A

5.5 MSME Hypothecation loan

MSME Hypothecation Loans witnessed a CAGR of ~11.1% between FY19 to FY24



Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

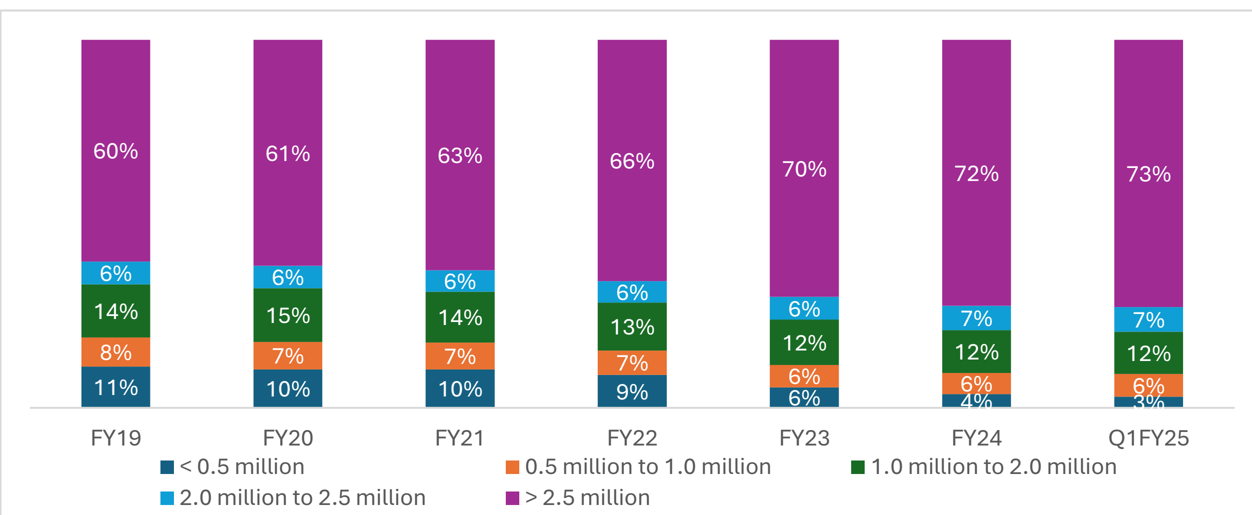
Source: TransUnion CIBIL, CRISIL MI&A

MSME Hypothecation Loan segment, which included Auto Loans, Commercial Vehicle Loan, Equipment Financing, Healthcare Finance, Demand Loan, Export Bill Discounting, Purchased and Advances against, Hire Purchase, Inland Bill Discounting and Purchased, Packing Credit and Seller Financing in India (reported to Commercial bureau), stood at Rs. 2.8 trillion as of FY24, witnessing a CAGR of 11.1% from FY19. As of Q1 FY25, overall Hypothecation Loan segment stands at Rs. 2.9 trillion.

The share of loans more than Rs. 2.5 million increased between fiscal 2019 and fiscal 2024

Among ticket brackets, the share of loans more than Rs. 2.5 million reached to 73% in Q1 fiscal 2025 from 60% in fiscal 2019.

Trend of ticket-wise share



Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Among lenders, private sector banks witnessed the fasted growth during fiscals 2019-24, growing at a CAGR of ~13.3% in the MSME Hypothecation Loan segment which was followed by NBFCs witnessing a CAGR of ~11.1%. As of Q1 fiscal 2025, among lenders, Private Sector banks accounted for the highest share in credit outstanding with a share of ~60% followed by NBFCs accounting for ~23% share.

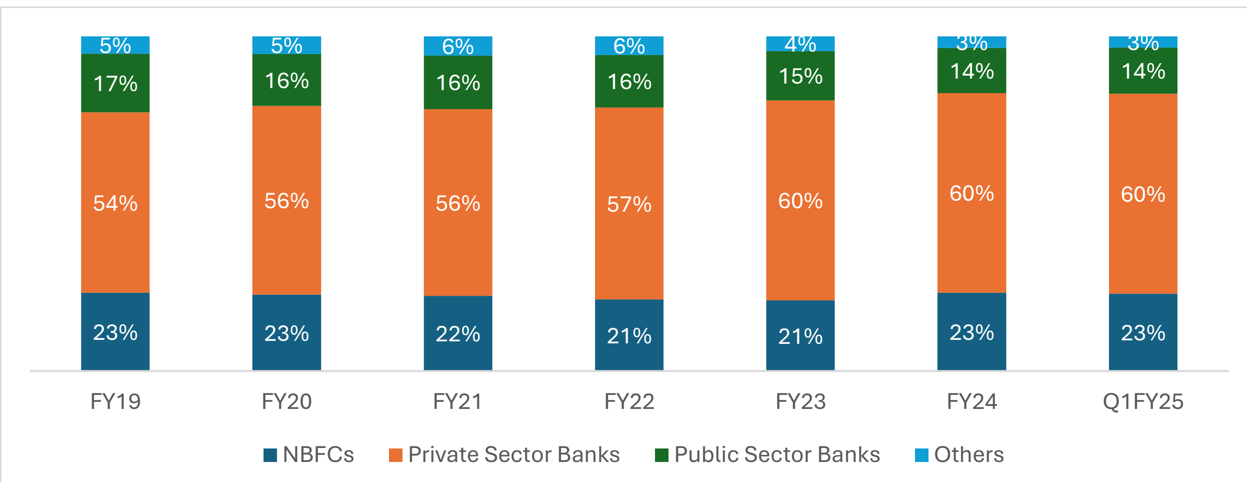
Private Sector Banks witnessed the fastest growth among lenders from FY19-24, while accounting for the highest share in MSME Hypothecation Loan Segment

Portfolio Outstanding (Rs. Tn)	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY 25	CAGR FY19-FY24
NBFCs	0.39	0.41	0.42	0.43	0.51	0.66	0.68	11.1%
Private Sector Banks	0.91	1.01	1.05	1.15	1.46	1.69	1.75	13.3%
Public Sector Banks	0.29	0.28	0.30	0.31	0.36	0.38	0.40	5.5%
Others	0.09	0.10	0.11	0.11	0.11	0.10	0.10	2.3%

Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Lender-wise share



Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Among lenders, Private Banks had the best asset quality in MSME Hypothecation Loan Segment as of Fiscal 2024

Among lenders, Private had the best asset quality in the MSME Hypothecation Loan segment with 90+ DPD at 2.9% as of FY24 and they dominate the market share for these loans as depicted in the previous chart. NBFCs' 90+ DPD stands at 9.6% as of FY24. Further, Public sector banks have a small market share in these loans and their asset quality is the lowest among lenders.

Among lenders, Private Banks had the best asset quality in MSME Hypothecation Loan Segment as of Fiscal 2024 (GNPA - 90+DPD)

Lender	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
NBFCs	5.1%	8.9%	10.1%	11.6%	9.9%	9.6%	13.0%
Private Sector Banks	3.4%	3.8%	4.7%	4.2%	3.3%	2.9%	2.9%
Public Sector Banks	18.1%	21.2%	19.5%	31.7%	29.8%	23.8%	23.8%
Others	16.6%	18.4%	17.2%	18.4%	14.6%	12.4%	12.8%
Industry	7.1%	8.4%	9.0%	10.9%	9.1%	7.6%	8.4%

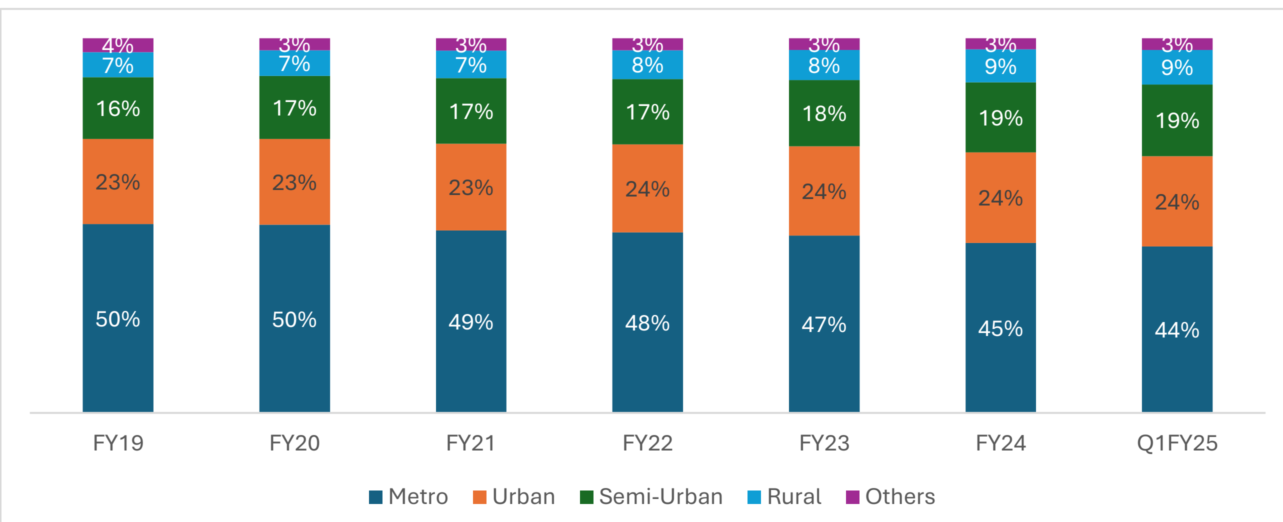
Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Semi-Urban and Rural regions held a total share of 23% in Fiscal 2019 which has grown to 28% as of Fiscal 2024 in MSME Hypothecation Loan Segment

Metro regions accounted for the highest share in MSME Hypothecation Loan Segment, accounting for ~45% market share followed by Urban regions accounting for ~24% share and semi-urban regions accounting for ~19% market share.

Semi-Urban and Rural Regions accounted for 28% share in MSME Hypothecation Loan Segment as of Fiscal 2024



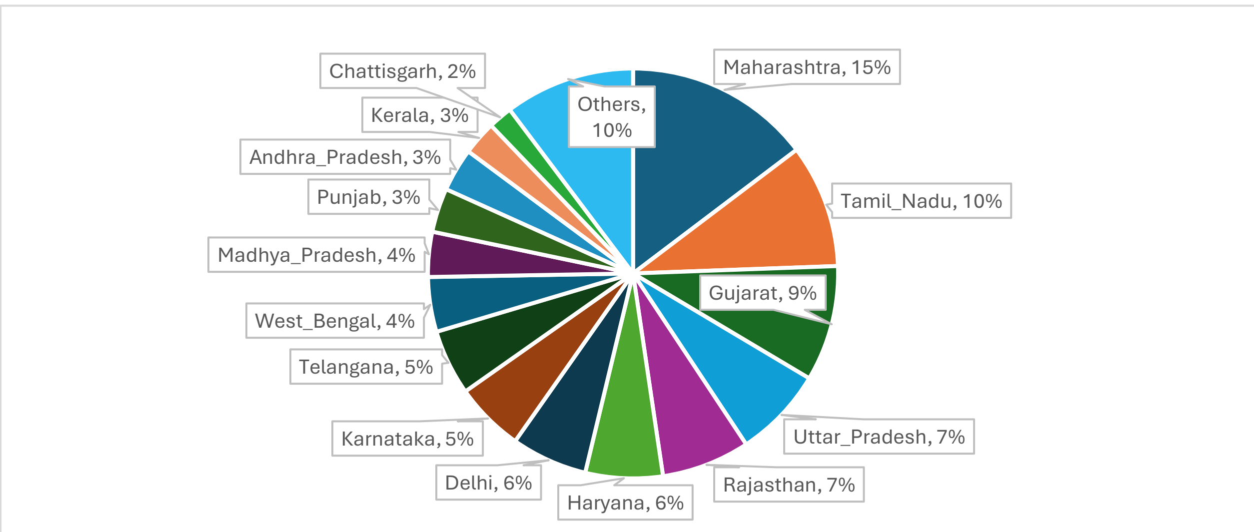
Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Top 5 states accounted for ~48% in MSME Hypothecation Loan Segment credit outstanding

Among states, Maharashtra accounted for highest share in MSME Hypothecation Loan outstanding accounting for ~15% share as of FY24, which was followed by Tamil Nadu accounting for ~10% share and Gujarat accounting for ~9% credit share. As of FY24, Top 5 states accounted for ~48% share, while top 10 states accounted for ~75% share.

Maharashtra accounted for the highest share in Hypothecation Loan Segment as of Fiscal 2024

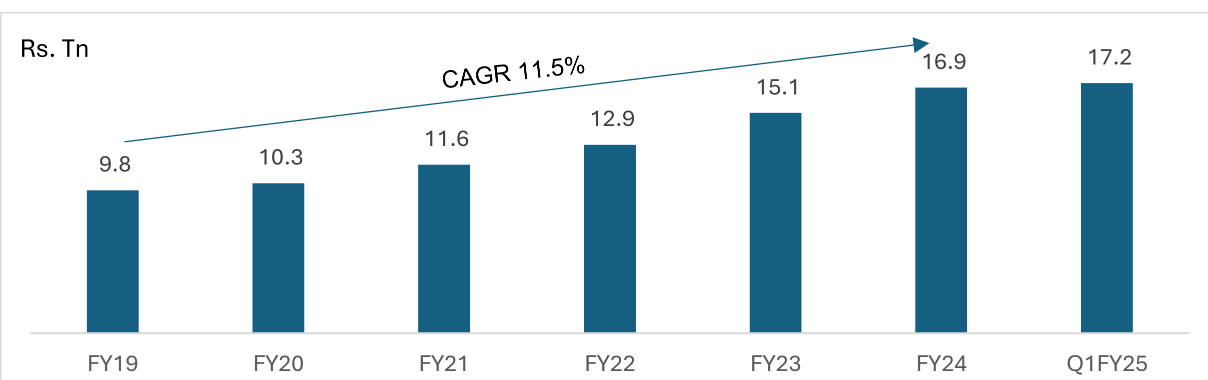


Note: MSME hypothecation loan portfolio includes Hypothecated credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

5.6 Unsecured MSME loans

Unsecured MSME Loans witnessed a CAGR of ~11.5% from FY19-24



Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

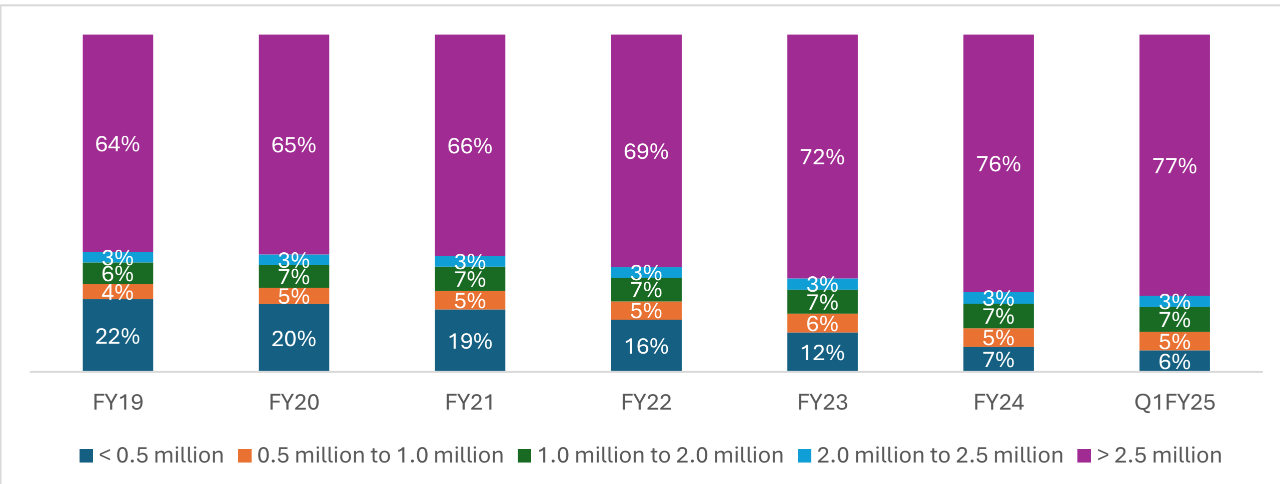
Source: TransUnion CIBIL, CRISIL MI&A

Overall Unsecured MSME Loan segment in India, stood at Rs. 16.9 trillion as of FY24, witnessing a CAGR of 11.5% from FY19. As of Q1 FY25, overall Unsecured MSME Loan segment stands at Rs. 17.2 trillion.

Unsecured MSME - The share of loans more than Rs. 2.5 million increased between fiscal 2019 and fiscal 2024

Among ticket brackets, the share of loans more than Rs. 2.5 million reached to 77% in Q1 fiscal 2025 from 64% in fiscal 2019.

Trend of ticket-wise share



Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

NBFCs witnessed the fastest growth among lenders from FY19-24, while public banks accounted for the highest share in overall Unsecured MSME Loan Segment

As of Q1 fiscal 2025, among lenders, Public Sector banks accounted for the highest share in credit outstanding with a share of ~45% followed by Private Sector banks accounting for ~41% share. NBFCs have increased their share from 4% in FY19 to 9% in Q1FY25.

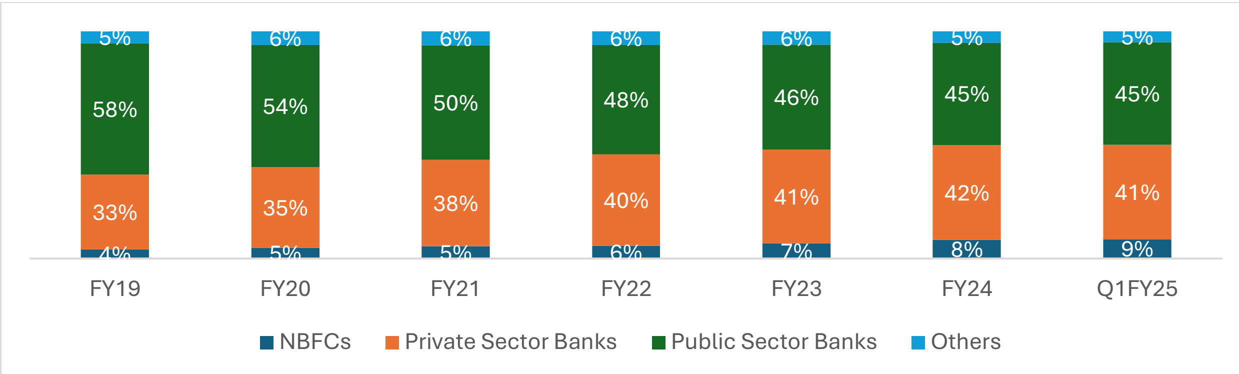
NBFCs witnessed the fastest growth among lenders from FY19-24

Portfolio Outstanding (Rs. Tn)	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25	CAGR FY19-FY24
NBFCs	0.39	0.49	0.62	0.72	1.01	1.38	1.47	28.5%
Private Sector Banks	3.23	3.65	4.40	5.21	6.24	7.05	7.12	16.9%
Public Sector Banks	5.66	5.54	5.84	6.22	6.98	7.59	7.74	6.0%
Others	0.52	0.62	0.70	0.79	0.88	0.85	0.84	10.4%

Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Trend of Lender-wise share



Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Among lenders, Private Banks had the best asset quality in Unsecured MSME Loan Segment as of Fiscal 2024

Among lenders, Private Banks had the best asset quality in the Unsecured MSME Loan segment with 90+ DPD at 5.6% as of FY24, this was followed by NBFCs with 90+ DPD at 7.2%.

Among lenders, Private Banks had the best asset quality (90+ DPD) in Unsecured MSME Loan Segment as of Fiscal 2024

Lender	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
NBFCs	5.8%	7.2%	7.9%	9.9%	8.4%	7.2%	7.4%
Private Sector Banks	6.0%	6.6%	7.2%	6.4%	5.6%	5.6%	5.8%
Public Sector Banks	13.4%	15.0%	15.3%	16.9%	15.8%	13.9%	14.2%
Others	9.6%	11.4%	11.6%	10.6%	9.8%	10.5%	11.4%
Industry	10.5%	11.4%	11.6%	11.9%	10.7%	9.7%	10.0%

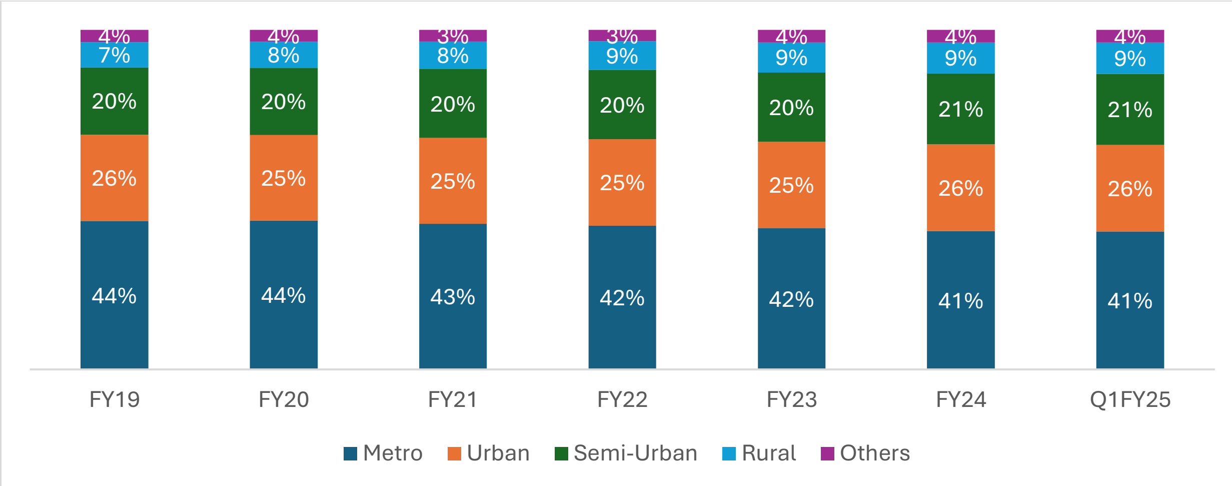
Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Semi-Urban and Rural Regions accounted for 30% share in Unsecured MSME Loan Segment as of Fiscal 2024

Metro regions accounted for the highest share in Unsecured MSME Loan Segment, accounting for ~41% market share followed by Urban regions accounting for ~26% share and semi-urban regions accounting for ~21% market share.

Semi-Urban and Rural Regions grew from 27% share in Fiscal 20219 to 30% share in Unsecured MSME Loan Segment as of Fiscal 2024



Note: Unsecured MSME loan portfolio includes unsecured credit products provided to MSMEs and reported to Commercial bureau.

Source: TransUnion CIBIL, CRISIL MI&A

5.7 Growth drivers for MSME Credit

Large and increasing credit gap in the MSME segment

As per estimates, less than 15% of approximately 70 million odd MSMEs have access to formal credit in any manner as of March 2022. High risk perception and the prohibitive cost of delivering services physically have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs and self-employed individuals historically. As a result, they resort to credit from informal sources. This untapped market offers huge growth potential for financial institutions. As stated earlier, the credit gap was estimated at around Rs. 58.4 trillion as of 2017 *(Source: IFC report named Financing India's MSMEs released in November 2018)* and is estimated to have widened further to around Rs. 103 trillion as of FY24.

Increased data availability and transparency

With increased digital initiatives by the MSMEs, the shift towards their formalisation and digitisation has created a plethora of data points for lenders that would help improve the efficacy of credit assessment and gradually enable provision of credit to hitherto underserved customer segments. This has created a digital footprint of customers, which can be potentially used for credit decision making, along with other relevant parameters such as customer demographics, business details, credit score, and personal situation of the borrower. Demonetisation and GST have further accelerated formalization of the Indian economy.

Advanced underwriting models powered by technology enabling lenders to serve MSMEs through unsecured loans

Underwriting and technology have become essential growth drivers for unsecured retail loans in MSME sector, fundamentally changing the way lenders assess risk and streamline processes. Modern underwriting models with data analytics leverage alternative data sources such as GST records, bank transaction history, e-commerce sales, digital payment history, utility bills, etc. This wider data set allows lenders to gauge financial health of the borrower without formal credit history. Machine learning algorithms analyse patterns with alternative data to predict default risk, enabling more accurate risk assessments which enables lenders to provide loans to self-employed individuals without collateral. Moreover, new-age credit scoring models integrate data from multiple sources, enabling quick assessment without traditional collateral. These dynamic credit scoring models are particularly beneficial for unsecured lending, where the focus shifts from collateral to creditworthiness.

With the adoption of artificial intelligence and machine learning, lenders are deploying models that continuously adapt from new data, improving their accuracy in predicting borrower behaviour. AI-powered early warning systems help lenders detect sign of potential defaults by continuously monitoring loan portfolios. Moreover, real-time monitoring and post-loan management systems are also enabling lenders to keep a real-time check on the ongoing financial health of the borrower post-disbursal analysing bank account activity, payment transactions, and other digital data. This is helping lenders to stay aware of changes in borrower's financial stability and manage the risk of unsecured loans.

With advanced underwriting models and adoption of technology, lenders have been able to better serve the self-employed with unsecured loans with greater efficiency, accuracy and reach. The ability to assess risk quickly and accurately without collateral has been transformative for MSME financing, helping fill a crucial gap in access to capital and fuelling growth in this segment.

Increasing access and faster TAT

Due to availability of multiple data points and technology solutions, the lending process involving documentation, verification and processing of the transactions has evolved and now takes much lesser time. Technology led enhancements such as use of big data analytics and social media campaigns to acquire customers, use of direct and derived variables for underwriting, automated processes, minimum documentations, Aadhar based e-KYC, Account aggregators, flexible repayment options due to simplified real-time digital payments system, have helped in reducing hassles, increasing access to credit for borrowers and faster TAT.

Growth in branch network of players offering MSME loans

Over past few years, players offering MSME loans have expanded their branch network with the intent to serve a larger customer base. Share of borrowers from top cities in India has been on a declining trend indicating that lenders are shifting their focus on MSMEs in rural and semi urban areas. In the future also, CRISIL MI&A expects lenders with a strong focus on MSME lending and healthy competitive positioning to continue to invest in branch expansion. With increasing branch network, customer acquisition and credit penetration, share of MSME loans is also expected to increase.

Increasing competition with entry of new players and partnerships between them

Lenders are increasing the use of digital platforms to help automate and digitize loan sanctioning process however the borrower is required to possess documents for the initial clearance as stated by the banks. Incumbent traditional lenders will increasingly leverage the network of their partners and/or digital ecosystem to cross-sell products to existing customers, tap customers of other lenders, and also cater to new-to-credit customers. This will expand the market for MSME loans.

Robust government support

The government has special focus on the MSME sector on account of its economic contribution to the economy and number of people employed in the sector. MSMEs in India come under the purview of Government of India, Ministry of MSME, Khadi Village and Coir Industries Commission (KVIC). The government launched Udyam Assist Platform (UAP) on 11th January 2023 to enhance formalization of the economy. As of 28th June 2024, 19 million informal micro enterprises have joined UAP to come under the formal economy.

Relaxation in the threshold under SARFAESI Act from Rs. 5 million to Rs. 2 million for NBFCs

In the Union Budget 2021-22, for NBFCs with a minimum asset size of Rs. 1 billion, the minimum loan size eligible for debt recovery under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002 was proposed to be reduced from the existing level of Rs. 5 million to Rs. 2 million. This relaxation is expected to facilitate recovery from stressed books, help the NBFCs to improve their ability to recover smaller loans and strengthen their overall financial health.

Inclusion of retail and wholesale trade under MSME category

In July 2021, the Ministry of Micro, Small and Medium enterprises decided to include Retail and Wholesale trade as MSMEs for the purpose of Priority Sector Lending and they would be allowed to be registered on Udyam Registration Portal. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government’s Udyam portal, participate in government tenders and also avail financing options/ benefits available to the category.

Prime Minister’s Employment Generation Programme (PMEGP) providing margin money to MSMEs

PMEGP is a credit linked subsidy scheme to provide employment opportunities by establishing new micro enterprises in the non-farm sector where margin money is provided to MSMEs availing loan from banks to set up new enterprises. The maximum margin money provided under the scheme for setting up a new project is Rs 5 million for manufacturing sector and Rs. 2 million for service sector. Geo-tagging for the products and services of the units set up under this scheme has been initiated. This will help the enterprises with creating market linkages.

Credit Guarantee Fund Scheme extended to cover NBFCs

The government launched the Credit Guarantee Fund Scheme under the aegis of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in order to make collateral-free credit available to micro and small enterprises. In January 2017, the scheme was extended to cover systemically important NBFCs as well.

Other government initiatives addressing structural issues in the MSME market

Some of the other government and regulatory initiatives are detailed below:

- **Stand-up India:** It facilitates bank loans between Rs. 1 million and Rs. 10 million to at least one scheduled caste or scheduled tribe borrower and at least one-woman borrower per bank branch for setting up a greenfield enterprise.
- **Make in India**: Launched with an intention to make India a global manufacturing hub, which in turn will provide employment to numerous youths in India
- **Mudra loans**: **Pradhan Mantri Mudra Yojana (PMMY)** is an initiative by the government to provide affordable and collateral-free credit to the non-corporate, non-farm small and micro-enterprises. PMMY provides loans under three categories: *Shishu* loans upto Rs. 50,000 for startups or new ventures; *Kishore* loans between Rs. 50,000 to Rs. 5,00,000 for businesses that need further growth; and *Tarun* loans between Rs. 5,00,000 to Rs. 10,00,000 for business expansion. Mudra loans have relatively low interest rates and entails a quick and easy processing of loans.
- **59-minute loan:** Online marketplace that provides in-principal approval to MSME loans up to Rs. 10 million in 59 minutes.
- **Unified Payments Interface 2.0 (UPI 2.0):** Real-time system for seamless money transfer from account
- **Trade Receivables Discounting System (TReDS):** Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporates and other buyers through multiple financiers.
- **Factoring Regulation:** In an amendment to Factoring Regulation Act, 2011, the Lok Sabha passed the Factoring Regulation (Amendment) Bill in July 2021

Further, there have been several schemes by the government such as Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship, Scheme of Fund for Regeneration of Traditional Industries, Micro and Small Enterprises-Cluster Development Programme, MSME Champions Scheme, etc.

Lending to micro-enterprises remains a huge opportunity

Lending to micro-enterprises provides a significant growth opportunity due to high demand for small scale credit, especially among businesses that lack access to traditional financing. These micro enterprises are often unable to get financing from banks due to lack of documents pertaining to income proof, business registration, GST registration, income tax filings, and bank statements. However, NBFCs who specialise in underwriting such businesses have been able to bridge this gap by offering tailored financial products, faster loan processing, unsecured loans, and flexible repayment terms. Usage of digital lending platforms is increasing which use data-driven models to assess creditworthiness, allowing the lenders to offer loans to micro-enterprises with more accurate risk management. This segment is poised for growth due to several other factors such as:

- Government initiatives like Pradhan Mantri Mudra Yojana (PMMY) which provides small ticket loans to promote self-employment
- Digitalization is streamlining loan processing and reach underserved regions
- Increased investor interest in fintech and other financing ventures, which are actively working to extend credit access

However, maintaining low NPAs and provisioning requirements remains challenging, particularly when lending to MSMEs, which often lack verifiable credit histories, formal business records, and adequate documentation. Moreover, the small loan sizes of MSMEs create difficulties in managing operational and credit risks effectively.

As the landscape of micro-enterprise financing evolves, continuous monitoring and adaptation are essential to maintaining resilience and promoting financial inclusion. NBFCs, however, are better positioned to address this gap through their flexibility, regional presence and innovative lending approaches.

5.8 Key success factors for NBFCs offering MSME Loans

- **Ability to dive into deeper geographies with a strong branch network**: Players need to have a clear and deeper understanding of their target customer segment, the markets they operate in and develop a strong local network. The deeper understanding and presence of inhouse sales team for direct sourcing within the segment also leads to lower customer churn.
- **Focussed approach to tap underserved niche borrower segments:** MSME focussed lenders need to build a portfolio with deep understanding of the target segment and market. Specific tailor-made lending products for MSMEs with easier data availability to help lenders take a focussed approach.
- **Strong underwriting capabilities**: MSMEs tend to generally be more impacted by vagaries of the business cycle given their limited financial wherewithal and/or reliance on larger buyers. On account of limited data to support credibility of the MSME borrower, lenders are now using alternate methods of underwriting like cash flow analysis to strengthen their underwriting capabilities.
- **On-the-ground presence to manage collections and maintain portfolio quality**: Additionally, given that players in the segment also cater to a relatively riskier profile, a strong focus on

collections and monitoring risk of default at customer level is vital to manage asset quality. Direct Sourcing allows control over the quality of customers and processes involved for disbursement, which can lead to better asset quality, as compared to other methods of customer acquisition.

- **Collateral risk management**: Properties that are used as collateral for MSME loans sometimes lack proper property titles, especially in the outskirts of large cities, semi-urban and rural areas.
- **Physical presence**: It is vital to have physical presence to cater to underserved and underbanked segments like MSMEs which still prefers to have in-person interactions and understand various nuances which are involved in lending. Physical presence with some extent of digitization will enable NBFCs to grow and serve in the market.

Lending to MSMEs involves challenges such as limited financial records, small loan sizes, restricted access to traditional banks and financial institutions, and reluctance to provide property as collateral for smaller loans, making it difficult to underwrite loans for such customers.

Building expertise in cluster-based approach requires considerable investment of time and resources and presents a notable challenge for new entrants to replicate in this sector.

Digital penetration

The lenders have been increasingly leveraging technology solutions and alternative data to source and underwrite MSME loans. Such changes in MSME lending have been driven by

Digital/technological changes:

- E-commerce platforms (B2C and B2B): Connecting buyers and sellers
- Introduction of digital lending focused NBFCs: Use of technology to provide MSME lending
- Low-cost internet data availability: Facilitating increase in internet penetration
- Business solutions focussed on MSME such as digitising accounting, workflows, operations, etc leading to better data availability

Government led initiatives:

- Introduction of UPI: Simplified real-time digital payments
- GST implementation: Simplified business taxes, Improved formalization of businesses
- Aadhaar based e-KYC: Reduced documents requirements, faster TAT, Aadhaar-PAN linkage facilitating lenders to verify information
- ONDC: Facilitated adoption of e-commerce through open protocol

RBI-led initiatives:

- TReDS: TReDS is an electronic platform for facilitating the financing/discounting of trade receivables of MSMEs through multiple financiers

- Account aggregators: Act as a common platform which enable sharing and consumption of data from various entities with user consent

Above are some of the broad initiatives in the market which are assisting lenders to facilitate growth in MSME lending market by leveraging technologies and alternate data points. Additionally, such technological changes have led to innovative, simple, and cost-effective processes. This has led to the rise of digital banking transforming the traditional banking model.

The growing liberalization of the financial sector in India is expected to bring new entrants, both domestic and foreign banks, NBFCs, and other entities operating in the financial services sector offering a wider range of products and services and increasing competition across the board. Additionally, consumer-facing companies with vast data repositories, such as e-commerce and payment service providers, are likely to enter the lending market, further intensifying the competitive landscape. Further, competitive landscape is expected to intensify in mortgage-based lending to businesses as well as individuals and in unsecured consumer lending.

Customer acquisition/Sourcing: Lenders can use big data analytics, social media campaigns, partner with various stakeholders such as e-commerce platforms, provide multilingual chatbots, mobile apps, etc. to generate leads, and acquire customers. This makes the application process convenient and quick and increases the success rate of customer onboarding.

Underwriting: Lenders can use alternative data points (direct and derived variables) to assess creditworthiness of borrowers. Usage of advanced algorithms to identify risk profiles and repayment ability of borrowers can lead to sanctioning of loans to underserved and new-to-credit customers within minutes.

Collection: Flexible repayment options can be provided with initiatives such as e-NACH, UPI and other digital payment options which make the collection process easier and increase collection efficiency.

With all these changes in the lending process, penetration of digital lending has been increasing in the past few years with lenders trying to provide all the services digitally to customers.

6. Secured MSME (LAP)

6.1 Secured MSME (LAP) portfolio

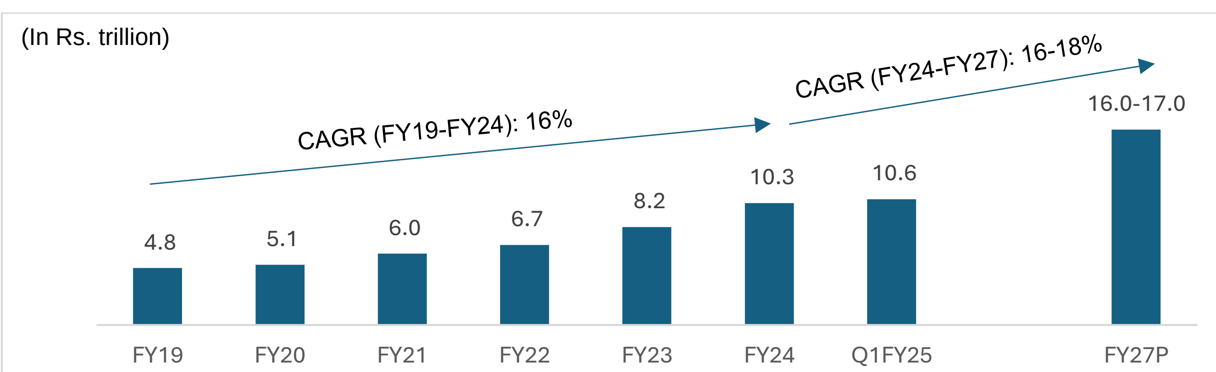
The LAP segment grew at a strong pace with portfolio outstanding registering a CAGR of ~16% from FY19 to FY24. LAP portfolio increased from Rs. 4.8 trillion as of fiscal 2019 to Rs. 10.3 trillion as of fiscal 2024 and reached Rs. 10.6 trillion as of Q1FY25.

A secured MSME (LAP) loan can be obtained by mortgaging residential or commercial real estate with the lender. The loan product can be used for personal or business objectives, and both salaried and self-employed individuals are eligible to apply. The main purpose of the loan is not strictly regulated as it offers the financier security in the form of real estate. LAP offers a lower interest rate than a personal or corporate loan. Self-employed borrowers are provided unsecured MSME loans in the absence of collateral.

In Fiscal 2022, secured MSME (LAP) loan portfolio outstanding grew at a slower rate of ~12% year on year as MSMEs needed cash for day-to-day activities in the backdrop of global and domestic uncertainties. NBFCs moved towards niche credit assessments without the requirement of property collateral to help provide credit and meet the rapid demand from MSMEs. In Fiscal 2023, secured MSME (LAP) loan segment bounced back with ~23% year on year growth as economic activity normalized through support of RBI and center's promotion of Aatmanirbhar Bharat. In Fiscal 2024, overall secured MSME portfolio grew at ~25% year on year backed by robust economic conditions and increase in domestic consumption and growth.

Over the last few years, expansion in branch network, more data availability and government initiatives like GST, Udyam, and increasing formalization of the MSME segment has led to increasing focus of lenders, especially the NBFCs, on this space. NBFCs (including HFCs, NBFC-Fintech) enjoy a market share of 36% as of March 2024 in overall secured MSME portfolio outstanding.

Secured MSME (LAP) portfolio outstanding is projected to grow by 16-18% over Fiscals 2024-27

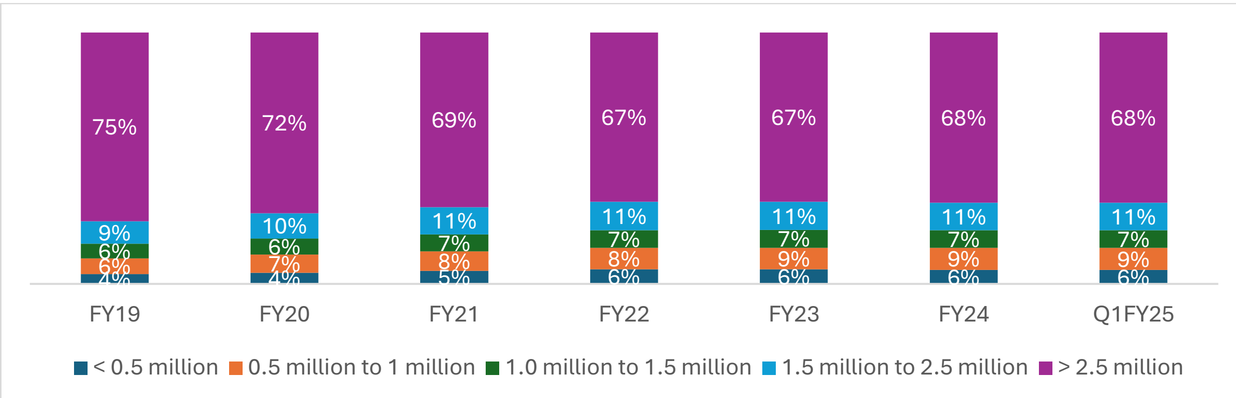


Note: P: Projected, Source: TransUnion CIBIL, CRISIL MI&A

Share of LAP outstanding with ticket size < Rs. 0.5 million has been increasing in the overall pie

The share of ticket size less than Rs. 0.5 million in overall LAP portfolio outstanding has increased from 4% as of fiscal 2019 to 6% as of Q1FY25. Ticket size greater than Rs. 2.5 million has declined from 75% as of fiscal 2019 to 68% as of Q1FY25 which reflects growing demand for small ticket size loans against property.

Trend of ticket-wise share of LAP portfolio

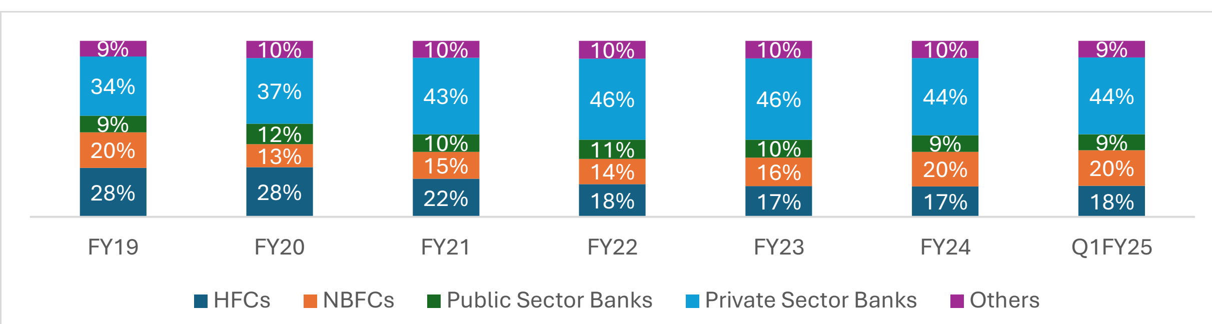


Source: TransUnion CIBIL, CRISIL MI&A

Private banks have the highest share of LAP portfolio outstanding

The market share of private sector banks in industry LAP portfolio has increased from 34% in Fiscal 2019 to 44% in Q1FY25. Moreover, NBFCs/HFCs have established a significant presence in the LAP segment by prioritizing customer needs, ensuring quick turnaround times, delivering excellent customer service, and expanding their geographic reach. Over time, the LAP portfolio of NBFCs has shown robust growth and it is expected that the competitive positioning of NBFCs will remain strong, given their strong target customer and product focus.

Share of lender wise portfolio outstanding in LAP portfolio outstanding

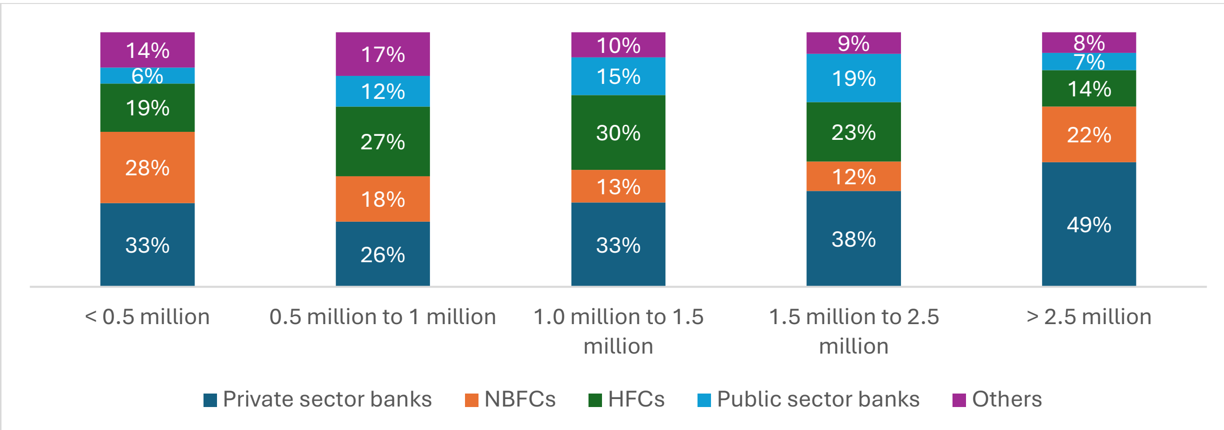


Note: NBFCs include NBFC-Fintechs
Source: TransUnion CIBIL, CRISIL MI&A

Private sector banks and NBFCs have highest share in LAP portfolio with ticket size < Rs. 0.5 million

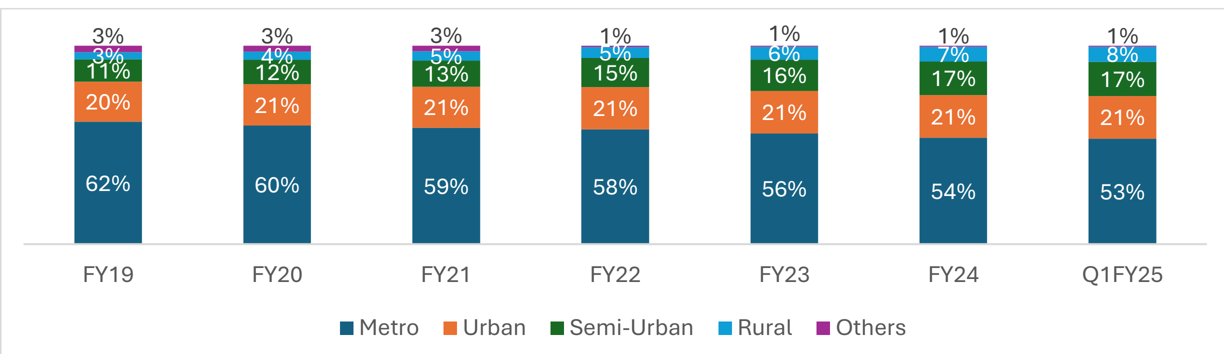
Among various ticket sizes of LAP portfolio, NBFCs have their highest share in smaller ticket size loans of less than Rs. 0.5 million at 28% as of Q1FY25. However, private sector banks remain dominant in all the ticket sizes considered in the LAP portfolio as of Q1FY25.

NBFCs have market share of 28% in LAP portfolio of ticket size < Rs. 0.5 million as of Q1FY25



Note: NBFCs include NBFC-Fintechs
Source: TransUnion CIBIL, CRISIL MI&A

Share of semi-urban and rural areas in LAP portfolio outstanding has been increasing

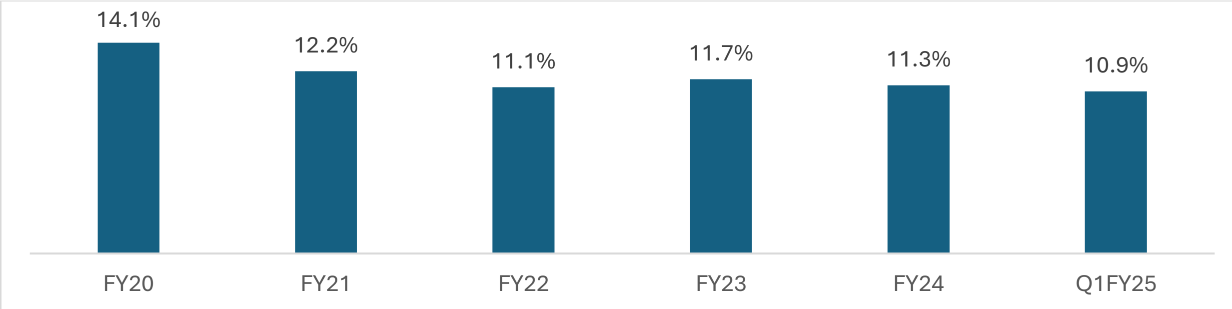


Source: TransUnion CIBIL, CRISIL MI&A

NTC customers comprised of 10.9% in MSME Secured (LAP) portfolio in Q1FY25

Lenders are utilizing technologies like AI, ML, and alternative credit scoring mechanisms to determine customer's creditworthiness. These non-traditional data points are assisting in the underwriting process for customers with limited credit history. The share of MSMEs obtaining secured loans who are new to credit is 10.9% in Q1FY25 indicating the increasing penetration levels in this target segment.

Trend in NTC customers for LAP portfolio from fiscal 2020 to Q1FY25



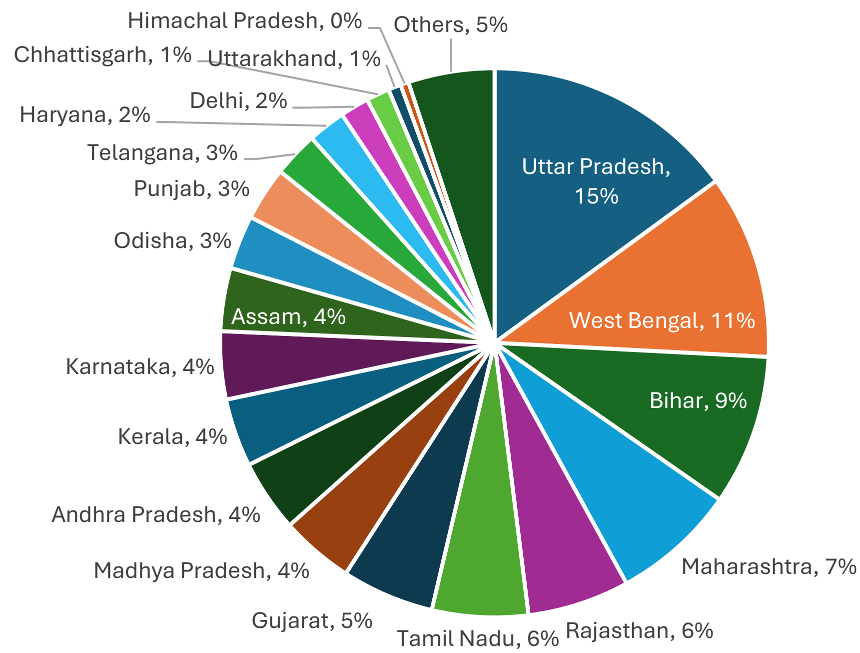
Source: TransUnion CIBIL, CRISIL MI&A

State wise split of addressable market (SORP) basis National Sample Survey (NSS) 73rd round conducted during 2015-16

Top 15 states	Total households ('000)	Total Non-Agri Self Employed households ('000)	Total Non-Agri Self Employed– Households - SORP ('000)	Total Non-agri Self Employed– Households - SORP - Pucca + Semi Pucca ('000)	Secured MSME Addressable Market Size with ATS < Rs 0.5 million (Rs billion)	% of secured MSME addressable market size with ATS < Rs 0.5 million	Market share of secured MSME < Rs. 5 lakhs as of FY24
Uttar Pradesh	38,224	7,776	7,023	6,674	3,337	14.96%	4.36%
West Bengal	23,781	5,923	5,143	4,849	2,424	10.86%	2.12%
Bihar	19,960	4,498	4,270	3,953	1,976	8.86%	0.55%
Maharashtra	24,120	4,353	3,316	3,270	1,635	7.33%	13.87%
Rajasthan	13,384	3,075	2,743	2,685	1,342	6.01%	8.86%
Tamil Nadu	20,200	3,715	2,584	2,523	1,262	5.66%	15.04%
Gujarat	13,064	3,188	2,471	2,428	1,214	5.44%	8.58%
Madhya Pradesh	15,251	2,360	1,988	1,922	961	4.31%	6.03%
Andhra Pradesh	14,279	2,677	1,956	1,895	947	4.24%	9.11%
Kerala	8,577	1,988	1,795	1,789	895	4.01%	7.45%
Karnataka	14,928	2,740	1,822	1,786	893	4.00%	9.11%
Assam	6,740	1,965	1,702	1,660	830	3.72%	0.30%
Odisha	10,401	1,909	1,647	1,415	707	3.17%	0.80%
Punjab	5,922	1,636	1,415	1,409	705	3.16%	2.05%
Telangana	9,793	1,788	1,205	1,188	594	2.66%	5.23%
Haryana	5,216	1,174	1,000	997	499	2.23%	2.12%
Delhi	4,255	1,122	766	760	380	1.70%	1.54%
Chhattisgarh	5,664	748	624	613	306	1.37%	0.86%
Uttarakhand	2,129	426	340	335	167	0.75%	0.84%
Himachal Pradesh	1,735	259	214	214	107	0.48%	0.18%
Others	13,485	2,856	2,373	2,261	1,131	5.08%	1.00%
All India	**2,71,105**	**56,115**	**46,397**	**44,624**	**22,312**	**100%**	**100%**

Note: States are arranged in order of Addressable market size,
Source: NSS 73rd round (July 2015 – June 2016) and NSS 76th round (July 2018 – December 2018), Periodic Labour Force Survey (PLFS) dated July 2019-June 2020, CRISIL MI&A

Uttar Pradesh, West Bengal and Bihar accounts for ~35% of secured MSME (SORP) addressable market size with ATS < Rs 0.5 million



Source: CRISIL MI&A

Large addressable market exists in Uttar Pradesh, West Bengal, Bihar, Maharashtra, Rajasthan, Tamil Nadu, Gujarat, Madhya Pradesh, Andhra Pradesh, Kerala, Karnataka and Assam accounting for almost 79% of the total secured MSME (SORP) addressable market with average ticket size less than Rs 0.5 million.

Average ticket size (ATS) decreased for all lenders except HFCs from Fiscal 2019 to Q1FY25

During Fiscal 2024, HFCs recorded the highest average ticket size of Rs. 2.26 million, trailed by NBFCs, Private Banks, NBFCs and Public sector banks. Except for HFCs, all other lenders witnessed a decline in the average ticket size within the overall secured MSME portfolio outstanding.

Trend in average ticket size of LAP for all lenders from fiscal 2019 to Q1FY25

ATS (In Rs. Mn)	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
Public sector banks	1.87	1.56	1.33	1.39	1.49	1.59	1.83
Private sector banks	2.44	1.58	1.72	1.97	2.08	2.24	2.25
NBFCs	1.97	1.88	1.41	1.68	1.96	1.78	1.86
HFCs	1.97	1.94	1.74	1.85	2.11	2.19	2.26
Others	2.61	2.41	1.96	2.14	2.18	2.51	2.28
Industry	**2.22**	**1.93**	**1.68**	**1.86**	**1.97**	**2.12**	**2.12**

Note: NBFCs include NBFC-Fintechs, Average ticket size is calculated as sum of sanctioned amount divided by number of trades during a given fiscal year,
Source: TransUnion CIBIL, CRISIL MI&A

Private banks had the best asset quality among major lenders with 90+ DPD at 1.8% as of Q1FY25

Asset quality for all lenders deteriorated in Fiscal 2021 due to the pandemic where income of the borrowers was impacted which led to rise in GNPA numbers. With continued improvement in economic activity, better collection efficiency and strong credit growth, GNPA level started improving. As of Fiscal 2024, the GNPA ratio for LAP industry stood at 3.8%. Private Banks and NBFCs exhibited better asset quality compared to the industry level.

NBFCs' LAP NPA% is lower than the industry as of Q1FY25

Lender	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
HFCs	2.3%	3.7%	6.3%	6.5%	4.9%	4.2%	4.2%
NBFCs	5.0%	7.2%	7.2%	7.4%	4.9%	3.5%	3.4%
Public Sector Banks	6.5%	7.3%	7.8%	7.8%	6.8%	5.4%	5.9%
Private Sector Banks	2.1%	2.4%	3.1%	2.3%	2.0%	1.7%	1.8%
Others	4.7%	7.1%	12.8%	11.8%	10.8%	9.9%	11.6%
Industry	**3.4%**	**4.4%**	**5.8%**	**5.4%**	**4.4%**	**3.7%**	**3.8%**

Source: TransUnion CIBIL, CRISIL MI&A

GNPAs (90+ DPD) of LAP portfolio have increased from FY19 across all ticket sizes but have improved for ticket size less than Rs 0.5 million

Although the GNPA of LAP portfolio with ticket size less than Rs 0.5 million is the highest, the difference with other ticket sizes has reduced after the Covid period.

Smaller ticket size loans are typically given to individuals or businesses with limited credit history, stable income source or established financial background. Moreover, the borrowers in this segment are often vulnerable to economic shocks such as job loss, medical emergencies, economic downturns, etc. which adds to deterioration of the asset quality in small ticket size loans portfolio. However, improved credit scoring models, detailed cash flow analysis, enhanced monitoring and early warning systems, adoption of artificial intelligence and machine learning, alternative data sources, digitization, improved recovery mechanisms, partnership and risk sharing models are enabling the lenders in keeping the NPAs of small ticket loans portfolio range bound.

Asset quality: 90+ Days Past Due ("DPD") across various ticket sizes

Ticket size	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
< 0.5 million	5.2%	6.2%	7.5%	6.9%	5.4%	4.9%	5.5%
0.5 million to 1 million	3.5%	4.3%	5.2%	4.8%	4.1%	3.5%	4.1%
1.0 million to 1.5 million	2.7%	3.6%	4.6%	4.1%	3.6%	3.2%	3.6%
1.5 million to 2.5 million	2.7%	3.6%	4.8%	4.2%	3.6%	3.1%	3.4%
> 2.5 million	3.4%	4.5%	6.0%	5.6%	4.5%	3.7%	3.7%
Overall (90+DPD)	**3.4%**	**4.4%**	**5.8%**	**5.4%**	**4.4%**	**3.7%**	**3.8%**

Note: To calculate NPA%, 90+ DPD across various ticket sizes has been considered

Source: TransUnion CIBIL, CRISIL MI&A

7. Business loans – Secured and Unsecured

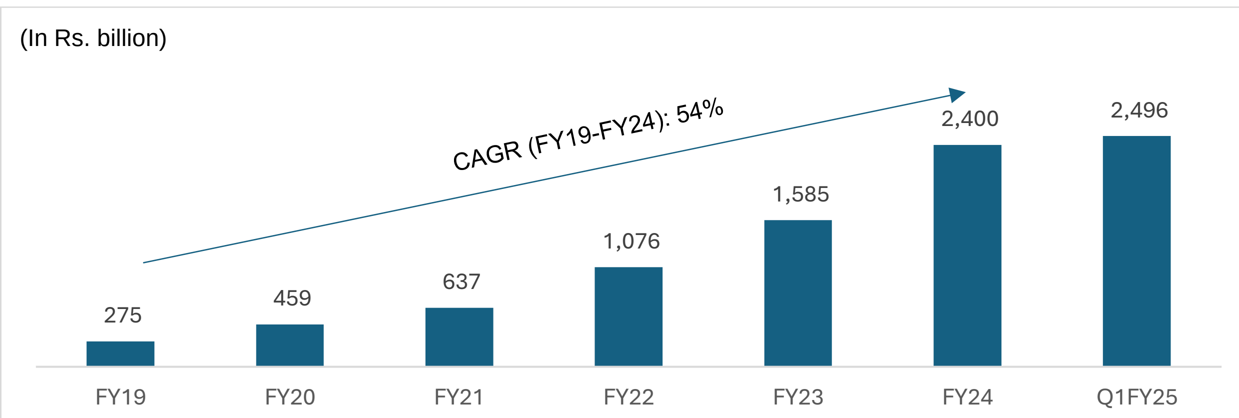
Note: *Business loans considered in this section are business loans – secured, business loans – unsecured and business loans – general which are reported to consumer bureau. For the analysis, CRISIL has considered Business loan – unsecured and business loan – general as unsecured business loans.*

7.1 Secured business loans

Secured Business Loans has witnessed robust growth in India

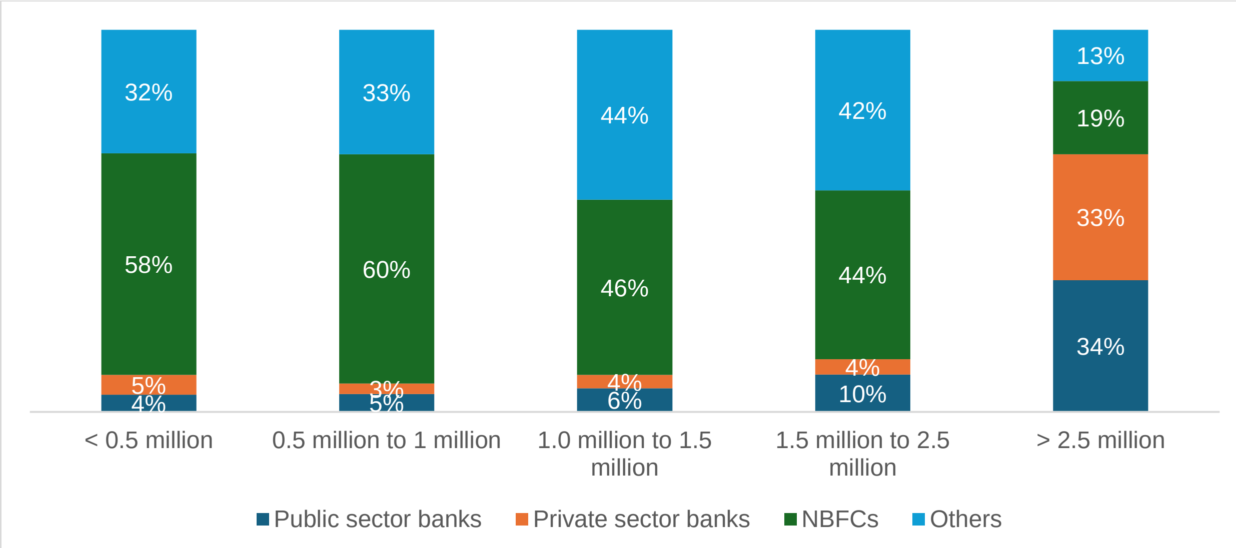
Secured Business Loans grew exponentially from Rs. 275 billion as of fiscal 2019 to Rs. 2,400 billion as of fiscal 2024, recording a CAGR of 54% during the same period. This growth is being driven by increasing demand for business loans among the growing number of entrepreneurs, startups and established businesses. Moreover, easy access to funds, multiple financing options and digitization are also driving the growth of this segment.

Secured Business Loans grew at CAGR of 54% between fiscals 2019 and 2024



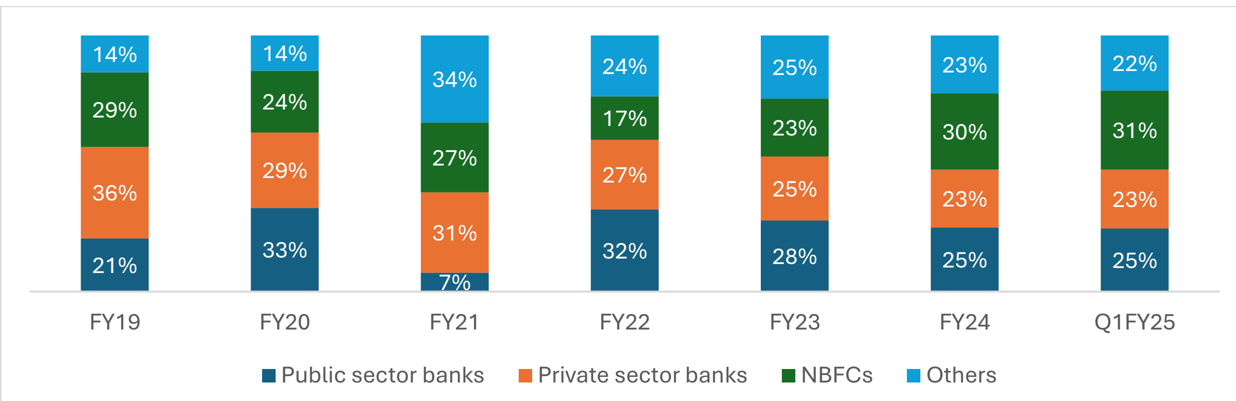
Source: TransUnion CIBIL, CRISIL MI&A

NBFCs have the largest share in secured business loans for all ticket sizes up to Rs 2.5 million (as of Q1FY25)



Note: NBFCs include HFCs
Source: TransUnion CIBIL, CRISIL MI&A

NBFCs' share in Secured Business Loans has increased to 31% as of Q1FY25



Note: NBFCs include HFCs
Source: TransUnion CIBIL, CRISIL MI&A

GNPA% of NBFCs in Secured Business Loans has reduced from 23% as of fiscal 2019 to 6% as of Q1FY25

Lender	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
Public Sector Banks	14%	26%	30%	40%	34%	29%	24%
Private Sector Banks	33%	5%	6%	4%	3%	3%	3%
NBFCs	23%	22%	20%	21%	14%	6%	6%
Others	16%	21%	13%	15%	10%	9%	11%
Industry	**23%**	**18%**	**14%**	**21%**	**16%**	**12%**	**11%**

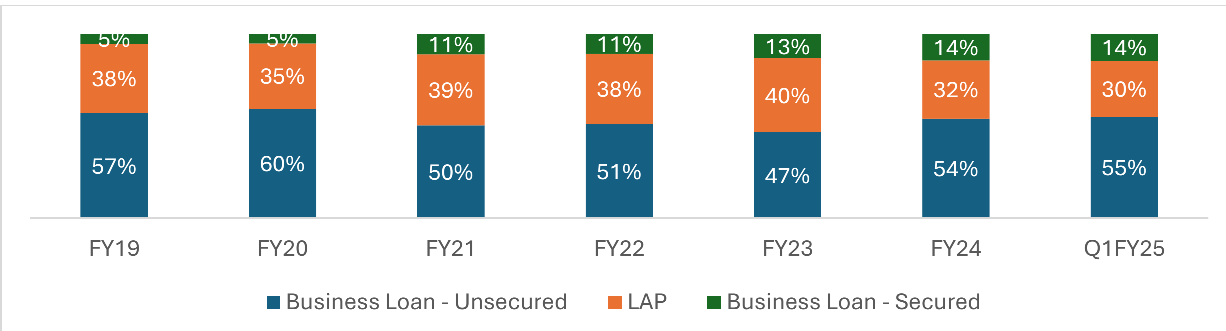
Source: TransUnion CIBIL, CRISIL MI&A

7.2 Unsecured business loans

Unsecured business loans are preferred by borrowers for ticket size less than Rs. 0.5 Mn

As of Q1FY25, 55% of loans with ticket size less than Rs. 0.5 million are unsecured business loans, followed by loans against property at 30% and secured business loans at 14%. Although during covid pandemic, share of loans against property increased but as economic activities resumed with full throttle post fiscal 2023 and income of MSMEs stabilized, the share of unsecured business loans reached its pre pandemic levels.

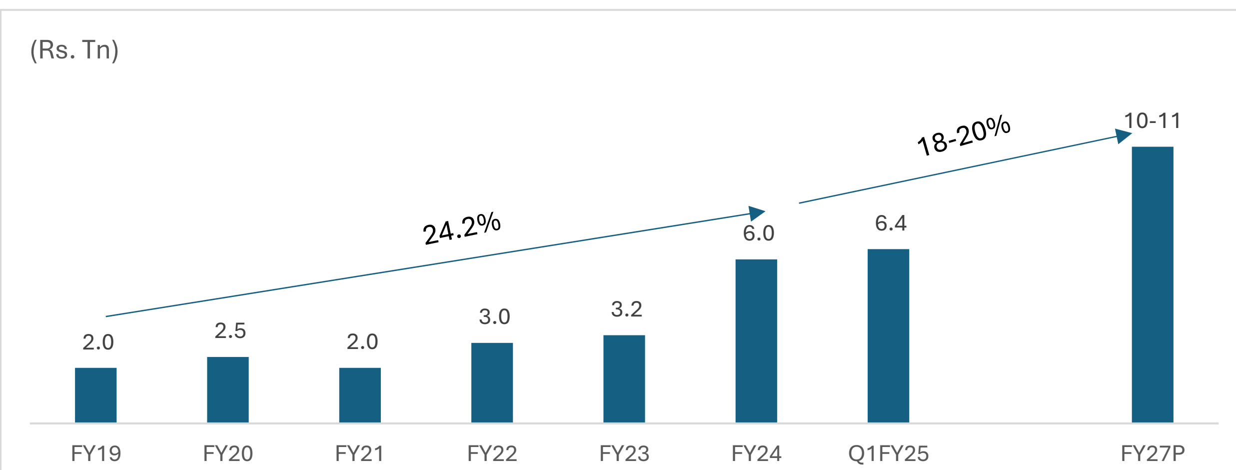
Business loans - secured have shown the fastest growth from 5% of the total business loans in FY19 to 14% in FY25, Business loans - unsecured remains the largest segment within business loans and LAP



Note: Business loans – Unsecured includes Business Loans – General

Source: TransUnion CIBIL, CRISIL MI&A

Unsecured Business loans witnessed a CAGR of ~24.2% from FY19-24



Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to Consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

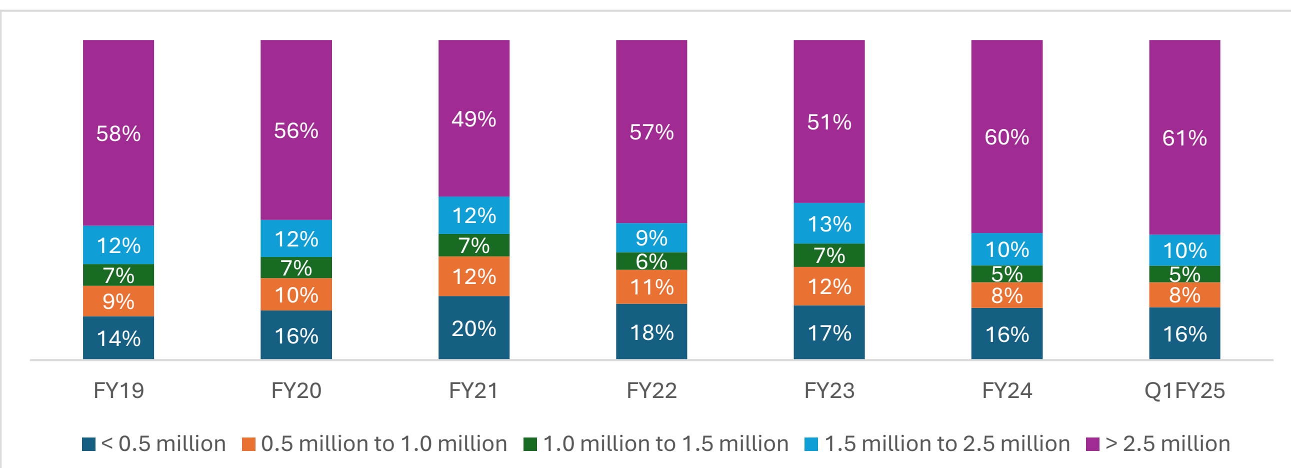
Overall Unsecured Business Loan segment, types of loan undertaken for business related purposes without any security and collateral, which included general business loans and Unsecured Business loans in India, stood at Rs. 6.0 trillion as of FY24, witnessing a CAGR of 24.2% from FY19. As of Q1 FY25, overall Unsecured Business Loan segment stands at Rs. 6.4 trillion. The segment has witnessed continuous growth across fiscals, with the fastest year-on-year growth in outstanding witnessed in FY24, Going forward, as per CRISIL MI&A estimates, it is expected that the segment will grow at a CAGR of 18-20% till FY27 primarily due to rising number of business enterprises in India and increasing financial penetration in both rural and urban areas aided by multiple government initiatives in the segment. In the upcoming fiscals, as financiers are moving to more advance methods of customer underwriting and not just taking credit bureau scores in consideration, lenders would be able to lend more, significantly helping the segment to grow at a faster pace. The faster growth will be supported by increasing number of micro businesses and enterprises in rural and semi-urban regions requiring credit facilities for working capital etc. with the advent of technology, players can digitally underwrite customers and disburse funds to them.

Around 71% of unsecured business loans are targeted at large ticket sizes of over Rs 1.5 million as of FY24

Among ticket brackets, the share of loans less than Rs. 0.5 million reached to 16% in fiscal 2024 from 14% in fiscal 2019.

This reflects that borrowers prefer unsecured business loans for ticket size less than Rs. 0.5 million over LAP and secured business loans. Over the years, preference of unsecured business loans for small ticket size loans have remained high among MSMEs.

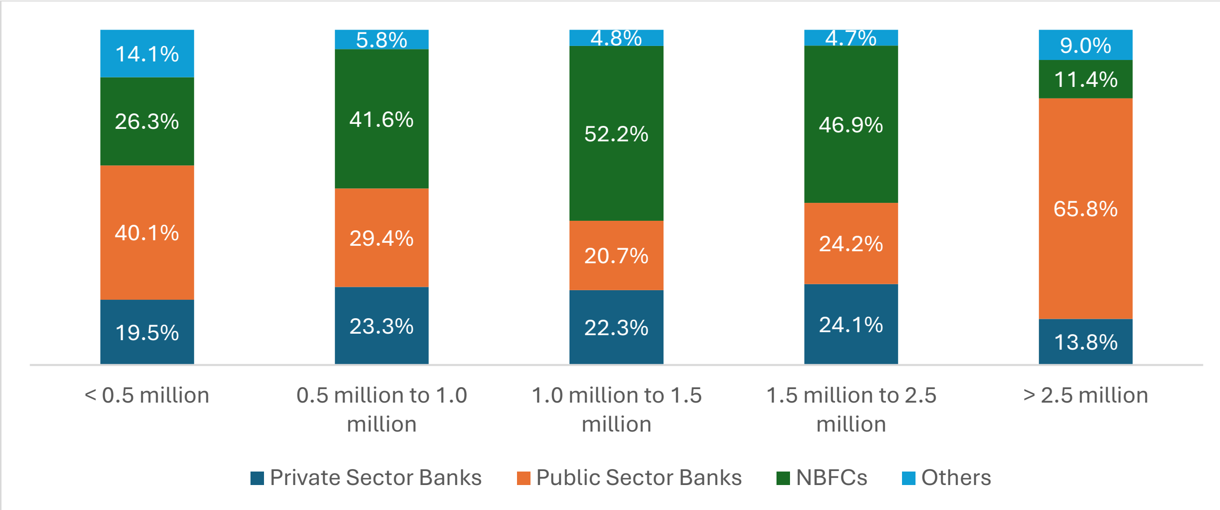
Trend of ticket-wise share



Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Ticket-size wise share of lenders in Unsecured Business Loans as of Q1FY25



Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

NBFCs witnessed the CAGR growth of 30% from FY19-FY24, while accounting for the 22% share in overall Unsecured Business Loan Segment

Among lenders in the Unsecured Business Loan segment, NBFCs witnessing a CAGR of ~30.0%. as of Q1 fiscal 2025, among lenders, Public Sector banks accounted for the highest share in credit outstanding with a share of ~52% followed by NBFCs accounting for ~22% share and private banks with 17% share.

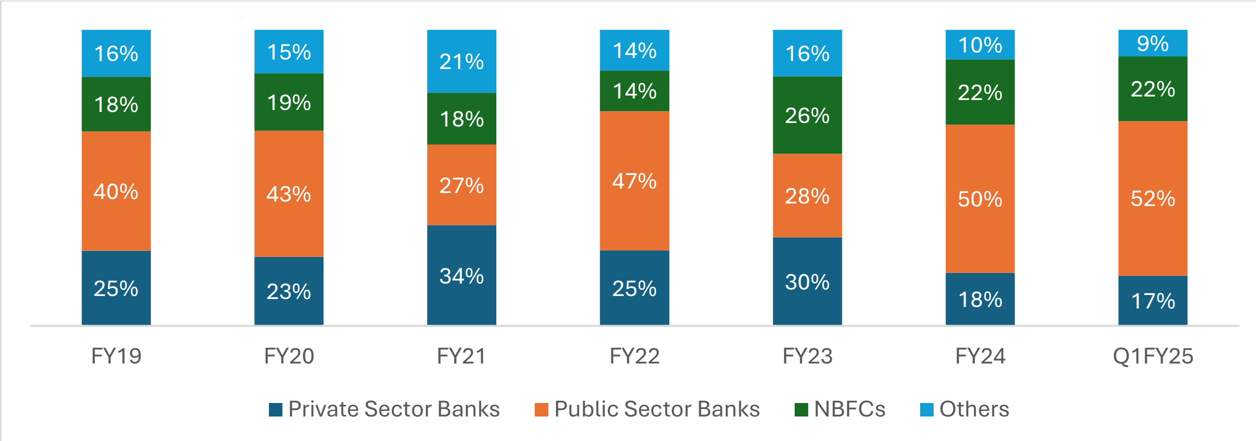
Public Sector Banks witnessed the fastest growth among lenders from FY19-24, while accounting for the highest share in overall Unsecured Business Loan Segment

Portfolio Outstanding (Rs Tn.)	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25	CAGR FY19-FY24
Private Sector Banks	0.52	0.57	0.70	0.76	0.97	1.08	1.09	15.9%
Public Sector Banks	0.82	1.04	0.56	1.40	0.91	3.03	3.36	32.5%
NBFCs	0.38	0.48	0.36	0.41	0.85	1.33	1.40	30.0%
Others	0.32	0.36	0.43	0.41	0.51	0.61	0.58	12.3%

Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Trend of Lender-wise share



Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to Consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Among lenders, NBFCs had the best asset quality in Unsecured Business Loan Segment as of Fiscal 2024

Among lenders, NBFCs had the best asset quality in the Unsecured Business Loan segment with 90+ DPD at 9.2% as of FY24, this was followed by Private Banks with 90+ DPD at 9.8%.

Among lenders, NBFCs had the best asset quality in Unsecured Business Loan Segment as of Fiscal 2024

Lenders	FY19	FY20	FY21	FY22	FY23	FY24	Q1FY25
Private Sector Banks	5.5%	7.3%	11.5%	11.6%	10.0%	9.8%	10.0%
Public Sector Banks	33.4%	44.8%	29.4%	35.7%	42.9%	22.8%	20.2%
NBFCs	7.8%	11.4%	16.9%	18.1%	10.7%	9.2%	9.5%
Others	6.8%	8.8%	16.9%	19.0%	17.3%	17.1%	18.7%
Industry	17.4%	24.3%	18.5%	24.8%	20.6%	16.9%	16.0%

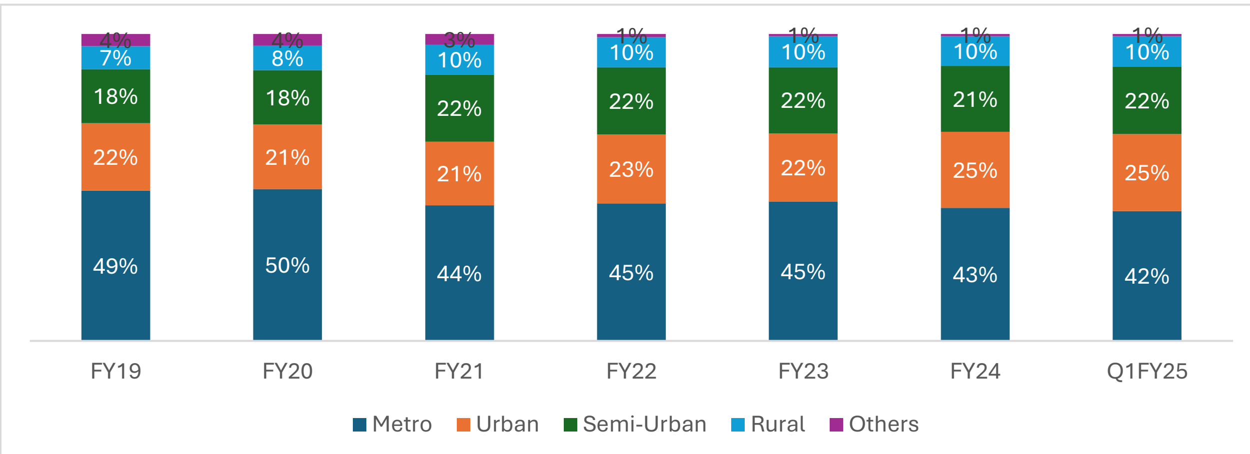
Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Semi-Urban and Rural Regions accounted for 25% share in Fiscal 2019 and grew to 31% share as of Fiscal 2024 in Unsecured Business Loan Segment

Metro regions accounted for the highest share in Unsecured Business Loan Segment, accounting for ~43% market share followed by Urban regions accounting for ~25% share and semi-urban regions accounting for ~22% market share.

Semi-Urban and Rural Regions accounted for 31% share in Unsecured Business Loan Segment as of Fiscal 2024



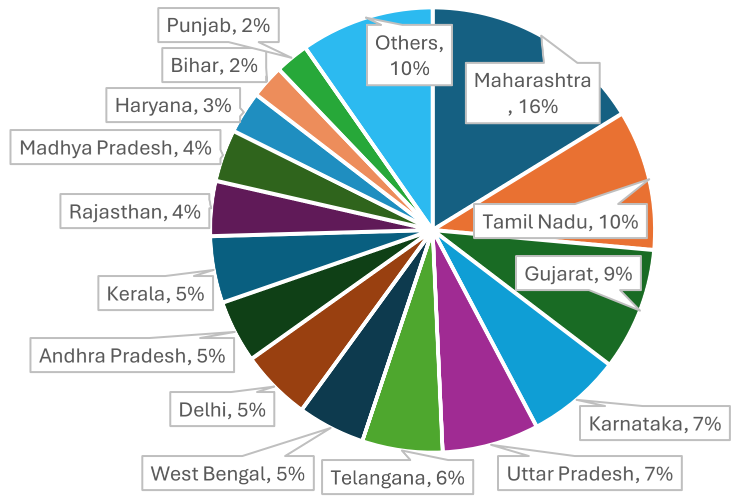
Note: Unsecured Business Loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Top 5 states accounted for ~50% in Unsecured Business Loan Segment credit outstanding

Among states, Maharashtra accounted for highest share in Unsecured Business Loan outstanding accounting for ~16% share as of FY24, which was followed by Tamil Nadu accounting for ~10% share and Gujarat accounting for ~9% credit share. As of FY24, Top 5 states accounted for ~50% share, while top 10 states accounted for ~75% share.

Maharashtra accounted for the highest share in Unsecured MSME Business Loan Segment as of Fiscal 2024



Note: Unsecured Business loan portfolio includes business loan general and business loan unsecured reported to consumer bureau.

Source: TransUnion CIBIL, CRISIL MI&A

Profitability of NBFC Players present in the Unsecured Business Loan Segment

NBFCs in the Unsecured Business Loan segment operate with yield in the range of 23-25%, on average. With average cost of funds being in the range of 12-13%, net interest margins (NIMs) for this segment are in the range of 12-14%. CRISIL MI&A estimates the profitability in this segment to have increased in Fiscal 2024 owing to improving credit costs and increase in interest yields. Going forward, profitability to improve on the back of growth in loan book and increasing operating efficiency.

Key metrics for Unsecured Business Loan Segment

Parameter	FY22	FY23	FY24
Yield on advances	25.7%	24.4%	24.6%
Cost of Borrowings	12.4%	12.2%	12.2%
Net Interest Margins	12.5%	14.2%	16.9%
Return on Assets	-3.2%	2.4%	2.9%

Sources: Company Reports, CRISIL MI&A

NBFCs operating in the Unsecured Business Loan Segment have been able to command higher margins (~16.9%) due to higher yield on advances (24.6%), with cost of borrowings at ~12.2%. leading to return on assets at 2.9% for FY24, rising from 2.4% in FY23.

Key Success Factors in the Unsecured Business Loan Landscape

Higher Interest Rate Margins: Unsecured Business Loans typically carry higher interest rates compared to secured loans. The higher yield on unsecured loans compensates for the additional risk involved, making it an attractive option for lenders seeking higher returns.

Technology Adoption: Leveraging technology in credit assessment, loan processing, and monitoring can streamline operations, reduce costs, and enhance efficiency in Unsecured Business Loan lending. Automated credit scoring models and digital platforms enable lenders to make faster decisions and serve a larger number of borrowers.

Regulatory Support: Government initiatives such as the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) provide support to lenders to offer unsecured credit to MSMEs. These schemes help mitigate risks for lenders and promote increased lending to small businesses.

Promoting Financial Inclusion: Providing Unsecured credit to micro and small enterprises plays a crucial role in promoting financial inclusion. Many small businesses lack requisite collateral to avail formal credit. By offering unsecured credit lenders can reach underserved businesses and support their growth and development.

Customised solutions: By understanding the challenges and aspirations of small businesses, lenders can provide tailored solutions, Lenders can customize financial products to suit the unique needs and cash flow patterns of Business loan borrowers, fostering long-term relationships and loyalty.

8. Peer Benchmarking

In this section, CRISIL MI&A has compared the financial and operating performance of NBFCs based on the fiscal 2022, fiscal 2023, fiscal 2024 and half year of fiscal 2025 (H1FY25). For analysis, CRISIL has considered the following MSME focused NBFCs as peers: Five-Star Business Finance Limited, SBFC Finance Limited, Veritas Finance, Aye Finance, Vistaar Financial Services, Kinara Capital and Finova Capital.

Players have been arranged as Aye Finance and subsequently in order of decreasing AUM as of Fiscal 2024 in each of the parameters.

Aye Finance saw the highest year-on-year growth in Fiscal 2024 over Fiscal 2023 among the peers considered in terms of AUM

Aye Finance is the fastest growing NBFC in India among the peers considered in terms of year-on-year AUM growth between Fiscal 2024 and Fiscal 2023, growing at 64.00%.. Aye Finance had an AUM CAGR of 60.7% between FY22 and FY24, behind Finova Capital with a CAGR of 67.4% between FY22 and FY24 followed by Veritas Finance at 61.8% among the peer set.

Assets under management (AUM)

Assets under Management (in Rs. million)	FY22	FY23	FY24	YoY Growth (in %)*	H1FY25	CAGR (FY22-24)
Aye Finance	17,285	27,216	44,633	64.0%	49,798	60.7%
Five Star Business Finance	50,671	69,148	96,406	39.4%	109,272	37.9%
SBFC Finance	31,922	49,428	68,219	38.0%	77,150	46.2%
Veritas Finance	21,874	35,337	57,238	62.0%	65,170	61.8%
Vistaar Financial Services Pvt Ltd	24,200	31,325	40,545	29.4%	N.A.	29.4%
Kinara Capital	12,680	24,870	31,420	26.3%	31,252	57.4%
Finova Capital	9,482	16,288	26,560	63.1%	N.A.	67.4%

Note: N.A. – Not Available; (*) - YoY growth from FY23 to FY24 is denoted; Source: Company reports, CRISIL MI&A

Aye Finance has the second highest growth in disbursement at a CAGR of 73.8% from Fiscal 2022 to Fiscal 2024 amongst the peer set

Aye Finance has the second highest disbursement growth rate of 73.8% from Fiscal 2022 to Fiscal 2024 amongst the peer set. Veritas Finance has the highest growth rate at 76.5% during the same time period.

Disbursements

Disbursements (in Rs. million)	FY22	FY23	FY24	H1FY25	CAGR (FY22-24)
Aye Finance	13,042	23,571	39,389	20,141	73.8%
Five Star Business Finance	17,562	33,914	48,814	25,689	66.7%
SBFC Finance*	13,328	22,768	27,930	6,720	44.8%
Veritas Finance	11,883	22,447	37,024	N.A.	76.5%
Vistaar Financial Services Pvt Ltd	8,995	13,835	16,872	N.A.	37.0%
Kinara Capital	7,930	18,830	19,050	N.A.	55.0%
Finova Capital	4,830	8,973	13,490	N.A.	67.1%

Note: N.A. – Not Available; (*) For secured MSME product
Source: Company reports, CRISIL MI&A

Aye Finance product portfolio is more diversified (Secured and Unsecured) than other MSME focused NBFCs in the peer set

Aye Finance is among the leading NBFCs providing business loans to the largely underserved micro scale enterprises in India, with 508,224 active unique customers diversified across 18 states and three union territories and with assets under management ("AUM") of Rs 49,797.64 million as of September 30, 2024.

Aye Finance is uniquely positioned in the micro enterprise lending space as one of the only providers among the peers considered offering a full product line (secured and unsecured) to serve a large unaddressed customer segment. It has a mix of secured and unsecured MSME loan portfolio. The product offerings are more diversified as compared to other MSME focused NBFCs such as Five-Star Business Finance, SBFC Finance, Veritas Finance and Vistaar Financial Services as of Fiscal 2024.

AUM Mix (Fiscal 2024)

AUM Mix as of Fiscal 2024	Secured MSME	MSME Unsecured	Others
Aye Finance	60%	40%	
Five Star Business Finance	100%	-	-
SBFC Finance*	83%	-	17%
Veritas Finance	89%	11%^	-
Vistaar Financial Services Pvt Ltd	100%	-	-

Kinara Capital**	-	81%	19.00%
Finova Capital	99.8%	-	0.2%

Note: (*) – Data as of September 2024; (**) – Data as of June 2024; (^) Working capital loans to urban shopkeepers; 1) Others include gold loan, unsecured (personal) loan, consumer durable loan etc.
Source: Company reports, CRISIL MI&A

Aye Finance offers granularity in their portfolio with a strong focus on lower ticket size loans

Aye Finance is technology-enabled pan-India player offering small-ticket loans with an average ticket size of Rs 0.1-0.15 million as of June 2024 to micro enterprises in semi-urban areas across India, primarily for working capital and business expansion needs against hypothecation of working assets or against the security of property.

Average Ticket Size as of September 2024

Players	Average Ticket Size
Aye Finance	Rs 0.10 - 0.15 million*
Five-Star Business Finance	Rs 0.35 million
SBFC Finance	Rs 0.936 million - Secured MSME
Veritas Finance	N.A.
Vistaar Financial Services Pvt Ltd	Rs 0.3 - 5 million**
Kinara Capital	Rs 0.80 million*
Finova Capital	Rs 0.36 million*

Note: N.A. – Not Available; (*) – As of June 2024; (**) – As of March 2024; Company reports, CRISIL MI&A

Aye Finance has the second highest number of branches as of Fiscal 2024 among the peer set

Aye Finance had the second highest number of branches at 478 as of Fiscal 2024 among the peers considered and it has grown the network at 24% CAGR from Fiscal 2022 to Fiscal 2024. Finova Capital saw the highest growth of 37% in branch growth from Fiscal 2022 to Fiscal 2024 among the peers considered on account of a lower base. The highest number of branches is that of Five-Star Business Finance at 520 as of Fiscal 2024. Aye Finance's growth in employee strength is commensurate to the branch growth between Fiscal 2022 and Fiscal 2024. Five Star Business Finance also saw growth in employee strength commensurate to branch growth between Fiscal 2022 and Fiscal 2024.

Number of branches and number of employees

Players	Branches				Employees			
	FY22	FY23	FY24	CAGR (FY22-FY24)	FY22	FY23	FY24	CAGR (FY22-FY24)
Aye Finance	311	398	478	24%	4,837	5,724	6,825	19%
Five-Star Business Finance	300	373	520	32%	5,675	7,347	9,327	28%
SBFC Finance	135	152	183	16%	2,048	2,822	3,758	35%
Veritas Finance	229	287	382	29%	2,727	4,432	6,299	52%
Vistaar Financial Services Pvt Ltd	193	211	212	5%	2,024	2,446	2,468	10%
Kinara Capital	110	125	133	10%	1,313	1,548	2,073	26%
Finova Capital	160	200	300	37%	1,426	1,988	3,664	60%

Source: Company reports, CRISIL MI&A

Aye finance has the highest geographic diversity among peers with presence in maximum number of states

Aye Finance maintained a balanced and well-diversified pan-India presence across all 4 geographies viz. North, East, South, and West, making them the fastest growing (in terms of year-on-year growth in AUM in Fiscal 2024) pan-India MSME lender among the peers considered.

Aye Finance is the most geographically diversified lender among the peers considered with top 3 states accounting for 40.00% of total AUM as of March 2024, as compared to the average of 70.90% among the peers considered.

Aye Finance's AUM has the most diversified footprint in terms of top state concentration, with no state having more than 15% AUM concentration as of March 2024, which is the lowest among the peer set considered.

As of March 2024, Aye Finance is the only diversified pan India player in the micro enterprise lending segment among the peers considered.

SBFC Finance is focusing on secured MSME lending with the next highest presence in India covering 18 states, and the top state contributing to 17% of the AUM as of June 2024.

Share of top states in AUM as of March 2024

Players	Presence in total Number of States	Share of top states by AUM		
		Top State	Top 3 states	Top 5 states
Aye Finance	21	14.1%	40.0%	53.5%
Five-Star Business Finance*	10	30.0%	87.0%	98.0%
SBFC Finance*	18	17.0%	N.A.	N.A.
Veritas Finance*	11	41.7%	69.4%	N.A.
Vistaar Financial Services Pvt Ltd	12	39.0%	77.0%	87.0%
Kinara Capital	7	33.1%	71.0%	93.0%
Finova Capital	14	64.0%	81.0%	N.A.

Note: N.A. – Not Available; (*): As of June 2024; Source: Company reports, CRISIL MI&A

Aye Finance has seen the highest reduction in the cost to income ratio from Fiscal 2022 to H1 Fiscal 2025

Aye Finance saw a substantial reduction in cost to income ratio from Fiscal 2022 to H1 Fiscal 2025 to the extent of 32.0%, which was the highest reduction among the peers considered. Aye Finance is achieving economies of scale through an increasing customer base thereby enabling the lowering of cost to income from Fiscal 2022 to Fiscal 2024. Aye Finance offers the lowest ticket sizes among peers considered and holds the largest customer base as of Fiscal 2024. In spite of average ticket size (as of Sep 30, 2024) that is about 1/3rd of the peers considered Aye has managed to keep its cost to income in a similar range as peers considered.

Cost to Income for players

Players	Average Ticket Size as of Sep 2024	Active Customer Base (FY22)	Active Customer Base (FY24)	Cost to Income (%)			
				FY22	FY23	FY24	H1FY25
Aye Finance	Rs 0.1 - 0.15 million**	396,766	508,224*	80.4%	66.0%	51.0%	48.4%

Five Star Business Finance	Rs 0.35 million	217,794	385,966	32.0%	34.7%	32.2%	30.3%
SBFC Finance	Rs 0.94 million	72,816	159,365*	57.0%	49.7%	45.7%	40.2%
Veritas Finance	N.A.	71,726	176,082	48.9%	45.5%	48.1%	43.1%
Vistaar Financial Services Pvt Ltd	Rs 0.3 - 5 million***	33,708	47,153	50.8%	52.7%	48.7%	41.7%
Kinara Capital	Rs 0.8 million**	25,330	42,948	64.6%	52.8%	40.6%	62.0%
Finova Capital	Rs 0.36 million**	26,868	82,183**	56.4%	43.2%	44.6%	N.A.

Note: N.A. – Not Available; (*) – Data as of September 2024; (**) – Data as of June 2024; (***) – Data as of March 2024; 1) Cost to Income ratio calculated as operating expenses for the relevant fiscal year / period divided by total income minus interest expense, Operating Expenses include employee expenses, depreciation and amortization, other expenses and fees and commission expense; Source: Company reports, CRISIL MI&A

Aye Finance recorded the second highest growth in AUM per branch and highest growth in AUM per employee between Fiscal 2022 and Fiscal 2024

Aye Finance' AUM per branch grew at a CAGR of 29.6% between Fisal 2022 and Fiscal 2024 which was the second highest amongst the peers considered, preceded by Kinara Capital which grew at a CAGR of 43.2%. Aye Finance achieved the fastest growth in AUM per employee at a CAGR of 35.3% between Fiscal 2022 and Fiscal 2024, followed by Kinara Capital at 25.3% during the same period.

AUM per branch and AUM per employee

Players	AUM per branch (in Rs. million)					AUM per employee (in Rs. million)				
	FY22	FY23	FY24	CAGR FY22-FY24	H1FY 25	FY22	FY23	FY24	CAGR FY22-FY24	H1FY 25
Aye Finance	55.6	68.4	93.4	29.6%	100	3.6	4.8	6.5	35.3%	5.9
Five Star Business Finance	168.9	185.4	185.4	4.8%	166	8.9	9.4	10.3	7.6%	10.5
SBFC Finance	236.5	325.2	372.8	25.6%	402	15.6	17.5	18.2	7.9%	18.9
Veritas Finance	95.5	123.1	149.8	25.2%	N.A.	8.0	8.0	9.1	6.4%	8.5

Vistaar Financial Services Pvt Ltd	125.4	148.5	191.3	23.5%	N.A.	12.0	12.8	16.4	17.2%	N.A.
Kinara Capital	115.3	199.0	236.2	43.2%	N.A.	9.7	16.1	15.2	25.3%	N.A.
Finova Capital	59.3	81.4	88.5	22.2%	N.A.	6.6	8.2	7.2	4.4%	N.A.

Note: N.A. – Not Available; 1) AUM per branch calculated as AUM for the relevant fiscal year divided by numbers of branches for the relevant fiscal year, 2) AUM per employee calculated as AUM for the relevant fiscal year divided by numbers of employees for the relevant fiscal year.
Source: Company reports, CRISIL MI&A

Aye Finance recorded the highest growth in disbursement per branch and disbursement per employee growing at CAGR of 40.2% and 46.3% respectively between Fiscal 2022 and Fiscal 2024

Aye Finance' disbursement per branch showed a CAGR of 40.2% between Fiscal 2022 and Fiscal 2024 which was the highest amongst the peers considered, followed by Kinara Capital which grew at a CAGR of 41.0%. Aye Finance also grew the fastest in terms of disbursement per employee at a CAGR of 44.2% between Fiscal 2022 and Fiscal 2024, followed by Five Star Business Finance which grew at a CAGR of 30.0% during the same period. Aye Finance has the lowest average ticket size among the peers considered but, disbursements per branch and disbursements per employee is fifth highest each among the peers considered as of Fiscal 2024.

Disbursement per branch and Disbursement per employee

Players	Average Ticket Size as of Sep 2024	Disbursement per branch (in Rs. million)					Disbursement per employee (in Rs. million)				
		FY22	FY23	FY24	CAGR FY22 - FY24	H1FY25	FY22	FY23	FY24	CAGR FY22 - FY24	H1FY25
Aye Finance	Rs 0.1 - 0.15 million**	41.9	59.2	82.4	40.2 %	40.4	2.7	4.1	5.8	46.3 %	2.4
Five Star Business Finance	Rs 0.35 million	58.5	90.9	93.9	26.6 %	38.9	3.1	4.6	5.2	30.0 %	2.5
SBFC Finance*	Rs 0.94 million	98.7	149.8	152.6	24.3 %	35.0	6.5	8.1	7.4	6.9%	1.6
Veritas Finance	N.A.	51.9	78.2	96.9	36.7 %	N.A.	4.4	5.1	5.9	16.1 %	N.A.

Vistaar Financial Services Pvt Ltd	Rs 0.3 - 5 million***	46.6	65.6	79.6	30.7 %	N.A.	4.4	5.7	6.8	24.0 %	N.A.
Kinara Capital	Rs 0.8 million**	72.1	150.6	143.2	41.0 %	N.A.	6.0	12.2	9.2	23.4 %	N.A.
Finova Capital	Rs 0.36 million**	30.2	44.9	45.0	22.0 %	N.A.	3.4	4.5	3.7	4.3%	N.A.

Note: N.A. – Not Available; (*) Disbursements for secured MSME product; (**) – Data as of June 2024; (***) – Data as of March 2024; 1) Disbursements per branch calculated as Disbursement for the relevant fiscal year divided by numbers of branches for the relevant fiscal year, 2) Disbursement per employee calculated as Disbursements for the relevant fiscal year divided by numbers of employees for the relevant fiscal year.
Source: Company reports, CRISIL MI&A

Aye Finance recorded the highest number of loans disbursed per employee as of Fiscal 2024 among the peer considered

Aye Finance disbursed ~45 loans per employee as of Fiscal 2024 which was the highest among the peers considered, followed by Five Star Business Finance at 15 loans per employee and Kinara Capital with 11 loans per employee.

Number of loans disbursed per employee as of Fiscal 2024

Disbursements (in Rs. million)	Number Loans Disbursed per Employee (Number of Loans Disbursed / Number of Employees)
Aye Finance*	45
Five Star Business Finance	15
SBFC	8
Veritas Finance	N.A.
Vistaar Financial Services Pvt Ltd*	3
Kinara Capital	11
Finova Capital	10

Note: N.A. – Not Available; Number of Loans Disbursed is calculated as Total Disbursement / Average Ticket Size; (*) – Average ticket size computed from range of ticket size; Source: Company reports, CRISIL MI&A

Aye Finance's profit after tax grew by 291.5% year-on-year from fiscal 2023 to fiscal 2024 which was the highest among the peers considered

Aye Finance's profit after tax was Rs 1,717 million in Fiscal 2024, which grew the highest year-on-year at 291.5% from Fiscal 2023 to Fiscal 2024 amongst the peers considered, followed by Finova Capital at 71.4% and SBFC Finance clocking a 58.1% growth year-on-year.

Profit after tax

Profit After Tax (in Rs. million)	FY22	FY23	FY24	YoY Growth (in %)*	H1FY25
Aye Finance	-513.5	438.5	1,716.8	291.5%	1,078.0
Five Star Business Finance	4,535.4	6,035.0	8,359.2	38.5%	5,195.1
SBFC Finance	645.2	1,497.9	2,370.2	58.1%	1,627.0
Veritas Finance	754.0	1,764.0	2,450.5	38.9%	1,331.1
Vistaar Financial Services Pvt Ltd	741.9	1,000.3	1,471.0	47.1%	940.5
Kinara Capital	145.9	411.9	621.5	50.9%	-372.5
Finova Capital	290.1	883.7	1,515.1	71.4%	N.A.

Note: N.A. – Not Available; (*) –YoY growth from FY23 to FY24 is denoted; Source: Company reports, CRISIL MI&A

Net worth

Net worth (in Rs. million)	FY22	FY23	FY24	CAGR (FY22-24)	H1FY25
Aye Finance	7,054	7,580	12,361	32.4%	15,966
Five Star Business Finance	37,104	43,395	51,962	18.3%	57,233
SBFC Finance	12,872	17,273	27,783	46.9%	29,678
Veritas Finance	14,080	15,913	23,296	28.6%	26,107
Vistaar Financial Services Pvt Ltd	7,849	8,851	13,677	32.0%	14,617
Kinara Capital	2,453	6,836	7,364	73.3%	6,973
Finova Capital	9,185	10,094	11,627	12.5%	N.A.

Note: N.A. – Not Available; 1) Net worth includes Equity share capital and reserves and surplus
Source: Company reports, CRISIL MI&A

Aye Finance grew at a highest CAGR of 155.9% in Pre-Provision Operating Profit (PPOP) between Fiscal 2022 and Fiscal 2024 among the peers considered

Aye Finance registered the highest growth at a CAGR of 155.9% in PPOP between Fiscal 2022 and Fiscal 2024 among the peers considered, followed by Kinara Capital (109.4%) and Finova Capital (101.7%).

PPOP

PPOP (in Rs. million)	FY22	FY23	FY24	CAGR (FY22-24)	H1FY25
Aye Finance	558	1,513	3,654	155.9%	2,518
Five Star Business Finance	6,497	8,249	11,713	34.3%	7,347
SBFC Finance	1,335	2,335	3,631	64.9%	2,490
Veritas Finance	1,607	2,797	4,194	61.5%	3,343
Vistaar Financial Services Pvt Ltd	1,365	1,549	2,254	28.5%	1,589
Kinara Capital	609	1,458	2,673	109.4%	666
Finova Capital	543	1,469	2,210	101.7%	N.A.

Note: N.A. – Not Available; Source: Company reports, CRISIL MI&A

Aye Finance's yield on advances stood at 28.4% and NIMs stood at 15.5% - both of which were the second highest among the peer set considered as of Fiscal 2024

Aye Finance's yield on net advances at 28.4% as of Fiscal 2024, which was second to Kinara Capital's yield on net advances at 32.3%.

Net interest margin for Aye Finance was the second highest amongst the compared peer set as of Fiscal 2024 at 15.5%. Five-Star Business Finance had the highest net interest margin as of Fiscal 2024 amongst the compared peer set at 16.2%.

Key Financial Ratios (Fiscal 2024)

FY24	Yield on Net Advances	Yield on Gross Advances	Cost of Borrowing	Net Interest Margin	Credit Cost	Risk adjusted NIM	Net total income	Opex - Overall(%)	Opex – Employee (%)	Opex – Non-Employee(%)	PPOP (%)
Aye Finance	28.4%	27.7%	11.3%	15.5%	3.3%	12.3%	22.7%	9.5%	6.9%	2.6%	9.1%
Five Star Business Finance	25.1%	24.7%	8.9%	16.2%	0.5%	15.6%	20.9%	5.4%	4.2%	1.2%	11.5%
SBFC Finance	16.9%	16.6%	9.1%	8.9%	0.7%	8.1%	13.1%	4.8%	3.4%	1.4%	5.7%
Veritas Finance	22.6%	22.2%	9.8%	14.1%	1.7%	12.4%	17.6%	7.4%	5.6%	1.8%	7.9%
Vistaar Financial Services Pvt Ltd	18.2%	17.9%	9.3%	9.7%	0.8%	8.9%	13.1%	5.6%	4.4%	1.2%	5.9%
Kinara Capital	32.3%	31.3%	14.2%	12.4%	6.7%	5.7%	25.2%	6.6%	3.9%	2.7%	9.6%

Finova Capital	22.8%	22.5%	9.0%	14.2%	0.7%	13.5%	18.8%	6.8%	5.5%	1.3%	8.5%

Note: 1) Yield on net advances calculated as Interest earned on loans and advances divided by average of total net advances on book, 2) Yield on gross advances calculated as Interest earned on loans and advances divided by average of total gross advances on book, 3) Cost of borrowing calculated as total interest paid divided by average of deposits and borrowings, Borrowings include debt securities, borrowings other than debt securities, subordinated liabilities and deposits,4) Net Interest Margin calculated as total interest income subtracted by total interest paid divided by average of total assets on book, 5) Risk adjusted net interest margin calculated as net interest margins subtracted by credit cost of the company for the relevant fiscal year, 6) Net Total Income calculated as Total Income (-) Interest Expense divided by average of total net advances on book, 7) Opex calculated as Operating expenses divided by total average assets at the end of the financial year, Operating Expenses include employee expenses, depreciation and amortization, other expenses and fees and commission expense, 8) PPOP calculated as pre provision operating profit divided by average of total assets, 9) Credit cost calculated as provision/impairment divided by average total assets on book
Source: Company reports, CRISIL MI&A

Key Financial Ratios (Fiscal 2023)

FY23	Yield on Net Advances	Yield on Gross Advances	Cost of Borrowing	Net Interest Margin	Credit Cost	Risk adjusted NIM	Net total income	Opex – Overall (%)	Opex – Employee (%)	Opex – Non-Employee (%)	PPOP (%)
Aye Finance	26.2%	25.5%	10.4%	13.5%	2.7%	10.8%	21.0%	10.8%	7.8%	3.0%	5.6%
Five Star Business Finance	24.5%	24.1%	7.8%	16.4%	0.3%	16.1%	21.2%	5.8%	4.6%	1.2%	11.0%
SBFC Finance	16.1%	15.8%	8.3%	7.4%	0.6%	6.7%	12.5%	4.5%	3.1%	1.4%	4.6%
Veritas Finance	22.6%	22.2%	9.4%	14.4%	1.4%	13.0%	18.3%	6.9%	5.0%	2.0%	8.3%
Vistaar Financial Services Pvt Ltd	18.1%	17.8%	9.3%	9.1%	0.6%	8.4%	12.6%	5.6%	4.3%	1.3%	5.0%
Kinara Capital	27.8%	27.0%	13.0%	10.2%	4.6%	5.5%	23.7%	8.2%	5.2%	3.0%	7.4%
Finova Capital	22.9%	22.6%	8.9%	13.5%	1.6%	11.9%	20.3%	6.1%	5.0%	1.1%	8.0%

Key Financial Ratios (Fiscal 2022)

FY22	Yield on Net Advances	Yield on Gross Advances	Cost of Borrowing	Net Interest Margin	Credit Cost	Risk adjusted NIM	Net total income	Opex - Overall(%)	Opex – Employee(%)	Opex – Non-Employee(%)	PPOP (%)
Aye Finance	24.9%	23.8%	11.2%	11.3%	5.5%	5.9%	17.9%	10.3%	7.9%	2.4%	2.5%
Five Star Business Finance	24.7%	24.3%	10.0%	14.9%	0.8%	14.1%	20.2%	5.0%	3.9%	1.1%	10.7%

SBFC Finance	15.0%	14.7%	7.7%	5.8%	0.81.1 %	4.7%	12.2%	4.0%	2.5%	1.5%	3.0%
Veritas Finance	22.4%	21.8%	10.5%	12.3%	2.5%	9.9%	17.2%	6.4%	4.6%	1.8%	6.7%
Vistaar Financial Services Pvt Ltd	18.6%	18.1%	9.2%	9.5%	1.4%	8.1%	13.2%	5.5%	4.3%	1.3%	5.4%
Kinara Capital	22.6%	21.9%	11.8%	7.5%	3.3%	4.3%	18.8%	8.6%	5.1%	3.5%	4.7%
Finova Capital	21.4%	21.1%	10.1%	9.1%	1.2%	7.9%	16.4%	5.4%	4.5%	0.9%	4.2%

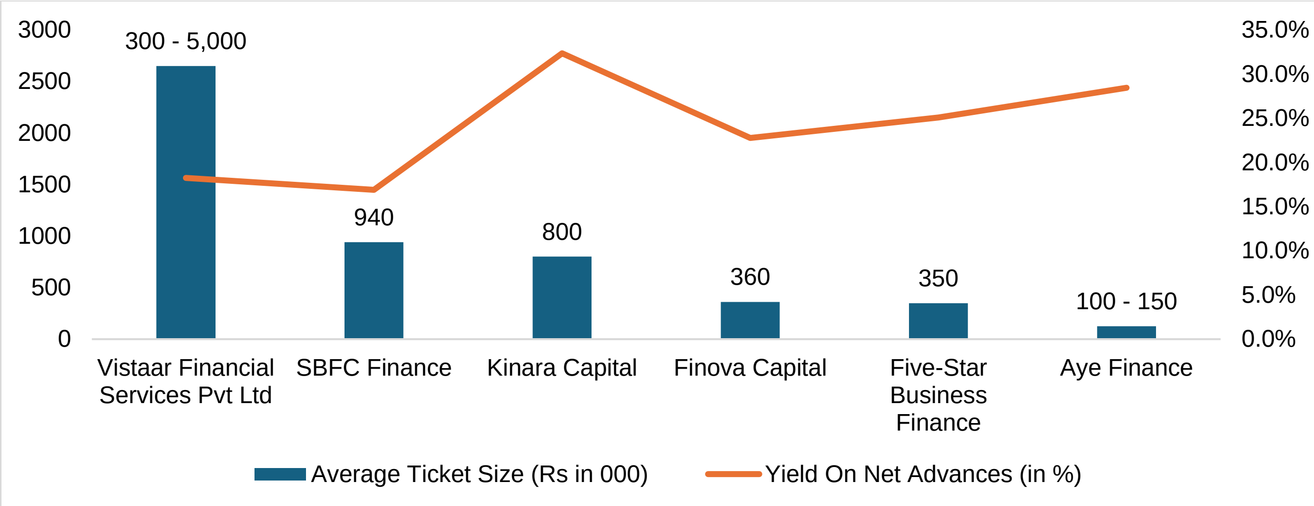
Key Financial Ratios (H1 Fiscal 2025)

H1FY25	Yield on Net Advances	Yield on Gross Advances	Cost of Borrowing	Net Interest Margin	Credit Cost	Risk adjusted NIM	Net total income	Opex - Overall(%)	Opex – Employee (%)	Opex – Non-Employee(%)	PPOP (%)
Aye Finance	29.6%	28.6%	12.1%	15.4%	3.8%	11.6%	22.9%	8.8%	6.5%	2.3%	9.4%
Five Star Business Finance	24.1%	N.A.	9.7%	16.3%	0.7%	15.6%	20.4%	5.2%	4.0%	1.2%	12.0%
SBFC Finance	17.5%	17.2%	9.3%	10.0%	0.9%	9.1%	13.4%	4.6%	3.3%	1.3%	6.8%
Veritas Finance	N.A.	N.A.	6.0%	15.8%	1.8%	14.0%	19.5%	7.2%	5.7%	1.6%	9.5%
Vistaar Financial Services Pvt Ltd	N.A.	N.A.	9.7%	10.3%	1.3%	9.0%	13.6%	5.0%	3.9%	1.1%	6.9%
Kinara Capital	N.A.	N.A.	14.3%	10.5%	7.5%	3.0%	18.1%	7.0%	4.1%	2.9%	4.3%
Finova Capital	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Note: All figures are annualised; N.A – Not Available.

Source: Company reports/financial statements, Investor presentations, CRISIL MI&A

Comparison of average ticket size as of September 2024 and Yield on Net Advances as of Fiscal 2024



Note: Average ticket size for Aye Finance, Kinara Capital and Finova Capital was as of June 2024; Vistaar Financial Services was of Fiscal 2024; ATS for Veritas was N.A.; Kinara Capital - The company has written-off a portfolio amounting to ₹1,230 million in FY24 as against ₹740 million in FY23; Source: Company reports, CRISIL MI&A

Aye Finance's restructured portfolio was the lowest among peers considered

Aye Finance reported a restructured portfolio of 0.22% as of December 2023 which was the lowest among peers considered, followed by Five-Star Business Finance and Veritas Finance with a restructured portfolio of 0.46% each as of June 2024 and March 2024 respectively.

Restructured Book

Players	Restructured Portfolio as of March 2024
Aye Finance	0.22%*
Five-Star Business Finance	0.46%**
SBFC Finance	1.80%^
Veritas Finance	0.46%
Vistaar Financial Services Pvt Ltd	0.70%*
Kinara Capital	1.80%
Finova Capital	N.A.

Note: N.A. – Not Available; (*): Data as of December 2023; (**): Data of June 2024; (^): Data as of June 2023; Source: Company reports, CRISIL MI&A

Aye Finance had among the lowest NNPA (%) as of Fiscal 2024 and the highest provision coverage ratio as of Fiscal 2024

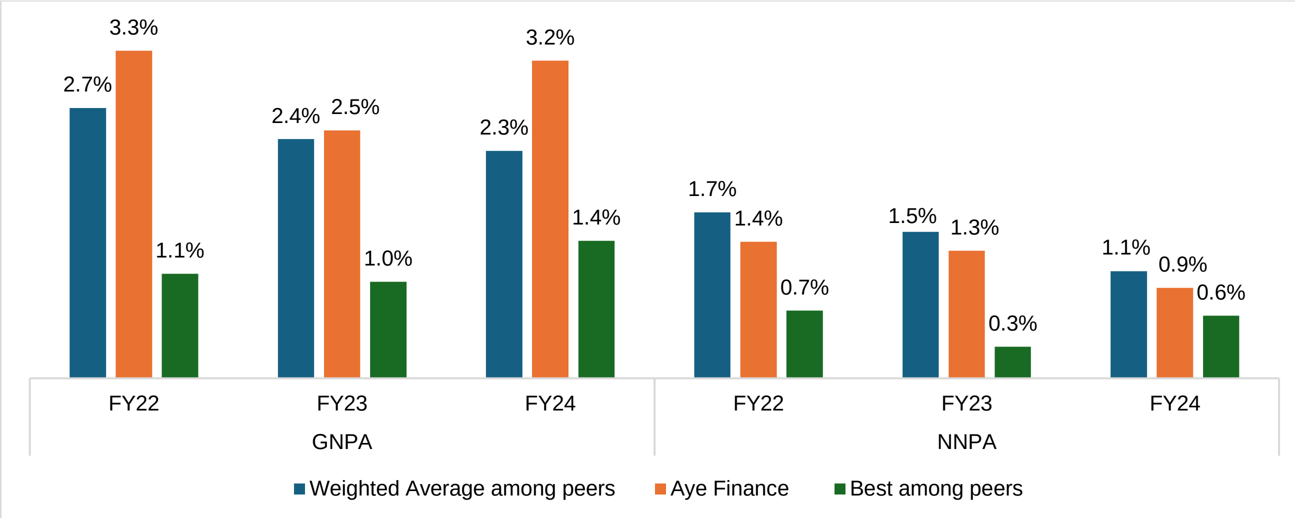
Aye Finance's NNPA was the second lowest at 0.9%, while Veritas Finance also had an NNPA of 0.9%, preceded by Five Star Business Finance with the lowest NNPA of 0.6% as of Fiscal 2024. Aye Finance recorded the highest provision coverage ratio of 71.5% as of fiscal 2024, followed by Five Star Business Finance with 54.3% as of fiscal 2024.

Asset quality

Players	GNPA				NNPA				Provision Coverage Ratio			
	FY22	FY23	FY24	H1FY25	FY22	FY23	FY24	H1FY25	FY22	FY23	FY24	H1FY25
Aye Finance	3.3%	2.5%	3.2%	3.3%	1.4%	1.3%	0.9%	1.2%	59.1%	49.8%	72.1%	66.1%
Five Star Business Finance	1.1%	1.4%	1.4%	1.5%	0.7%	0.7%	0.6%	0.7%	34.9%	49.3%	54.3%	51.8%
SBFC Finance*	2.7%	2.6%	2.4%	2.7%	1.6%	1.6%	1.4%	1.6%	40.4%	39.3%	44.7%	40.2%
Veritas Finance	3.9%	2.2%	1.8%	2.0%	2.3%	1.3%	0.9%	1.0%	41.5%	42.8%	53.1%	50.8%
Vistaar Financial Services Pvt Ltd**	2.6%	3.7%	2.7%	2.7%	1.9%	2.4%	1.3%	1.6%	28.1%	35.3%	50.8%	43.4%
Kinara Capital**	8.6%	5.6%	5.6%	8.6%	5.9%	4.6%	3.0%	5.1%	31.0%	18.0%	46.9%	40.7%
Finova Capital	1.8%	1.0%	1.8%	N.A.	1.1%	0.3%	1.0%	N.A.	41.2%	67.3%	45.0%	N.A.

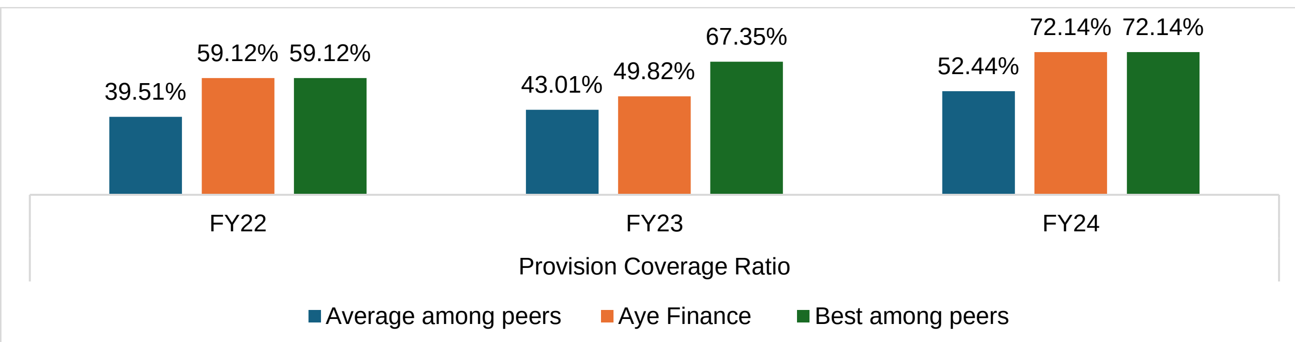
Note: N.A.- Not Available; Provisioning Coverage Ratio is as reported by the company for the relevant fiscal year; (*) After impact of RBI circular; (**) PCR calculated as (GNPA – NNPA) / GNPA for the relevant fiscal year
Source: Company reports, CRISIL MI&A

Comparison of GNPA - Weighted Average among peers, Aye Finance and the Best among peers



Note: Weighted Average among peers is calculated using sum product of GNPA and Gross Advances of peers divided by Gross Advances of peers; Best among peers is considered as lowest values across peers for Fiscal 2022, Fiscal 2023, Fiscal 2024; Source: Company reports, CRISIL MI&A

Comparison of Provision Coverage Ratio - Average among peers, Aye Finance and the Best among peers



Note: Best among peers is considered as highest values across peers for Fiscal 2022, Fiscal 2023, Fiscal 2024; Source: Company reports, CRISIL MI&A

Aye Finance had the lowest Stage 2 Portfolio as percentage of total gross loans among the peers considered as of Fiscal 2024 and H1 FY25

Aye Finance's stage 2 assets as a percentage of total gross loans was the lowest at 1.0% as of Fiscal 2024 among the peers considered, followed by Finova Capital with 1.4% and Vistaar Financial Services with 1.6%.

As of H1 FY25, Aye Finance's stage 2 assets as a percentage of total gross loans was the lowest at 1.7% among the peers considered, followed by SBFC Finance at 3.2% and Five-Star Business Finance at 7.0%.

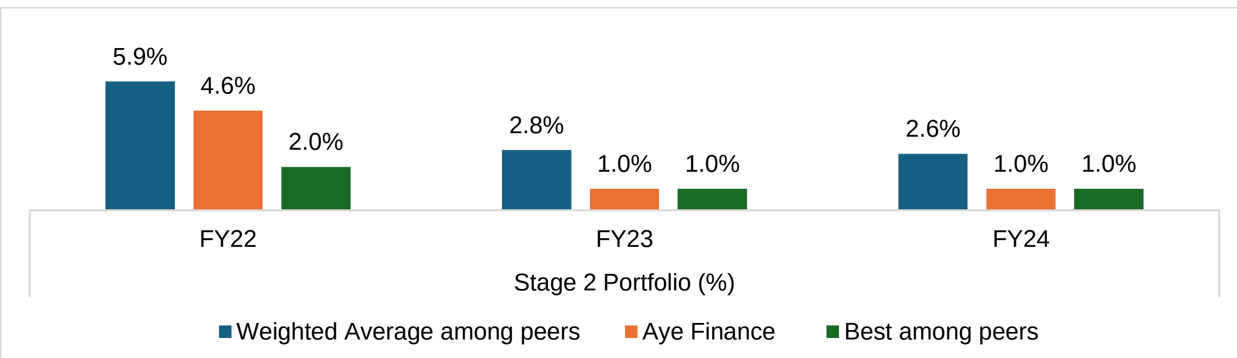
Stage 2 Portfolio

Players	Stage 2 Portfolio (%)

	FY22	FY23	FY24	H1FY25
Aye Finance	4.6%	1.0%	1.0%	1.7%
Five Star Business Finance	15.7%	9.1%	6.5%	7.0%
SBFC Finance	6.0%	4.0%	4.4%	3.2%
Veritas Finance	5.1%	2.2%	1.5%	N.A.
Vistaar Financial Services Pvt Ltd	7.1%	1.5%	1.6%	N.A.
Kinara Capital	4.0%	2.0%	3.0%	N.A.
Finova Capital	2.0%	1.6%	1.4%	N.A.

Note: N.A.- Not Available; Source: Company reports, CRISIL MI&A

Comparison of Stage 2 Portfolio - Weighted Average among peers, Aye Finance and the Best among peers



Note: Weighted Average among peers is calculated using sum product of Stage 2 (%) and Gross Advances of peers divided by Gross Advances of peers; Best among peers is considered as lowest values across peers for Fiscal 2022, Fiscal 2023, Fiscal 2024; Source: Company reports, CRISIL MI&A

Aye Finance had the second highest total assets to equity ratio as of fiscal 2024

Five-Star Business Finance has the lowest debt to equity ratio at 1.2x followed by SBFC Finance at 1.4x, while Aye Finance reported 2.8x as of Fiscal 2024. Aye Finance had the second highest total assets to equity ratio as of fiscal 2024 at 3.9x, preceded by Kinara Capital 4.1x.

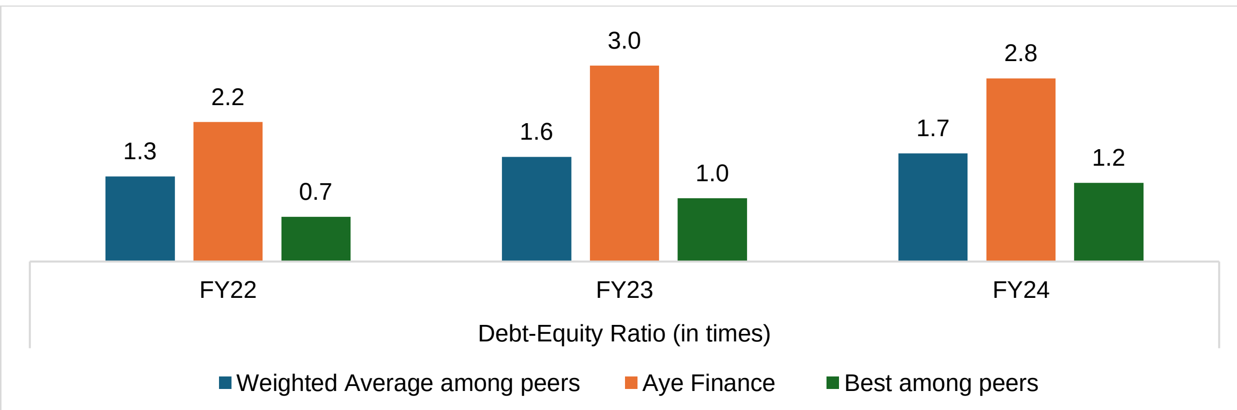
Debt to equity and total assets to equity ratio

Players	Debt to Equity (in times)				Total Assets to Equity (in times)			
	FY22	FY23	FY24	H1FY25	FY22	FY23	FY24	H1FY25

Aye Finance	2.2	3.0	2.8	2.6	3.3	4.1	3.9	3.6
Five Star Business Finance	0.7	1.0	1.2	1.2	1.7	2.0	2.2	2.2
SBFC Finance	2.3	2.2	1.4	1.5	3.5	3.3	2.5	2.5
Veritas Finance	0.8	1.5	1.7	1.9	1.9	2.6	2.8	2.9
Vistaar Financial Services Pvt Ltd	2.4	2.7	2.1	2.3	3.6	3.8	3.2	3.3
Kinara Capital	4.6	2.4	2.9	3.4	6.0	3.7	4.1	4.5
Finova Capital	0.7	1.0	1.6	N.A.	1.7	2.1	2.7	N.A.

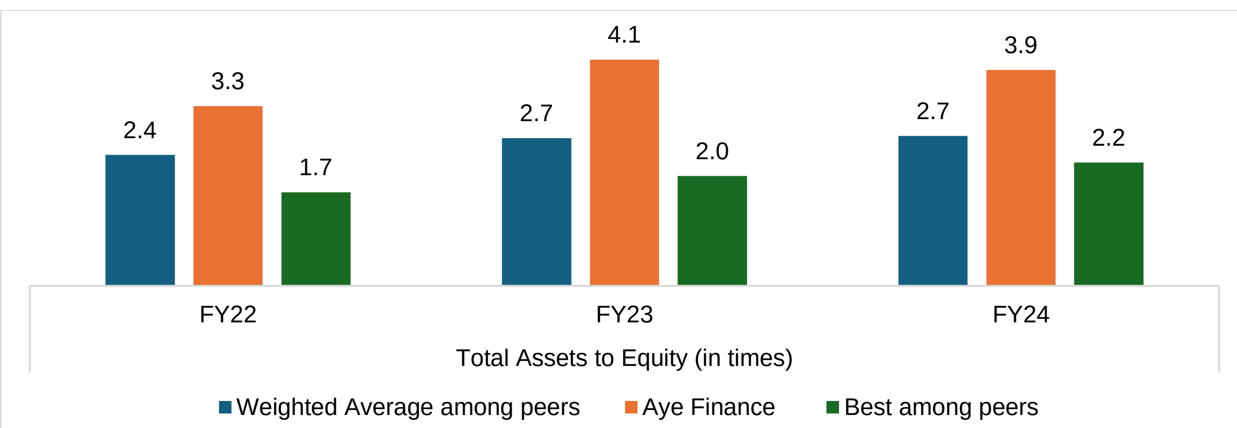
Note: 1) Debt to Equity ratio calculated as total borrowings divided by total shareholder equity of the company, 2) Total Assets to Equity ratio calculated as total assets divided by total shareholder equity of the company
Source: Company reports, CRISIL MI&A

Comparison of Debt-Equity Ratio - Weighted Average among peers, Aye Finance and the Best among peers



Note: Weighted Average among peers is calculated using sum product of Debt-Equity Ratio and Net worth of peers divided by Net worth of peers; Best among peers is considered as lowest values across peers for Fiscal 2022, Fiscal 2023, Fiscal 2024; Source: Company reports, CRISIL MI&A

Comparison of Total Assets-Equity Ratio - Weighted Average among peers, Aye Finance and the Best among peers



Note: Weighted Average among peers is calculated using sum product of Total Assets-Equity Ratio and Net worth of peers divided by Net worth of peers; Best among peers is considered as lowest values across peers for Fiscal 2022, Fiscal 2023, Fiscal 2024; Source: Company reports, CRISIL MI&A

Aye Finance's return on assets is the fourth highest amongst the peer set and return on equity is the second highest as of fiscal 2024 and H1FY25

Five-Star Business Finance has the highest return on assets at 8.2% in Fiscal 2024 amongst the peer set, followed by Finova Capital (5.8%), Veritas Finance (4.7%), and Aye Finance (4.3%).

Aye Finance reported the second highest return on equity of 17.2%, preceded by Five-Star Business Finance at 17.5% in Fiscal 2024.

As of H1FY25, Aye Finance reported the fourth highest RoA at 4.0% (annualized) and second highest RoE of 15.2% (annualized). Five Star reported the highest RoA and RoE as of H1FY25 at 8.5% (annualized) and 19.0% (annualized) respectively.

Return on assets and return on equity

Players	RoA				RoE			
	FY22	FY23	FY24	H1FY25*	FY22	FY23	FY24	H1FY25*
Aye Finance	-2.3%	1.6%	4.3%	4.0%	-7.1%	6.0%	17.2%	15.2%
Five Star Business Finance	7.5%	8.0%	8.2%	8.5%	15.0%	15.0%	17.5%	19.0%
SBFC Finance	1.5%	2.9%	3.7%	4.5%	5.2%	9.9%	10.5%	11.3%
Veritas Finance	3.1%	5.2%	4.7%	3.8%	6.6%	11.8%	12.5%	10.8%
Vistaar Financial Services Pvt Ltd	2.9%	3.2%	3.8%	4.1%	10.0%	12.0%	13.1%	13.3%
Kinara Capital	1.1%	2.1%	2.2%	-2.4%	6.1%	8.9%	8.8%	-10.4%
Finova Capital	2.3%	4.8%	5.8%	N.A.	4.3%	9.2%	14.0%	N.A.

Note: N.A – Not Available; 1) RoA calculated as profit after tax divided average of total assets on book of the company, 2) RoE calculated as profit after tax divided average of shareholder equity of the company; (*) – Annualised figures
Source: Company reports, CRISIL MI&A

Aye Finance was adequately leveraged as of Fiscal 2024

Five Star Business Finance reported the highest capital adequacy ratio of 50.5% as of Fiscal 2024. Aye Finance reported a capital adequacy ratio of 32.8% as of Fiscal 2024, which is well above the mandatory requirement.

Capital Adequacy ratio and Tier 1 ratio for players

Players	Capital Adequacy Ratio				Tier 1 Ratio			
	FY22	FY23	FY24	H1FY25	FY22	FY23	FY24	H1FY25
Aye Finance	36.0%	31.1%	32.8%	37.6%	36.0%	31.1%	32.8%	37.6%
Five Star Business Finance	75.2%	67.2%	50.5%	48.7%	75.2%	67.2%	50.5%	N.A.
SBFC Finance	26.2%	31.9%	40.5%	38.6%	25.9%	31.7%	40.5%	N.A.
Veritas Finance	64.4%	45.0%	41.5%	40.9%	64.0%	44.7%	41.5%	N.A.
Vistaar Financial Services Pvt Ltd	30.0%	26.4%	33.4%	31.1%	30.1%	26.4%	33.1%	N.A.
Kinara Capital	18.5%	32.0%	27.6%	29.2%	16.7%	30.5%	26.8%	N.A.
Finova Capital	78.5%	59.1%	40.7%	N.A.	78.1%	58.6%	40.4%	N.A.

Note: N.A – Not Available; Source: Company reports, CRISIL MI&A

Borrowing mix for companies (Fiscal 2024)

Players	NCD	Term loans from banks	Term Loans from others	Securitisation	Subordinated Liabilities	Short Term Borrowings	ECB
Aye Finance	29%	19%	18%	23%	-	0%	10%
Five Star Business Finance*	12%	62%	11%	14%	-	-	1%
SBFC Finance	10%	49%	13%	-	-	7%	21%
Veritas Finance	8%	76%	3%	12%	-	-	-
Vistaar Financial Services Pvt Ltd	-	88%	8%	-	-	0%	4%
Kinara Capital	35%	19%	45%	-	1%	-	-
Finova Capital	0%	79%	13%	8%			

Note: (*) Data as of June 2024; NCD: Non-convertible debentures, ECB: Exchange commercial borrowings; Short term borrowings include cash credit and overdraft facilities,
Source: Company reports, CRISIL MI&A

Share of Digital Collections

Players	Digital collection share (%) as of June 2024
Aye Finance	91% ACH Activation Rate*

Five-Star Business Finance	65%
SBFC Finance	98%
Veritas Finance	Collections are done majorly through automatic clearing house (ACH) payments/direct debit mandate (DDM), and through digital payment modes.
Vistaar Financial Services Pvt Ltd	N.A.
Kinara Capital	N.A.
Finova Capital	N.A.

Note: N.A. – Not Available; (*) – As of Sep 2024; Source: Company reports, CRISIL MI&A

Sourcing Mix as of June 2024

Players	DSA	Non-DSA
Aye Finance	-	100%**
Five-Star Business Finance	-	100%
SBFC Finance	-	100%
Veritas Finance	Yes*	
Vistaar Financial Services Pvt Ltd	N.A.	N.A.
Kinara Capital	N.A.	N.A.
Finova Capital	N.A.	N.A.

Note: N.A. – Not Available; (*) – As of December 2023; (**) – As of March 2024; Source: Company reports, CRISIL MI&A

Aye Finance reported a customer base of 508,224 as of September 2024

As of September 30, 2024, Aye Finance had a active base of 508,224 active customers, which makes them the MSME lender among the peer set considered with the largest customer base in India.

Customer Profile

Players	Active Customers as of Fiscal 2024	Customer Profile
Aye Finance	508,224*	Micro businesses like kiranas/general stores, dairies, manufacturers and traders with an annual turnover of Rs. 10 lakh -1 crore

Five-Star Business Finance	385,966	Customers with informal income derived from everyday 'services'; Household gross income of Rs 25,000 – 40,000
SBFC Finance	159,365*	Over 85% AUM from customers with CIBIL >700 (Jun-24); Often first-time commercial borrowers with past consumer loans; Focus on services/ trading/ retailing businesses; Customer with businesses in essential services - less impacted by macro down-cycles
Veritas Finance	176,082	Unorganised MSME segment in rural and semi-urban areas and lends small ticket loans ticket size
Vistaar Financial Services Pvt Ltd	47,153	Textiles, Small Manufacturing Units, Hotel/Bakery, Kirana/Retail Shops
Kinara Capital	42,948	Customers are usually traders (62% in June 2024) and small manufacturers (34%), a largely underserved and unserved segment, which is susceptible to economic shocks
Finova Capital	82,183**	Micro-entrepreneurs and semi-skilled professionals who have limited or no access to lending from formal financing institutions

Note: (*) – Data as of September 2024; (**) – Data as of June 2024; Source: Company reports, CRISIL MI&A

Aye Finance saw an improvement in outstanding long-term credit rating as of October 2024

Aye Finance's long-term outstanding credit rating saw an improvement from IND A- as of May 2024 to IND A as of July 2024 and ICRA BBB+/ICRA AA (CE) as of May 2023 to ICRA A as of October 2024.

Five Star Business saw an improvement in outstanding long-term credit rating from CARE A+ as of July 2022 to CARE AA- as of June 2024. SBFC Finance saw an improvement in outstanding long-term credit rating from IND A+ as of April 2023 to IND AA- as of June 2024, ICRA A+ as of September 2023 to ICRA AA- as of September 2024, CARE A+ as of March 2024 to CARE AA- as of July 2024.

Credit rating of companies (Latest Available Ratings)

Players	Long Term Credit Rating
Aye Finance	ICRA A, IND A
Five-Star Business Finance	ICRA AA-, IND AA-, CARE AA-
SBFC Finance	ICRA AA-, CARE AA-, IND AA-
Veritas Finance	CARE A+

Vistaar Financial Services Pvt Ltd	CARE A+, IND A+
Kinara Capital	ICRA BBB, CARE BBB+, IND BBB+
Finova Capital	ACUITE A+, CARE A

Source: Company reports, CRISIL MI&A

List of Formulae

Parameters	Formula
Cost to Income Ratio	Operating expenses for the relevant fiscal year divided by total income minus interest expense
Operating Expense	Operating Expenditure (Employee Expenses + Depreciation and amortization expense + Fees and commission expense+ Other expenses)
Opex to total average assets	Operating expenses divided by total average assets at the end of the financial year
RoA	Profit after tax / average of total assets on book
RoE	Profit after tax / average net worth
NIMs	(Interest income on loans and advances – interest paid) / average of total assets on book
Yield on net advances	Interest earned on loans and advances / average of total net advances on book
Yield on gross advances	Interest earned on loans and advances / average of total gross advances on book
Cost of borrowings	Interest paid / (average of deposits and borrowings)
Credit cost	Provisions / average total assets on book
Stage 2 assets	Stage 2 Assets for the fiscal year / total gross loans
Stage 2 and 3 assets	(Stage 2 Assets + Stage 3 Assets for the fiscal year) / total gross loans
Provisioning Coverage Ratio	Provisioning Coverage Ratio calculated as GNPA subtracted by NNPA and divided by GNPA for the relevant fiscal year
Debt to Equity Ratio	Total Borrowings / Total shareholder equity of the same fiscal

PPOP %	Pre provisioning operating profit (Total income – Interest expenses – Operating expenditure)/ Average total assets
Net Total Income %	(Total Income – Interest Expense)/ Average total advances on book

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