Co-lending in India: Expanding credit access for MSMEs

March 2025

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Foreword

The co-lending sector is poised to revolutionise India's credit landscape, driving financial inclusion and economic growth through collaborative partnerships and technological innovation.

In today's dynamic economic environment, access to credit is vital for India's growth and development. The co-lending sector has emerged as a game-changer, harnessing the strengths of banks and non-banking financial companies (NBFCs) to extend credit to underserved segments. As a fintech industry leader, I am excited to witness this transformative journey.

The government of India has prioritised the credit sector in the Union Budget 2025-26, recognising its crucial role in boosting economic growth. This focus is part of the government's broader initiatives to enhance financial inclusion and promote economic development. The co-lending model has gained traction, with the Reserve Bank of India (RBI) introducing guidelines to facilitate collaboration between banks and NBFCs. This partnership has the potential to increase credit access, reduce costs, and promote financial inclusion.

Technology has been a key enabler in the co-lending sector, streamlining processes, and enhancing customer experience. The adoption of digital platforms, artificial intelligence (AI) powered credit scorecards, and electronic know your customer (e-KYC) has improved lending efficiency and reduced risks.

The growth drivers of the co-lending sector are clear: regulatory support, cost efficiency, market potential, inclusive growth, and technological integration. Large banks are increasingly opting for co-lending, targeting priority sectors such as micro, small and medium enterprises (MSMEs), agriculture, and housing.

As we move forward, it is essential to address the challenges and opportunities in the co-lending sector. This report provides a comprehensive overview of the co-lending landscape, highlighting its potential to drive economic growth and financial inclusion. I believe that collaborative efforts, technological innovation, and supportive policies will be crucial in unlocking the full potential of the co-lending sector.

Let us work together to create a vibrant and inclusive credit ecosystem, empowering entrepreneurs, small business owners, and individuals to contribute to India's economic growth story.

Dharmender Jhamb

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Executive summary

The co-lending model has emerged as a key enabler of credit expansion in India, facilitating partnerships between banks and NBFCs to extend credit more efficiently to underserved segments. By leveraging banks' access to low-cost funds and NBFCs' distribution reach, co-lending is helping drive financial inclusion, particularly in sectors like MSMEs, agriculture, and affordable housing.

At Grant Thornton Bharat, we recognise co-lending as a critical model for strengthening the lending ecosystem, optimising capital deployment, and enhancing risk-sharing mechanisms. As regulatory frameworks evolve and technology plays an increasing role in credit decision-making, co-lending is set to redefine how financial institutions collaborate to bridge India's credit gap.

This thought leadership report provides an analysis of the sector's evolution, trends, challenges and future outlook.

Key insights

Macroeconomic and credit growth trends

- India's GDP is projected to grow at 6.4% in FY25, moderating from 8.2% in FY24 due to global uncertainties and inflationary pressures. However, strong domestic demand and financial sector reforms continue to drive economic resilience.
- The RBI's repo rate cut to 6.25% (February 2025) aims to stimulate credit expansion, particularly in MSMEs, infrastructure, and retail sectors.
- Rural and semi-urban regions now account for 67% of small borrower credit, highlighting the deepening of financial inclusion beyond metro cities.

NBFCs: A growing force in credit expansion

- NBFCs are increasing their focus on personal and retail loans, which now account for 46.2% of their total credit portfolio, reflecting a shift toward consumer lending.
- Bank borrowings by NBFCs have grown to 22.6%, indicating greater integration with formal banking institutions and a move toward stable funding sources.

Co-lending: A game-changer in credit distribution

- Co-lending exposure for public sector banks surged from INR 1,618 crore in 2022 to INR 11,497 crore in 2024, demonstrating its rapid adoption in the MSME and agricultural sectors.
- The risk-sharing model (80:20 split between banks and NBFCs) is reducing credit risk while improving the access to finance for underserved borrowers.
- AI-powered credit scoring, e-KYC, and digital lending platforms are accelerating loan approvals and minimising underwriting risks, making co-lending more scalable.

Microcredit and financial Inclusion: A critical lever for growth

- Mudra loans have shifted towards higher ticket sizes, with Kishore loans (INR 50,000–5 lakh) now accounting for 48% of total disbursements, reflecting rising working capital needs of micro-businesses.
- Around 56 lakh self-help groups accessed loans in FY24, up from 43 lakh in FY22, showcasing the continued growth of microfinance as a tool for rural financial empowerment.
- Digital financial services are driving last-mile credit access, with SHGs and micro-entrepreneurs increasingly using digital channels for loan disbursements and repayments.

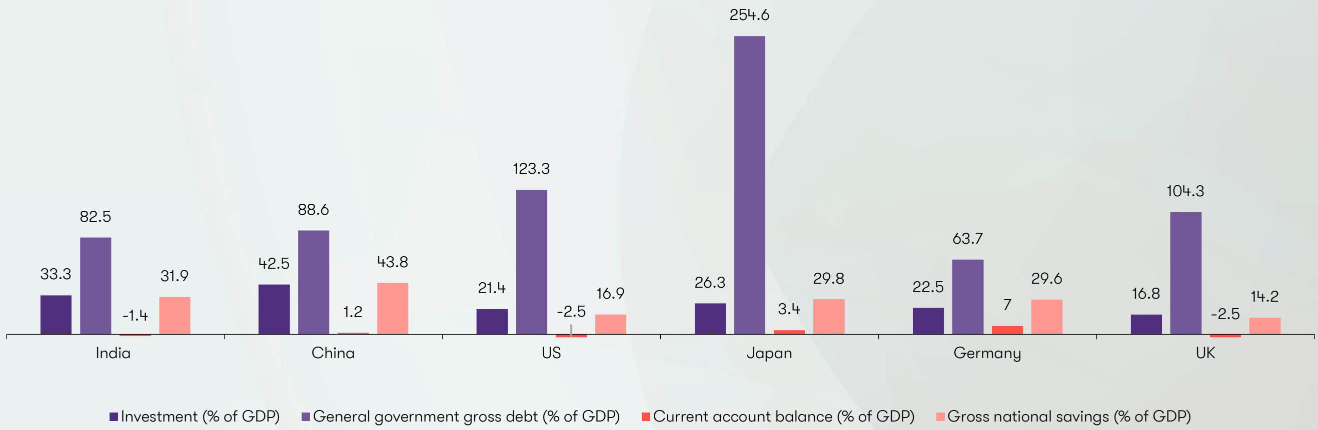
Co-lending is redefining the financial sector by bridging India's credit gap, enabling cost-effective, risk-shared lending to MSMEs, small borrowers, and rural entrepreneurs. With rising regulatory support, digital transformation, and increased collaboration between banks and NBFCs, the model is set for further expansion. As co-lending continues to scale, it will play a pivotal role in accelerating financial inclusion, fostering economic growth, and ensuring sustainable credit access for underserved segments.
Through this report, Grant Thornton Bharat aims to provide a comprehensive perspective on the evolution of co-lending, its impact on the financial sector, and the road ahead for financial institutions looking to leverage this model effectively.

Indian and global economy: macroeconomic scenario

This section provides a comprehensive analysis of India's macroeconomic landscape in the context of global trends. It examines key indicators such as investment, savings, debt, and the current account balance, offering insights into India's economic resilience and growth trajectory amidst global uncertainties.

Investment, savings, debt, and current account balances are key indicators of economic stability and growth. Investment as a share of Gross Domestic Product (GDP) reflects capital formation and industrial expansion, while gross national savings indicate financial resilience. Government debt levels signal fiscal sustainability, and the current account balance highlights trade competitiveness.

India, despite global uncertainties like geopolitical tensions and supply chain disruptions, remains a fast-growing economy, driven by domestic demand, digitalisation, and reforms. Inflation, interest rates, and fiscal policies play a crucial role in shaping economic stability and investment flows. Comparing these indicators globally reveals different growth models—investment-led, savings-driven, or consumption-based expansion.



The analysis of top economies reveals distinct trends in investment, debt, trade, and savings. China leads in investment as a percentage of GDP, driven by financial services, industrials, and consumer goods, but also faces a high debt service ratio due to cross-border lending. India, meanwhile, has a lower investment-to-GDP ratio but is taking steps to attract foreign investment and has a relatively low debt-service ratio. The US and UK exhibit high consumption and lower investment levels, while Germany stands out for its prudent economic policies, strong current account balance, and low debt service ratio. In terms of savings, India and China have higher gross national savings rates, indicating a cautious approach to spending. In contrast, the US, UK, Japan, and Germany have lower savings rates, reflecting a more investment-oriented approach. Overall, these trends highlight the diverse economic priorities and strategies among the world's top economies.

Macroeconomic variables

The underlying table provides the financial data for India for major macroeconomic variables for FY24 and the estimates for FY25.

Financial data for India for major macroeconomic variables for the FY24 and the projections for FY25

Macro variables	FY24	FY25 (E)	Rationale for outlook
Growth in GDP	8.2%	6.4%	The global trade outlook remains positive, with caution regarding geopolitical conflicts, supply chain disruptions, higher commodity prices, inflationary pressures, and influence on the RBI's monetary policy.
Consumer Price Index (CPI) inflation	5%	4.9%	CPI is expected to decline marginally in FY25 due to the softening in prices of specific CPI components.
Population	136.9 crore	141.3 crore	India's population is projected to rise in FY25, reflecting continued population growth, which signals an expanding consumer base, offering significant potential for economic activity and market expansion.
Per capita Net National Income (NNI) (at constant prices)	INR 1,06,744	INR 1,12,258	The steady increase in per capita income reflects the resilience of Indian economy and highlights the potential for improved individual prosperity.

Trends in RBI rates and ratios

RBI's key policy rates and banking ratios play a crucial role in shaping credit availability, borrowing costs, and overall liquidity in the financial system. Changes in these indicators impact the cost of funds for banks and NBFCs, influencing their ability to lend, especially under the co-lending model.

Credit-Deposit Ratio (CDR):

The CDR reached 78.6% in January 2025, its highest level in the observed period. This reflects sustained high credit demand, particularly from the retail and business sectors, driven by economic growth and increasing consumption. However, the elevated CDR highlights a potential challenge for banks in bridging the gap between credit growth and slower deposit mobilisation. This could lead to increased competition among banks to attract deposits, possibly impacting interest rates for depositors..

Repo rate:

On 7 February 2025, the RBI's Monetary Policy Committee (MPC) cut the repo rate by 25 bps to 6.25%—its first cut in nearly five years, signalling a shift toward growth support. The reduction ensured a push towards investment and consumption for businesses and consumers, supporting growth in borrowing-dependent sectors.

Cash Reserve Ratio (CRR):

The CRR stands at 4.0% as on 10th January 2025, a slight reduction from 4.5% in January 2023. This signals a calibrated move by the RBI to inject liquidity into the banking system, ensuring that banks have more funds available for lending. It reflects a shift towards supporting growth while maintaining sufficient control over inflation.

Lending and credit expansion in Union Budget 2025-26

The Union Budget 2025-26, presented by Finance Minister Nirmala Sitharaman in February 2025, reinforces the government's focus on financial inclusion, credit accessibility, and entrepreneurship development. These initiatives aim to strengthen the lending ecosystem, ensuring that businesses, farmers, and street vendors have the necessary financial backing to sustain and expand their economic activities.

MSMEs and start-ups

Expansion of credit guarantee cover: The government has significantly enhanced the credit guarantee cover to improve access to capital

For micro and small enterprises, the cover has doubled from INR 5 crore to INR 10 crore, unlocking INR 1.5 lakh crore in additional credit over the next five years.

For start-ups, the guarantee cover has been raised from INR 10 crore to INR 20 crore, with a reduced guarantee fee of 1% for loans in 27 Atmanirbhar Bharat focus sectors.

For exporter MSMEs, well-run firms can now avail term loans up to INR 20 crore under enhanced credit coverage, supporting export growth.

Support for first-time entrepreneurs: Recognising the need for financial assistance among new businesses, a new scheme has been launched for 5 lakh first-time entrepreneurs from women, scheduled castes (SC), and scheduled tribes (ST) communities.

This scheme will:

- Provide term loans up to INR 2 crore over the next five years.
- Incorporate lessons from the successful Stand-Up India scheme.
- Offer online capacity-building programmes for entrepreneurship and managerial skills.

Customised credit cards for micro enterprises: A significant step towards formalising micro businesses, customised credit cards with a INR 5 lakh limit will be introduced for micro enterprises registered on the Udyam portal. In the first year, 10 lakh such cards will be issued, providing easier access to working capital.

Street vendors and urban informal sector

Revamping the PM SVANidhi scheme: The PM SVANidhi scheme, which has already benefitted 68 lakh street vendors, will be revamped to:

- Offer enhanced loans from banks.
- Introduce Unified Payments Interface (UPI) linked credit cards with a INR 30,000 limit.
- Provide capacity-building support to help vendors grow their businesses and transition from informal to formal financial systems.

Agriculture and rural lending

- **Enhanced loan limits for Kisan Credit Card (KCC):** The loan limit under the KCC scheme has been increased from INR 3 lakh to INR 5 lakh under a modified interest subvention scheme. This move benefits 7.7 crore farmers, fishermen, and dairy farmers, ensuring greater financial support for their working capital needs.
- **Grameen credit score framework for rural borrowers:** Public sector banks will develop a 'Grameen credit score' framework to serve the credit needs of self-help group (SHG) members and the rural population. This initiative will improve financial inclusion and ensure better access to formal credit for rural borrowers.

Investment and state support

- **50-year interest-free loans to states for capital expenditure:** To boost infrastructure and economic growth, the government has proposed an outlay of INR 1.5 lakh crore for 50-year interest-free loans to states, linked to capital expenditure and reform incentives. This funding will help states invest in key sectors, including infrastructure, industry, and social welfare.
- **Digital public infrastructure to promote international trade:** The Export Promotion Mission has been launched to help MSMEs tap into international markets, supported by the new BharatTradeNet (BTN) digital public infrastructure, which will streamline trade documentation and financing solutions.

01

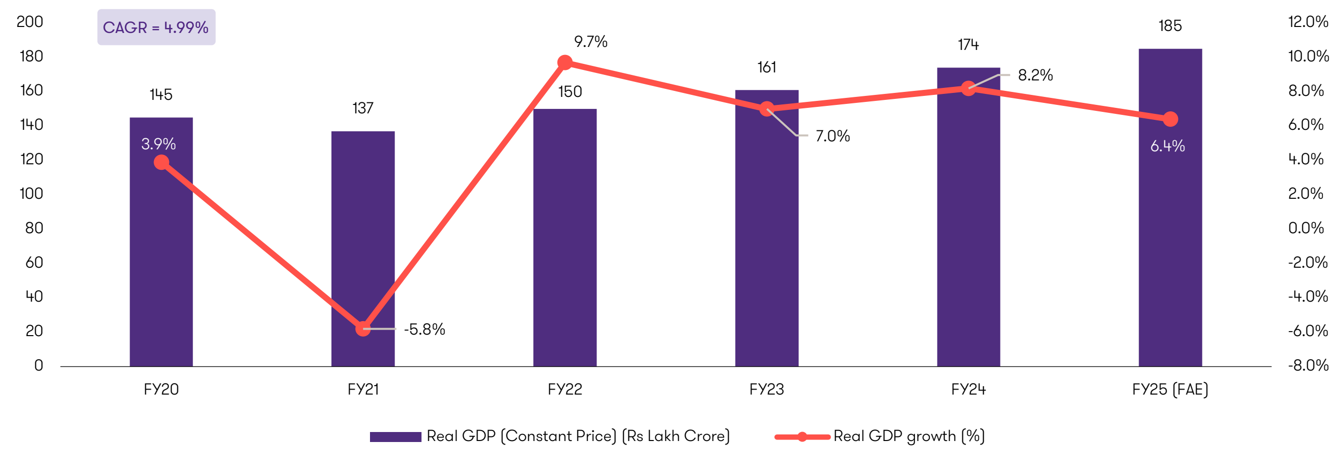
Deepening of DPI in India and its role in co-lending

This chapter delves into the expansion of India's digital public infrastructure (DPI), assessing its role in transforming financial services. It highlights key initiatives such as the Jan Dhan, Aadhar and Mobile (JAM) Trinity, advancements in payments infrastructure, and the impact of digital adoption on economic inclusion. It explores the evolution of India's DPI, its role in enhancing credit accessibility, and how digital innovations are driving the efficiency and growth of co-lending partnerships.

India's GDP in last five years

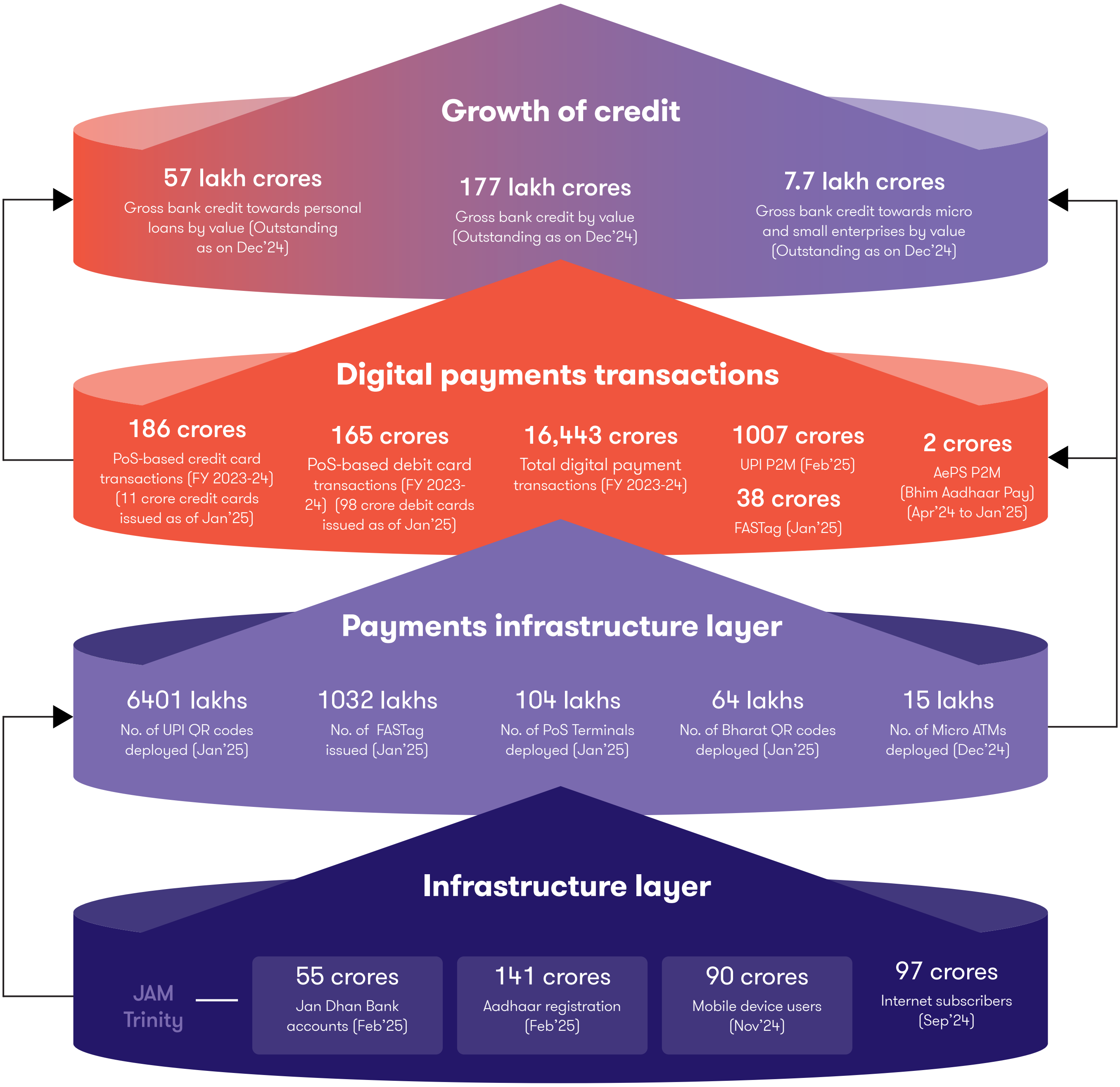
India's GDP trends over the past five years reflect resilience, policy-driven recovery, and digital transformation. After a modest 3.9% growth in FY20, the economy contracted by -5.8% in FY21 due to lockdowns caused due to the COVID-19 pandemic. A sharp rebound followed in FY22 (9.7%), driven by pent-up demand, infrastructure expansion, and fintech adoption. Growth stabilised at 7.0% in FY23 and surged to 8.2% in FY24, fuelled by start-up activity, AI adoption, and government reforms. However, the FY25 first advance estimate (6.4%) indicates moderation amid global uncertainties and inflationary pressures. Despite fluctuations, India's structural reforms and technology-led growth continue to position it as a global economic leader.

India's GDP in last five years | FAE – First Advance Estimates | *Rounded off to the nearest decimal



Regulatory and policy reforms on DPI leading to lending growth

DPI is the government-led technological framework enabling seamless digital transactions, service access, and financial inclusion. India's DPI is anchored in the JAM trinity and expanded through UPI, Bharat Bill Payment System (BBPS), FASTag, Point-of-Sale (PoS) terminals, micro-automated teller machine (ATMs), prepaid payment instruments (PPIs), and quick response (QR) codes, driving real-time payments and accessibility. These advancements support India's shift toward a cashless economy, enhancing convenience, reducing cash dependence, and fostering inclusive growth.



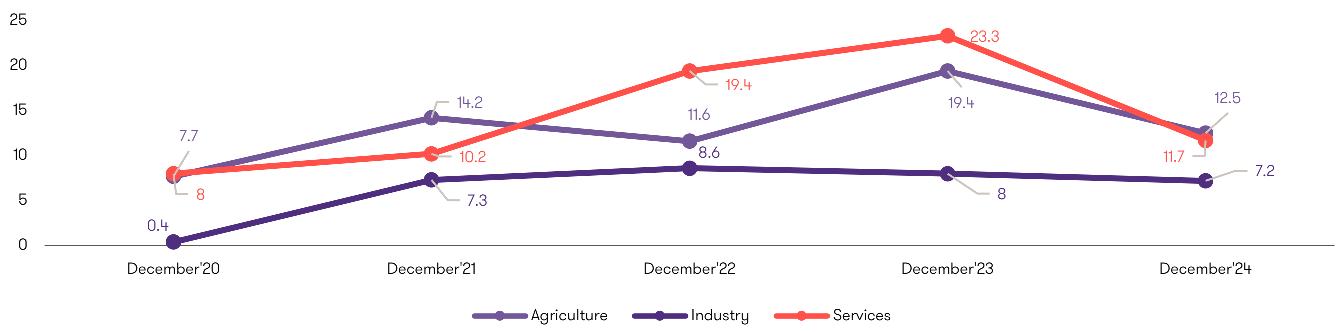
02
Credit growth in India

This chapter analyses the trends and patterns in India's credit growth over the past five years. It examines sectoral credit expansion, the role of different banking institutions, and the evolving credit landscape driven by policy reforms and economic shifts.

Growth of bank credit as per sector

- **Agriculture sector:** Growth rose from 7.7% in December 2020 to a peak of 19.4% in December 2022 before stabilising at 12.5% in December 2024. Steady credit expansion is driven by government-backed loans, minimal COVID-19 impact, and seasonal borrowing trends.
- **Industry sector:** Credit grew from 0.4% in December 2020 to 8% in December 2023, slightly dipping to 7.2% in December 2024. The rise reflects post-COVID recovery, industrial investments, and policy support.
- **Services sector:** The most volatile, credit surged from 8% in December 2020 to 23.3% in December 2023 before dropping to 11.7% in December 2024. High demand from retail, IT, and financial services drove growth, while the 2024 decline suggests market saturation or policy shifts.

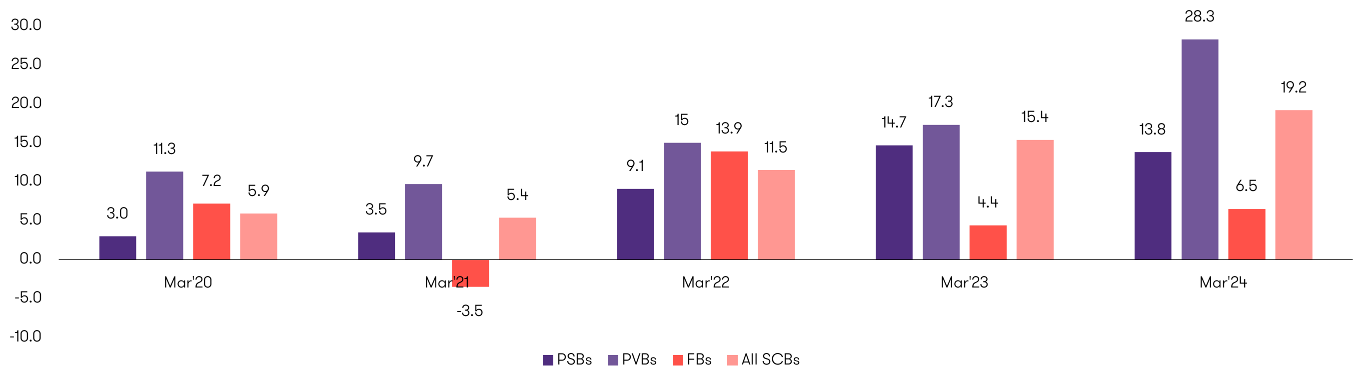
YoY growth of gross bank credit infrastructure through agriculture, industry and service sectors (in percent)



Growth of credit by bank as per bank type in last five years

Private sector banks (PVBs) have grown rapidly, averaging 16% YoY growth over five years, peaking at 28% in 2024, driven by aggressive lending and efficient risk management. In contrast, public sector banks (PSBs) have seen a modest 9% growth due to conservative approaches and non-performing assets (NPA) clean-up. Foreign banks (FBs) have recovered from a 2021 downturn, showing post-pandemic growth.

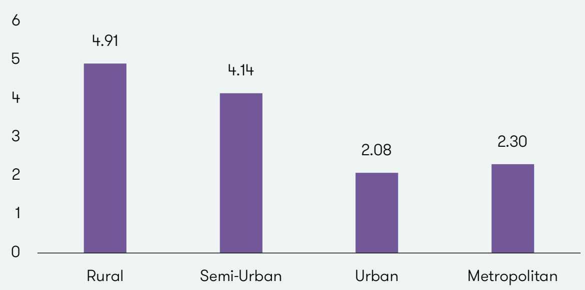
Overall credit growth (in percent)



Regional breakdown of small borrower credit

India's credit distribution to small borrowers has significant regional variations, with the majority of credit being availed in rural and semi-urban regions (67%) Specifically: INR 4.91 lakh crores for rural areas (financial inclusion and agriculture), INR 4.14 lakh crores for semi-urban areas (peri-urban economies and micro-enterprises), INR 2.08 lakh crores for urban areas (diverse financial needs and small businesses), and INR 2.30 lakh crores for metropolitan regions (start-ups, SMEs, and service sector enterprises).

Credit distribution to small borrowers as on March 2024 (INR lakh crores)



- "Rural" includes all centres with populations of less than 10,000;
- "Semi-urban" includes centres with populations of 10,000 and above, but less than 1,00,000;
- "Urban" includes centres with populations of 1,00,000 and above, but less than 10,00,000;
- "Metropolitan" includes centres with populations of 10,00,000 and more.

As per the RBI, a 'small borrowal account' (SBA) is defined as an account having a credit limit of up to INR 200,000 (INR 25,000 till 1998 and INR 10,000 till 1983). The holders of these accounts are individuals/entities who have relatively small credit/borrowed requirements.

03

Growth of credit through NBFCs

This chapter explores the crucial role of NBFCs in driving credit expansion in India, focusing on their evolving regulatory landscape, funding patterns, and asset quality. It examines the impact of scale-based regulations and the increasing reliance on NBFCs for priority sector lending. Additionally, it highlights the growing adoption of the co-lending model, where NBFCs collaborate with banks to extend credit efficiently, leveraging their agility in last-mile outreach while benefiting from banks' lower-cost funds.

Key highlights

Role of NBFCs in credit expansion

NBFCs continue to bridge the credit gap, particularly in underserved segments. Their flexible lending models and sector-specific expertise have driven sustained growth.

Regulatory developments

Recent RBI regulations focus on transparency, risk mitigation, and governance improvements. Key changes include mandatory disclosure of total loan charges, prepayment penalty exemptions for MSEs, and enhanced fraud detection measures.

Credit growth trends

NBFC lending has shifted toward personal and retail loans, which now account for 46.2% of total credit. Industrial lending has seen a marginal increase, while the services sector's share has declined.

Asset quality trends

NBFCs have improved their GNPA ratios through better risk management and digital collection strategies. However, exposure to unsecured lending remains a potential risk factor in the current macroeconomic landscape.

Borrowing composition

NBFCs are increasingly relying on bank borrowings, which have grown from 19.8% to 22.6%. This shift highlights their deepening integration with the banking sector while reducing dependence on market borrowings.

Profitability and sector growth

A strong post-pandemic recovery, particularly in retail and MSME lending, has fuelled NBFC growth. Improved profitability metrics indicate a more resilient and sustainable business model.

Scale-based regulation (SBR) for NBFCs

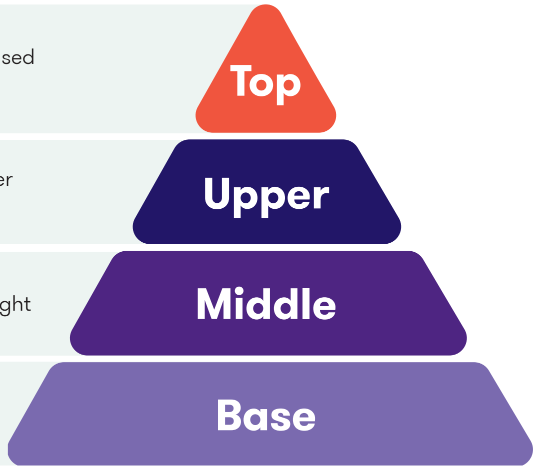
From October 2022, NBFCs have been classified into four tiers under SBR:

Top layer (NBFC-TL): Reserved for NBFCs posing a significantly increased systemic risk, to be populated by the RBI as needed.

Upper layer (NBFC-UL): NBFCs identified by the RBI as needing stricter regulations, plus top 10 NBFCs by asset size.

Middle layer (NBFC-ML): Deposit-taking NBFCs, non-deposit-taking NBFCs with assets > INR 1,000 crore, and those requiring closer oversight due to systemic importance or complexity.

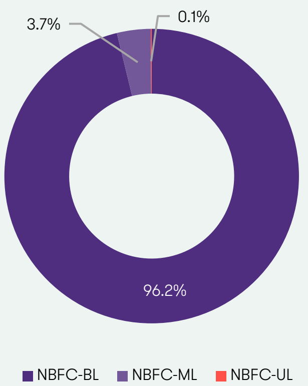
Base layer (NBFC-BL): Non-deposit-taking NBFCs with assets < INR 1,000 crore and specialised activities.



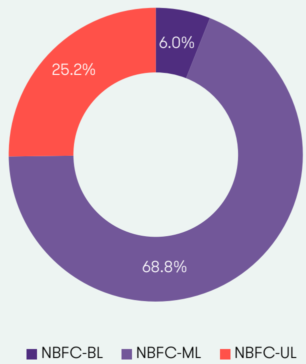
Distribution of NBFC as per category (at end-March 2024)

The NBFC sector in India has experienced rapid growth, extending financial services to previously underserved groups through specialised products. However, this expansion has led to increased interconnectedness with the broader financial system, prompting regulatory action. To address this, the RBI has introduced a tiered regulatory framework, scaling requirements to the size and complexity of NBFCs.

Percentage share of NBFCs by different layers



Percentage share of total assets held by NBFCs across different layers



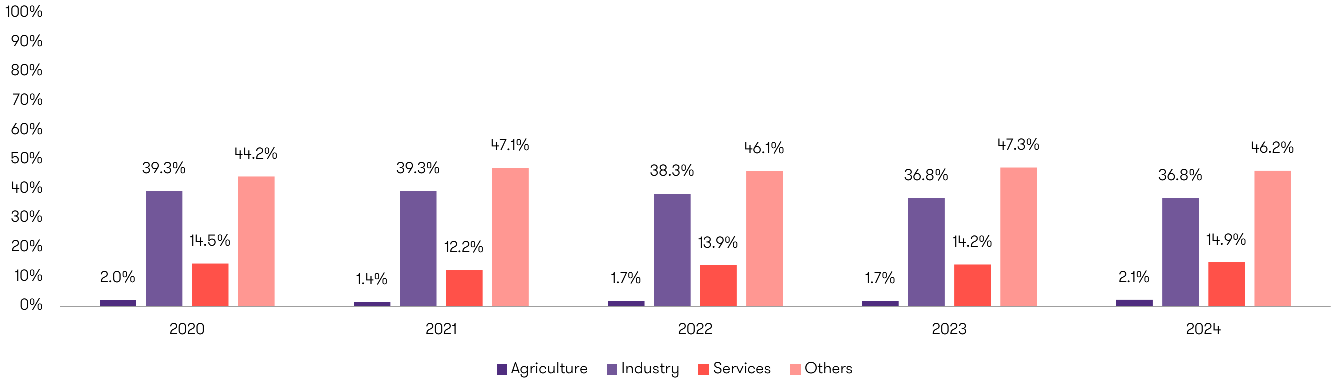
As of March 2024, the majority of NBFCs (96%) fell under the smaller NBFC-BL category, yet they accounted for only 6% of total assets. In contrast, a small fraction of NBFCs (3.8%) held a significant 94% of total assets, indicating a high level of market concentration. In response, the RBI has implemented increasingly stringent regulations for larger NBFCs to ensure stability and mitigate potential risks.

Growth of NBFC credit across sectors

The distribution of NBFC credit across sectors from 2020 to 2024 has been relatively stable. The agriculture sector maintains a steady 2% share, while the industry sector's share has slightly increased from 14.5% to 14.9%, despite fluctuations.

Services see a drop from 39.3% to 36.8%. The most notable change is in the "Others" category, which includes personal loans, retail loans, etc., growing from 44.2% to 46.2%. This trend indicates the increasing focus of the NBFCs on diversifying credit into emerging or non-traditional sectors, reflecting strategic shifts to capitalise on new opportunities and manage risks better.

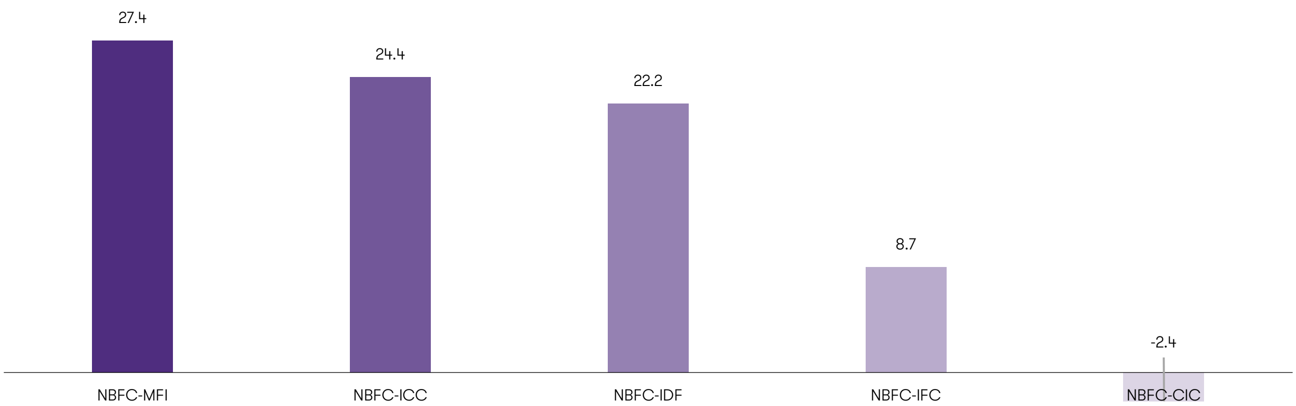
Share of different sectors in NBFC credit



Activity-based credit of NBFC for 2024

The RBI classifies NBFCs based on their core activities, revealing diverse post-pandemic credit growth trends. NBFC-microfinance institutions (NBFC-MFIs), the largest category, recorded 27.4% growth, highlighting a strong focus on financial inclusion. NBFC-ICCs grew by 24.2%, reflecting increased demand for investment and credit services. In contrast, infrastructure finance companies (IFCs) saw slower growth due to delayed projects and funding constraints, while core investment companies (NBFC-CICs) experienced negative growth in 2024, impacted by economic slowdowns and market volatility.

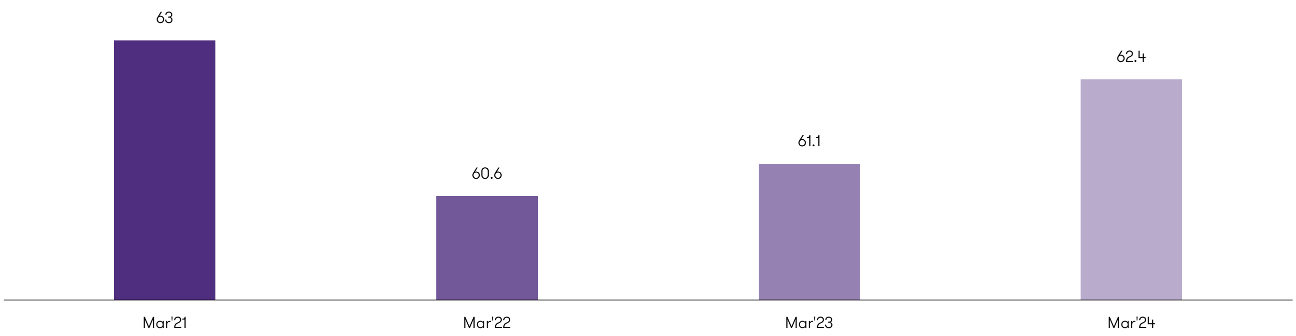
Activity-based credit growth of NBFCs (2024)



Growth of borrowings by NBFCs

There was a 4% decrease in dependence on borrowings by NBFCs in 2022. Share capital, reserves, and surplus compensated for the decrease in borrowings during March 2021-22. However, after 2022, the share of borrowings in the funding sources is steadily increasing. The increasing reliance on bank borrowings (from 19.8% to 22.6%) and the growing share of total borrowings from banks (from 23.2% to 25%) suggests a deepening dependence on bank funding.

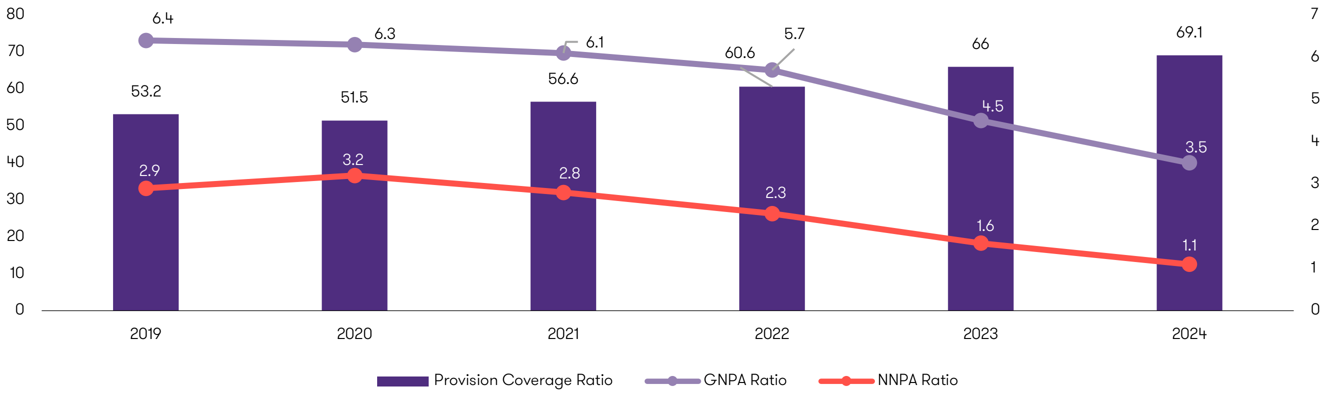
Total borrowings by NBFCs



Improved asset quality of NBFCs

In FY23, NBFCs saw a significant improvement in asset quality due to better collections and economic recovery, despite past challenges from aggressive growth, regulatory changes, and the COVID-19 pandemic.

Asset quality of NBFCs



- The RBI extended the NPA compliance deadline to 30 September 2022, requiring loans to be upgraded to standard assets only after full repayment of arrears.
- Gross non-performing assets (GNPA) hit a five-year low in FY23, with reduced slippages and a higher provision coverage ratio (PCR), rising from 51.5% in March 2020 to 65.1% in March 2023, strengthening financial stability.
- By March 2024, GNPA and net non-performing assets (NNPA) fell to 3.5% and 1.1% , respectively, reflecting sustained asset quality improvement and sector resilience.

Recent regulatory developments impacting the NBFC sector

February 2025

The RBI, under the Master Circular – Fair Practices Code (July 2011) , mandated large NBFCs to disclose total loan charges—including interest, processing fees, and insurance—and required board approval for maximum rates. This enhances transparency, prevents hidden charges, and ensures fair lending amid rising household debt. NBFCs must clearly outline these charges across loan categories, with any rate revisions needing fresh board approval. The directive strengthens consumer protection, mitigates excessive charges, and reinforces governance, promoting accountability in the NBFC sector.

October 2024

The RBI extended the prohibition on foreclosure fees and prepayment penalties for floating-rate term loans taken by individual borrowers for non-business purposes. This regulation now also applies to loans provided to MSEs by the RBI-regulated entities, aiming to enhance customer protection, promote transparency, and ensure fair lending practices.

August 2024

The regulatory framework for housing finance companies (HFCs) was reviewed, along with efforts to align regulations for both HFCs and NBFCs. As part of this process, certain NBFC regulations were also revised. The updated regulations came into effect on 1 January 1 2025, ensuring greater consistency and regulatory clarity across both sectors.

July 2024

The RBI issued the Master Direction on treatment of wilful defaulters and large defaulters, outlining the criteria for identifying borrowers who intentionally evade repayment and specifying the actions to be taken against them. This framework aims to strengthen credit discipline, enhance transparency, and safeguard lenders from the financial risks associated with intentional defaults.

The RBI released the Master Directions on fraud risk management for NBFCs, including HFCs. These guidelines set a framework for NBFCs to strengthen fraud prevention, enable early detection, and ensure timely reporting to law enforcement agencies, the RBI, and the National Housing Bank (NHB). This will enhance risk mitigation, improve regulatory compliance, and safeguard financial stability by ensuring a proactive approach to fraud management.

June 2024

The RBI invited applications for the recognition of self-regulatory organisations (SROs) for NBFCs. The SROs will primarily focus on NBFC-investment and credit companies (NBFC-ICCs), HFCs, and NBFC-factors, with the possibility of including other NBFC types. This initiative aims to strengthen governance and industry standards through a structured self-regulatory framework.

April 2024

The RBI issued the Master Circular on bank finance to NBFCs, providing regulatory guidelines on bank lending to NBFCs. While banks have been given greater flexibility in extending credit to NBFCs, certain restrictions remain for specific activities due to associated risks. These guidelines aim to ensure responsible lending while maintaining financial stability.

04

Evolution of co-lending sector

This chapter examines the evolution of co-lending as a transformative model in India's financial landscape. It highlights regulatory frameworks, various co-lending models, and the growing adoption of technology to deepen financial outreach and risk-sharing mechanisms. It also examines the extent of co-lending adoption among major banks like State Bank of India (SBI), and others showcasing their pivotal roles in advancing these practices.

Key highlights of co-lending norms

- Co-lending banks take loans back-to-back
- NBFCs retain at least 20% of loans
- Board-approved CLM policies must be published online
- Master agreements allow banks to take or reject loans after due diligence
- CLM excludes foreign banks with fewer than 20 branches

The RBI introduced priority sector lending (PSL) guidelines , but banks faced challenges. The RBI introduced the co-lending model (CLM) to address this, allowing banks to partner with NBFCs to co-lend to priority sectors. The CLM offers benefits such as increased credit reach, shared risk, and lower operational costs. Banks and NBFCs entered into co-lending agreements, leveraging each other's strengths to lend to priority sectors. In this arrangement, one party originates a loan, another takes 80-100%, and the originator retains 20% and handles collections. The model evolved as a solution to address bank challenges in lending to priority sectors, enabling increased credit flow, shared risks, and improved recovery rates.

Models of co-lending

The RBI promotes co-lending to priority sectors to increase credit flow to unserved and underserved areas of the economy.

Co-lending model 1

Banks and NBFCs jointly originate and disburse loans, sharing participation in the lending process, with proportional reflection in their balance sheets as per agreement terms.

Co-lending model 2

NBFCs originate and disburse loans, with banks reimbursing up to 80% of the amount, enabling banks to meet priority sector lending targets while NBFCs focus on customer reach and loan origination.

Emphasis of Government of India (GoI) on co-lending sector

The Department of Financial Services (DFS) has formed a Co-Lending Committee, led by SBI, to optimise co-lending practices and boost credit flow to MSMEs. The committee aims to streamline practices, address credit gaps, and promote financial inclusion through bank-NBFC partnerships. By leveraging the strengths of banks and NBFCs, this initiative can potentially increase credit access for MSMEs, driving economic growth and financial inclusion.

The Co-Lending Committee is set to shape India's co-lending future by:

- Developing standardised co-lending guidelines
- Enhancing risk management practices
- Fostering greater collaboration between banks and NBFCs

This initiative is a significant step towards boosting MSME credit access, driving economic growth, and supporting a thriving MSME ecosystem through optimised co-lending practices and financial inclusion.

Adoption of technology advancement in deepening of co-lending adoption

- e-KYC and Aadhaar ID verification streamline customer verification, preventing identity fraud and reducing physical documentation.
- e-Sign enables paperless operations, allowing customers to sign documents electronically.
- AI-powered credit scorecards evaluate creditworthiness by analysing various data points, predicting default likelihood, and assigning risk scores.
- Account aggregators gather relevant financial information, including deposits, investments, and credit instruments.
- Loan origination and management systems (LOS/LMS) enable real-time tracking of loan lifecycles, ensuring accurate and up-to-date data.
- Credit bureau integration provides a detailed credit history, supplementing unique credit scores for comprehensive evaluation.
- Proprietary applications offer multiple loan repayment methods (QR codes, SMS links, voice payments) for enhanced customer convenience.
- Management information systems provide real-time data on business parameters, including loan disbursement and collection trends.
- Enterprise resource planning (ERP) solutions offer a centralised platform for managing financial data, ensuring accurate reporting, and supporting strategic decision-making.

Growth drivers of co-lending sector

- **Regulatory support:** The RBI's notifications and circulars facilitate collaboration between banks and NBFCs, harmonising lending efforts and promoting financial inclusivity.
- **Cost efficiency:** Combining banks' low-cost funds with NBFCs' operational efficiency reduces lending costs, making loans more affordable and accessible, especially in priority sectors.
- **Market potential:** India's retail credit market has significant expansion potential, and co-lending enables banks to create priority sector assets without extra resources, while the NBFCs build high-quality loan books and maintain profitability.
- **Inclusive growth:** Co-lending promotes inclusive growth by focusing on underserved areas like SMEs, agriculture, and housing, leveraging the combined expertise of banks and NBFCs to drive development in these sectors.
- **Technological integration:** NBFCs' technological advancements enhance reach and service delivery to remote areas, combining with banks' robust financial backing to improve lending and borrowing efficiency in priority sectors.
- **Enhanced credit access:** Co-lending addresses the credit access crisis for SMEs and retail customers by pooling resources and expertise, extending credit to traditionally underserved segments.

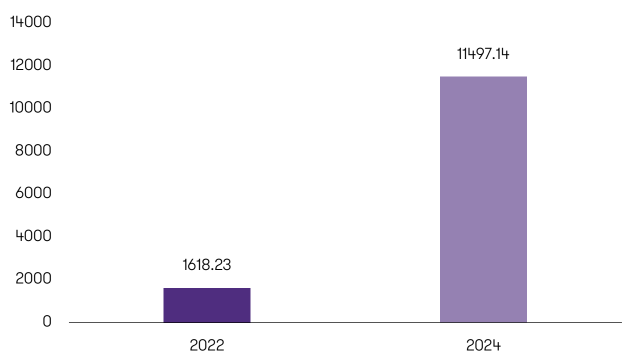
Co-lending by PSBs in agriculture and MSME

The total outstanding loans disbursed under co-lending arrangements by public sector banks have witnessed a significant rise, growing more than sevenfold from INR 1,618.23 crore in March 2022 to INR 11,497.14 crore in March 2024 . This surge has been primarily observed in the agriculture and MSME sectors.

The sharp increase in co-lending by PSBs reflects a growing reliance on this model to expand credit access, particularly in priority sectors like agriculture and MSMEs. Several factors are contributing to this growth:

- **Policy push for financial inclusion:** Government and regulatory initiatives have encouraged PSBs to collaborate with NBFCs and fintech firms to enhance credit penetration in underserved segments.
- **Risk-sharing and capital efficiency:** The co-lending model enables PSBs to leverage the origination capabilities of NBFCs while mitigating risks through shared exposure. This structure allows for a wider distribution of credit without overburdening bank balance sheets.
- **Increased demand for MSME and agri credit:** The post-pandemic recovery, coupled with digital transformation in lending, has boosted the demand for financing in these sectors. MSMEs require working capital and growth financing, making them key beneficiaries.
- **Digital lending infrastructure:** The integration of digital lending platforms and alternative credit assessment mechanisms has improved the efficiency of co-lending partnerships, leading to faster loan approvals and disbursements.

Outstanding advances in agriculture and MSME (in crore)

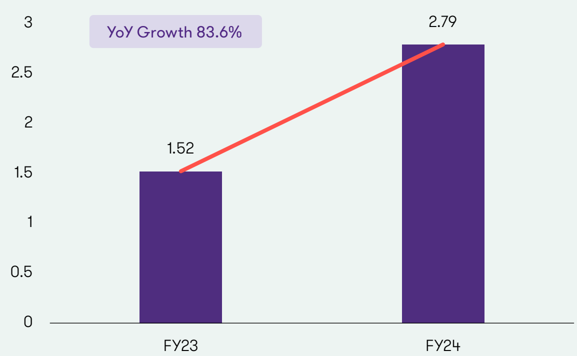


Large banks opting for co-lending

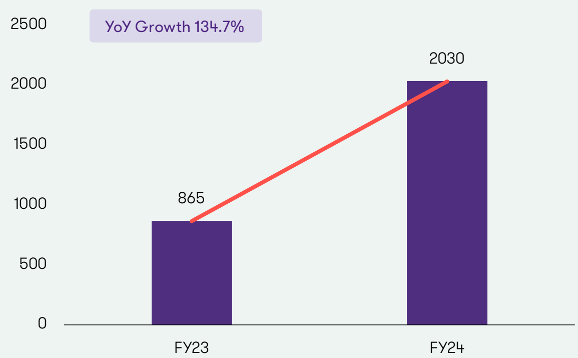
Most scheduled commercial banks (except regional rural banks and small finance banks) are partnering with NBFCs for co-lending, targeting priority sectors. This collaboration combines banks' resources and expertise with NBFCs' market knowledge and agility, enhancing lending capabilities and promoting financial inclusion in underserved segments like agriculture, retail, and MSME, driving economic growth.

Adoption of co-lending by State Bank of India (SBI)

Volume of loans disbursed (in lakhs)



Value of loans disbursed (in crore)



In FY23, SBI, India's largest public sector bank, processed over 1,52,000 co-lending transactions worth INR 865 crore to NBFCs, improving credit access for agriculture, personal loans, and MSMEs. The initiative grew significantly in its second year, with a 134% YoY increase in loan value and an 84% rise in volume in FY24. By partnering with NBFCs, SBI enhances financial inclusion, providing affordable credit to rural entrepreneurs while leveraging its scale for lower interest rates. The nationwide rollout will further support small businesses and agricultural livelihoods, driving sustainable growth in underserved communities.

Adoption of co-lending by Central Bank of India (CBI)

In FY 2024, CBI sanctioned co-lending amounts, with MSMEs being the largest beneficiaries, followed by retail and corporate sectors. MSME co-lending has grown exponentially at a CAGR of 424%. While the agriculture and corporate sectors saw relatively slower growth, the outlook remains promising. However, retail sector co-lending surged between FY 2022-23 but declined sharply by 46% in FY 2024.

The sharp rise in MSME financing highlights the increasing role of co-lending in supporting small businesses, encouraged by government initiatives to enhance credit flow. Agriculture remains a marginal participant in co-lending for the Central Bank of India, indicating the need for further incentives to promote financial inclusion in rural areas. The introduction of corporate co-lending in FY 2024 suggests that banks are exploring diversified lending opportunities under this model.

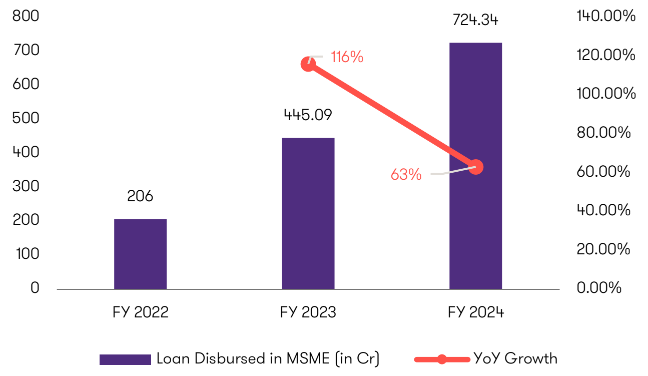
Distribution of segment-wise co-lending by CBI[57]

Segment	Sanction FY 2022	Sanction FY 2023	Sanctions during FY 2024
MSME	198.63	198.63	5,461.02
Retail	1588.98	3694.32	1,980.70
Agriculture	1.68	4.72	7.05
Corporate	Nil	Nil	391.47

Co-lending in MSME sector by Canara Bank

Canara Bank's co-lending initiative has experienced exponential growth, with over a 100% increase in the value of loans sanctioned in the first year (FY 2022) and a CAGR of 87.47% after that. By FY 2024, the value of loans sanctioned reached INR 724 crores, primarily driven by MSME sector growth, demonstrating the initiative's success in promoting financial inclusion and economic growth in India.

Value of loans sanctioned by Canara Bank



Adoption of co-lending by United Commercial Bank Limited (UCO)

As of 2022, UCO bank adopted a co-lending model for agriculture and collected INR 167.39 crore. As for retail, the portfolio for co-lending has experienced an increment of INR 1,121 crore in FY 2022-23 and INR 1,822 crore by the end of FY 23.

Adoption of co-lending by Bank of India

Under MSME and retail products, the Bank of India, with various NBFCs, has disbursed the total amount of INR 186 crore with an increase of 60%, i.e., INR 95 crore during FY24. Furthermore, the bank has planned to double the tie-ups with an incremental growth of 200% in the co-lending domain by FY25.

05

Micro credit to entrepreneurs and small business owners

This chapter assesses the growth of microcredit, focusing on financial access for entrepreneurs and small businesses. It explores key initiatives like the Mudra Scheme, the role of SHGs, and the state-wise distribution of small loans, highlighting their impact on financial empowerment.

Growth of micro credit through Mudra by banks in last five years

The Pradhan Mantri Mudra Yojana (PMMY) is a flagship scheme launched by the government of India on 8 April 2015, which aims to provide loans up to INR 10 lakh to non-corporate, non-farm small/micro enterprises through various financial institutions like banks, regional rural banks (RRBs), micro finance institutions (MFIs), and NBFCs, etc.

The scheme offers three categories of loans:

Shishu: Loans up to INR 50,000 for start-ups and early stage businesses.

Kishore: Loans ranging from INR 50,000 to INR 5 lakh for growing businesses.

Tarun: Loans from INR 5 lakh to INR 10 lakh for established businesses looking to expand.

The primary objective is to "fund the unfunded" by bringing such enterprises into the formal financial system and providing them with affordable credit.

Category-wise trends in PMMY

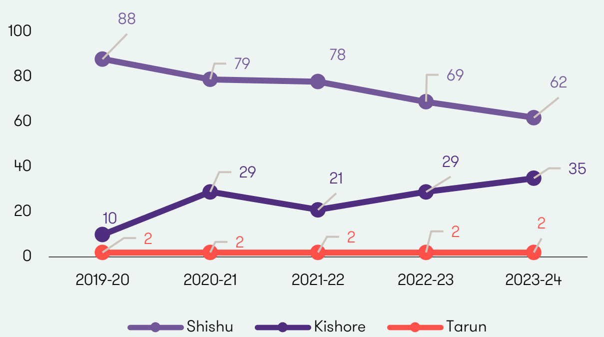
- **Loan account distribution:** Shishu loans make up 80% of total accounts, while Kishore and Tarun account for 18% and 2%, respectively.
- **Disbursement share:** Shishu and Kishore each contribute 38% of total disbursed amounts, while Tarun accounts for 23%.

Shifting trends (FY20–FY24)

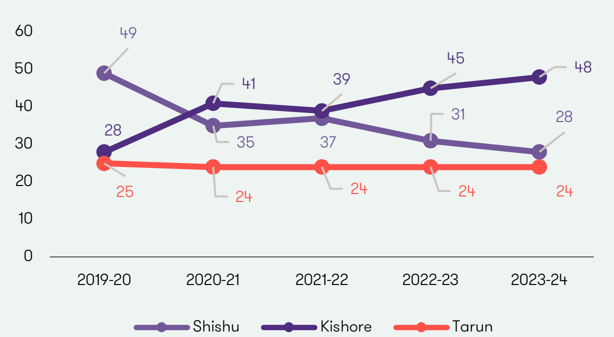
- **Shishu loans:** Account share declined from 88% (FY20) to 62% (FY24), with disbursement share dropping from 49% to 28%.
- **Kishore loans:** Share increased from 10% to 35%, with disbursement surging from 28% to 48%.
- **Tarun loans:** Disbursement remained steady at 23%.

This shift reflects the rising demand for larger Kishore loans, indicating increased capital needs among micro and small enterprises, while the demand for smaller Shishu loans has moderated.

Category-wise share of accounts in PMMY



Percentage disbursements under each category



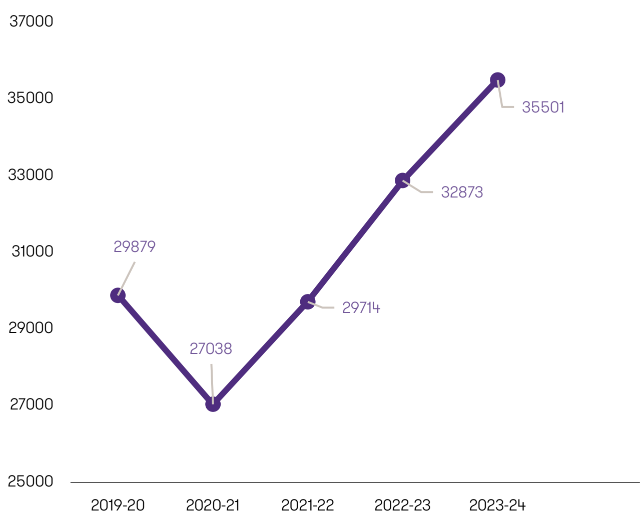
Average loan size for Shishu loans (value up to INR 50,000) under PMMY:

The steady rise in the average loan size for Shishu category accounts—from INR 29,879 in 2019 to INR 35,501 in 2023-24—indicates a growing demand for slightly higher capital among micro-entrepreneurs. This trend, despite slight dips in 2019-20 and 2020-21, suggests an evolving financial landscape where small business owners require more funds to sustain and expand their enterprises.

Key insights:

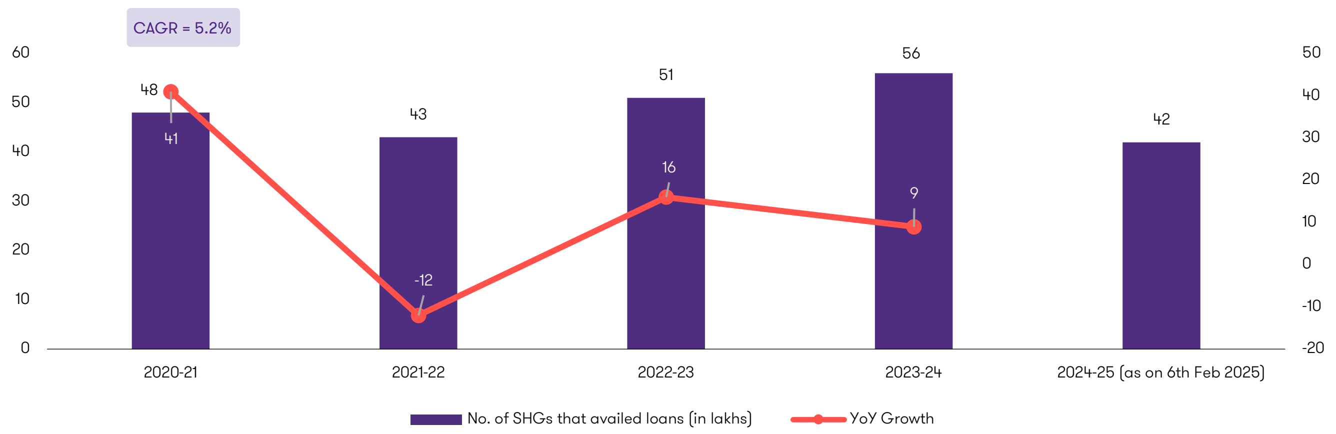
- Increased credit appetite: The rising loan size implies that micro-entrepreneurs, especially those in early stage businesses, are seeking larger amounts to meet working capital and operational needs.
- Inflation and cost pressures: Higher loan sizes could reflect increased business costs, including raw materials, rent, and wages, making larger loan amounts necessary for sustainability.
- Improved credit access: The growth suggests enhanced lender confidence and a willingness to offer higher ticket sizes, possibly due to better repayment trends or digital credit assessments.
- Resilience post-pandemic: While the economic slowdown in 2019-21 temporarily affected this trend, the subsequent recovery has restored growth in loan sizes, highlighting resilience in micro-business financing.

Average loan size for Shishu loans (<50,000)



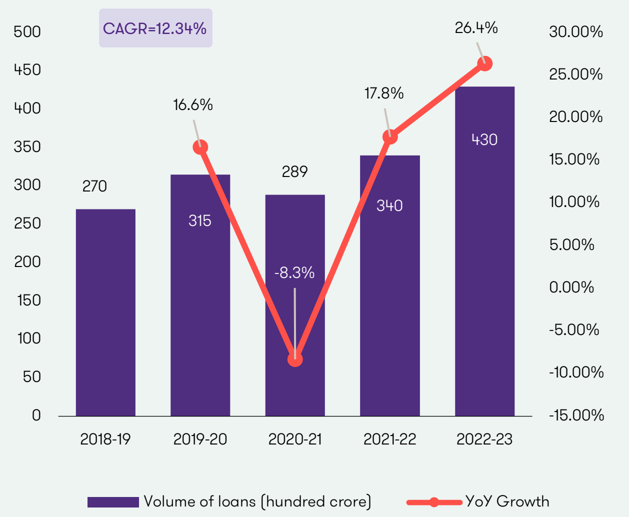
SHGs a major segment for micro credit in rural India

Number of SHGs that availed loans

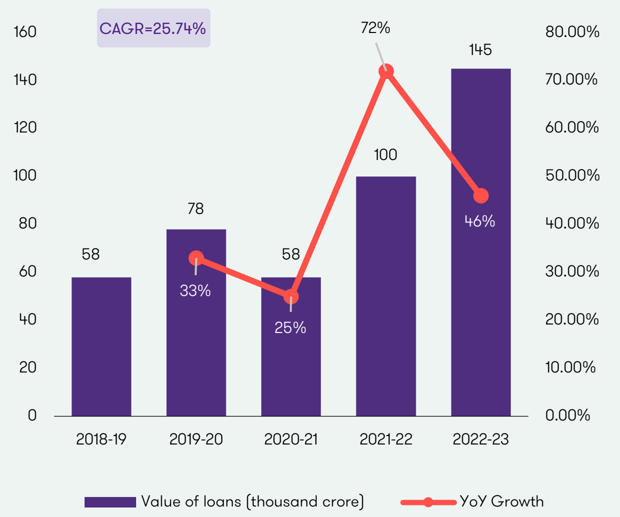


The number of SHGs availing loans has shown a fluctuating trend over the past five years, with an overall upward trajectory. After a decline from 48 lakh in FY 2020-21 to 43 lakh in FY 2021-22, the number increased to 51 lakhs in FY 2022-23 and further to 56 lakh in FY 2023-24. This growth momentum continues in FY 2024-25, with 42 lakh SHGs availing loans as of February 2025, indicating a strong demand for microfinance and a vibrant entrepreneurship ecosystem. This steady growth suggests a significant expansion of microfinance in supporting entrepreneurship and small business growth, enabling more individuals to access capital.

Loans disbursed to SHGs by banks



Volume of loan disbursement through bank branches - Commercial bank (Public and private banks), regional banks and co-operative banks

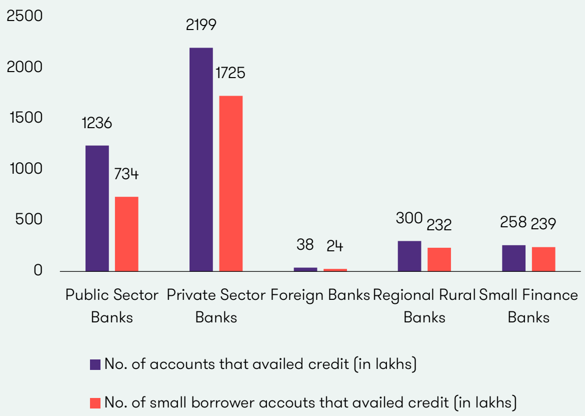


Value of loan disbursement through bank branches - Commercial bank (Public and private banks), regional banks and co-operative banks

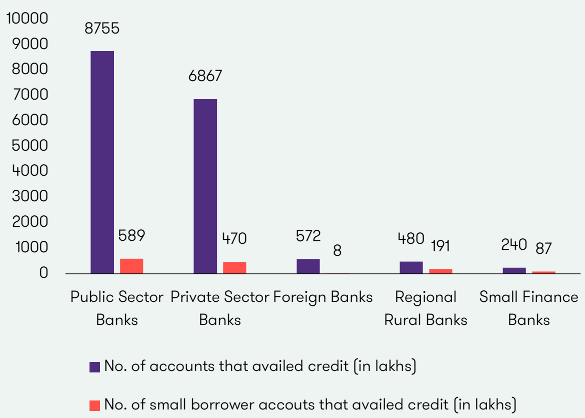
The volume and value of loans disbursed to SHGs through bank branches have consistently grown, with a few exceptions. The volume increased from INR 270 hundred crore in 2018-19 to INR 430 hundred crore in 2022-23, with a 12.34% CAGR, despite an 8.3% dip in 2020-21 due to the COVID-19 pandemic. Values grew at a 25.74% CAGR, with a 16% decline in 2020-21, but rebounded with a 72% surge in 2021-22, reaching an all-time high of INR 145 thousand crore in 2022-23. Economic recovery, government initiatives, and micro credit-process easing drove this growth.

Credit availed by small borrowers

Volume of accounts and small borrower accounts that availed credit



Total value of credit and credit availed by small borrowers



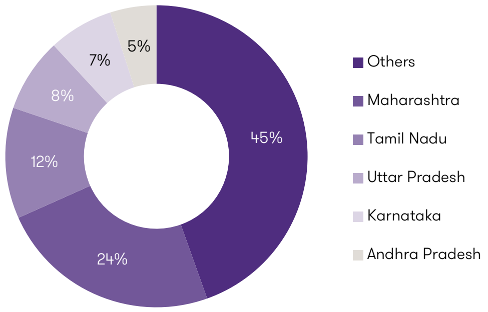
PSBs and PVBs dominate total credit value, with INR 8755 thousand crore and INR 6867 thousand crore, respectively, but their share of small borrower credit is just 6.7% and 6.8%. In contrast, regional rural banks and small finance banks have a higher share of small borrower credit at 39.7% and 36.4%. Foreign banks contribute just 1.2%.

PVBs lead in credit accounts (2,198 lakh), including 1,724 lakh small borrower accounts, followed by PSBs (1,236 lakh total, 734 lakh small). Small finance banks show the highest focus on small borrowers (92.7%), with PVBs (78.4%) and regional rural banks (77.3%) following closely. PSBs have a lower share at 59.4%, while foreign banks remain limited.

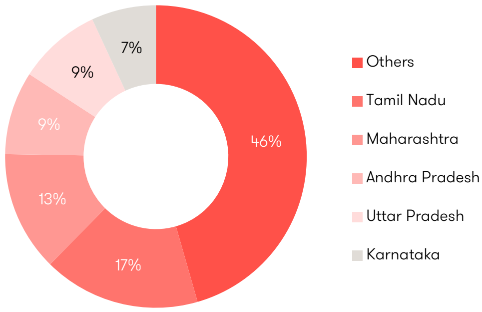
State-wise distribution of small loans

Small loans offer quick access to limited funds for temporary financial needs, typically unsecured, with lower amounts, shorter terms, and higher interest rates. They are ideal for unexpected expenses or small payments, with a straightforward application process and minimal documentation required. funds for temporary financial needs, typically unsecured, with lower amounts, shorter terms, and higher interest rates. They are ideal for unexpected expenses or small payments, with a straightforward application process and minimal documentation required.

State-wise distribution of small borrowable loans
(accounts opened percentage of total)



State-wise distribution of small borrowable loans
(value of loans disbursed percentage of total)



Maharashtra leads in small loan accounts (24%), followed by Tamil Nadu (12%) and Uttar Pradesh (8%), indicating a high demand for credit in these states, driven by agriculture and small enterprises. In terms of loan value disbursed, Tamil Nadu tops at 17%, followed by Maharashtra (13%) and Andhra Pradesh (9%). This distribution reflects state-specific policies and financial support for small borrowers, especially in agriculture and local businesses, contributing to regional economic growth and financial inclusion. Other states collectively account for 46% of the loan value, showing a wide reach across diverse regions.

As co-lending continues to grow, its potential to scale small loan distribution and increase financial inclusion becomes increasingly significant. By combining resources and expertise, co-lending partners can better serve the diverse financial needs of small borrowers across India, driving economic growth and social progress.

06

SWOT analysis of the NBFC industry in co-lending

This section identifies key trends shaping the future of the co-lending sector, including digital lending innovations, strategic bank-NBFC partnerships, and the increasing role of AI and data analytics in credit assessment. It also explores the sector's opportunities and challenges in the evolving financial ecosystem.

Strengths

- **High-growth potential –** Digital lending and co-lending partnerships drive expansion, allowing NBFCs to diversify.
- **Lower interest rates and cost efficiency –** Digital lending reduces acquisition costs, and banks' low-cost capital benefits borrowers.
- **Expanding customer reach –** Fintech platforms enable broader financial access, supporting underserved segments.
- **Regulatory clarity –** DLG 2023 provides a stable regulatory framework.
- **Improved asset quality –** NPAs have declined from due to risk-sharing.
- **Larger loan approvals –** Banks' capital support allows NBFCs to underwrite bigger loans.

Weaknesses

- **Regulatory and compliance hurdles –** Differing rules for banks and NBFCs create operational challenges.
- **High dependence on unsecured loans –** Most co-lending loans are unsecured, increasing the risk.
- **Integration issues –** Mismatched systems between banks and NBFCs delay operations.
- **Low trust in NBFCs –** Past failures (IL&FS, DHFL) have weakened consumer confidence.
- **Complex model –** Extensive documentation and separate accounting add complications.
- **Risky customer profiles –** NBFC borrowers pose higher credit risks for banks.

Opportunities

- **Tech-driven lending –** AI, data analytics, and digital KYC enhance efficiency.
- **Growth in underserved segments –** Co-lending expands credit access in PSL sectors.
- **Stronger bank-NBFC partnerships –** Collaboration ensures stable credit flow.
- **Financial inclusion –** CLM can bridge credit gaps in MSMEs and rural areas.

Threats

- **Rising competition –** Low entry barriers intensify competition.
- **Need for strong risk management –** Financial stability depends on sustainable lending.
- **Systemic risk –** Inter-bank exposure increases contagion threats.
- **Economic vulnerability –** Slowdowns can impact credit demand and repayment.
- **Risk of credit defaults –** Economic downturns may lead to higher NPAs.

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