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Growth, Funding Transition and Profitability of Small Finance Banks in India: Sector-Level Evidence

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ABSTRACT
Purpose: This paper asks how Small Finance Banks (SFBs) in India have grown since they were first licensed in 2014, and whether that growth is helping them serve underserved customers in a lasting way. It judges the banks by their reach, depth and resilience, not by size alone.
Design/methodology: The paper uses sector-level data from the Reserve Bank of India and the Department of Financial Services for FY 2016–17 to FY 2024–25, and estimates FY 2025–26 under alternative scenarios. The analysis covers growth rates, CAGRs, funding and per-office ratios, a profit decomposition, exploratory econometric models and a forecast backtest.
Findings: Deposits grew 63.6-fold and advances 16.2-fold by FY 2024–25, but growth has slowed sharply: deposit CAGR was 42.5% for FY 2017–18 to FY 2024–25 against 28.2% for the last three years, and office growth fell from 96.5% to 3.8%. Deposits rose from 18.0% to 77.8% of assets, and the credit–deposit ratio fell from 339.1% to 86.4%. In FY 2024–25, return on average assets fell from 2.06% to 0.94% as expenditure grew 29.5% and income 19.4%, and the gross NPA ratio was 3.6%. The models point to growth convergence and no error correction between advances and deposits.
Originality/value: The study separates growth from new offices from growth in business per office, traces the shift in funding, and breaks down the FY 2024–25 profit fall within a framework of reach, depth and resilience.
Practical implications: Supervisors should look beyond branch and balance-sheet expansion to cost-to-serve, asset quality and outcome-based measures of inclusion.
Keywords: Small Finance Banks; financial inclusion; sustainable banking; funding structure; bank profitability; India

1. INTRODUCTION

Access to formal savings, credit and payment services helps households smooth their spending, lets small businesses invest, and reduces dependence on informal lenders. India has expanded account ownership quickly: the Global Findex 2021 found that about 78% of adults held an account, up from 35% in 2011 (Klapper et al., 2022). The same report also noted inactive accounts and limited use of digital payments, which shows that owning an account is a weak measure of inclusion. The question for policy has moved from access to whether people use financial services regularly, affordably and responsibly.

The RBI introduced Small Finance Banks (SFBs) in its November 2014 licensing guidelines (RBI, 2014). They were meant to bring savings products and credit to small businesses, small and marginal farmers, micro and small industries and other unorganised-sector entities. Ten applicants received in-principle approval in September 2015. Capital Small Finance Bank started operating on 24 April 2016, followed by Equitas in 2016, seven more banks in 2017 and one in 2018 (RBI, 2021a). Several of these banks grew out of microfinance institutions and non-bank lenders. In about a decade, the sector has become a material part of the banking system.

Size alone, however, does not show that inclusion is sustainable. A bank that serves vulnerable borrowers can grow fast while carrying high costs, concentrated credit risk and thin earnings. If those weaknesses come to a head, the customers the model was built for are the first to lose access. Sustainability therefore has to be judged on three linked dimensions: reach (physical and financial presence), depth (deposit mobilisation and credit provision) and resilience (funding stability, profitability, asset quality and capital).

This paper makes three contributions. First, it covers the full period since licensing at sector level and treats the start-up years explicitly, so that base effects do not inflate headline growth. Second, it separates growth from new offices from growth in business per office, and it shows the change in funding behind balance-sheet growth. Third, it breaks the FY 2024–25 profit decline into income, cost and asset-yield effects, and links the findings to the sustainability of inclusion through a scorecard.

2. INSTITUTIONAL BACKGROUND AND CONCEPTUAL FRAMEWORK

SFBs are a special type of bank. They take deposits and lend like universal banks, but they work under a mandate to serve small borrowers, including priority-sector lending obligations under the RBI framework. Many started as microfinance institutions, non-bank finance companies or local area banks. That gave them relationships with borrowers and the ability to collect in the field, but it also left them with loan books and cost structures built for funding that did not come from deposits.

This history matters for the analysis. A newly converted SFB first funds its assets with borrowings carried over from its earlier form, and only then builds a base of deposits. The expected pattern is a high credit–deposit ratio at the start, a rising share of deposits in assets, and eventually a balance sheet funded mainly by deposits. Whether that shift makes the bank more resilient depends on what the deposits cost and how stable they are.

The study uses a framework with three dimensions of sustainability (Table 1), each measured with sector-level indicators from the RBI and DFS series. What happens to individual account holders, such as their income, women's participation, rural share or repeated use, cannot be seen in aggregate data, so it is treated as a limitation (Section 8).

Table 1: Conceptual framework and indicators

Dimension	Question	Indicators used
Reach	Is the sector present where it is needed?	Functioning offices, office growth, assets per office
Depth	Does it mobilise savings and supply credit at scale?	Deposits, advances, per-office business, credit–deposit ratio
Resilience	Can it keep serving without distress?	Deposit share of assets, ROA, cost ratio, GNPA, CRAR

3. LITERATURE REVIEW AND PROPOSITIONS

Inclusion is more than owning an account. A phenomenological study of employees in two SFBs identified financial literacy, technology, credit identity, prompt repayment and financial stability as the main themes of inclusion, which suggests that customers must understand and use services for inclusion to be real (Joshi et al., 2021). The Findex evidence on inactive accounts points the same way (Klapper et al., 2022). National account-ownership figures reflect many programmes, so they cannot be credited to SFBs alone.

Performance and efficiency. Ray and Shantnu (2021) applied the CAMEL framework to ten SFBs for FY 2019–20 and found that performance differed across banks. The RBI's early review looked at efficiency, leverage and liquidity as factors in whether the business model is viable (RBI, 2021a). Bhatia and Mahendru (2024) combined CAMEL indicators with data envelopment analysis, and Arora and Arora (2025) found fairly low efficiency over FY 2017–18 to FY 2019–20, with a higher cost of funds linked to lower efficiency. Taken together, these studies suggest that being bigger does not make a bank more efficient and that the cost of funds matters a great deal. More recent bank-level work applies the CAMELS framework (Mahajan and Bhatia, 2024), estimates scale efficiency for SFBs operating since 2017 (Deb, 2024) and links corporate governance to profitability in a panel of 25 private and small finance banks (Tikku et al., 2024). These studies cover short periods and use bank-level indicators. None of them connects performance to the sector-wide shift in funding or to whether inclusion can be sustained.

Gap. Existing work usually covers short periods or small groups of banks, focuses on CAMEL or efficiency scores without linking them to inclusion, and rarely separates growth from new offices from growth in business per office or breaks down recent profit changes. This paper addresses those gaps at sector level over the whole period since licensing.

Propositions. Drawing on the institutional logic in Section 2 and on the literature, the paper tests four propositions:

P1 (growth maturation): sector growth rates decelerate as the base expands and conversions are completed.

P2 (funding transition): the deposit share of assets rises and the credit–deposit ratio converges towards one.

P3 (intensive growth): growth shifts from adding offices to increasing business per office.

P4 (non-monotonic profitability): profitability does not rise monotonically with scale, because expenditure, including provisions, can outgrow income.

4. DATA AND METHODOLOGY

4.1 Data

The data are annual sector-level figures for FY 2016–17 to FY 2024–25 (and, for offices, FY 2025–26). They come from the RBI Report on Trend and Progress of Banking in India (various editions; RBI, 2018, 2020, 2021b, 2022, 2023, 2024, 2025a) and Statistical Tables Relating to Banks in India (RBI, 2025b), together with functioning-office counts from DFS Banking Analytics (Department of Financial Services, n.d.). Income, expenditure and net profit are available for FY 2021–22 to FY 2024–25. Asset-quality and capital indicators (GNPA and CRAR) are the RBI's figures for end-March 2025.

How FY 2016–17 and FY 2025–26 are treated. FY 2016–17 covers only the first banks to start operating, and the RBI notes that most SFBs began operations in 2017–18 (RBI, 2021a). Window CAGRs are therefore reported from both FY 2016–17 and FY 2017–18, and headline statements use the later start. Consolidated FY 2025–26

financial figures were not available in the RBI series consulted. FY 2025–26 deposits, advances and total assets are therefore estimates (E): each series' FY 2024–25 growth rate (25.7%, 20.5% and 20.9%) is applied to its FY 2024–25 value (Scenario A), and Section 6 examines other growth paths. The FY 2025–26 office count (8,133 at 31 March 2026) is an actual DFS figure, so per-office values for that year combine an estimated numerator with an actual denominator. FY 2025–26 profitability, asset quality and capital are not estimated. DFS functioning offices and RBI domestic branches are measured differently, so the two are not used interchangeably.

4.2 Methods

Let Y denote deposits, advances, assets or offices.

Growth rate: $g(t) = (Y(t) - Y(t-1)) / Y(t-1) \times 100$.

Window CAGR: CAGR = (Y(end) / Y(start))^(1/n) − 1, where n is the number of annual intervals; several windows are reported to expose base effects.

Log-linear trend: $\ln Y(t) = \alpha + \beta \cdot t + \varepsilon(t)$, with trend growth = $\exp(\beta) - 1$.

Funding elasticity: $\ln \text{Advances}(t) = a + b \cdot \ln \text{Deposits}(t) + \varepsilon(t)$, and $\ln \text{Deposits}(t) = c + d \cdot \ln \text{Assets}(t) + \varepsilon(t)$.

Structure and intensity: credit–deposit (CD) ratio = Advances / Deposits × 100; incremental CD ratio = ΔAdvances / ΔDeposits × 100; deposit share = Deposits / Assets; per-office values = Y / functioning offices.

Profitability: ROA = net profit / average total assets; cost ratio = total expenditure / total income; income and expenditure yields are measured on average assets, and the change in ROA is decomposed into the change in income yield minus the change in expenditure yield.

Sensitivity: FY 2025–26 values are estimated under alternative growth assumptions, and the effect on CAGRs and the CD ratio is examined.

With only nine to ten annual observations, and the last one partly estimated, the estimates are descriptive summaries. They are not causal or inferential tests. Because the series trend strongly, high correlations and R^2 values mainly reflect shared trends. The analysis cannot isolate the independent effect of SFBs on national inclusion outcomes, and the econometric results are best read as consistency checks on the descriptive findings.

4.3 Econometric specifications

Six exploratory models are estimated on published data for FY 2017–18 to FY 2024–25 (8 observations). The FY 2025–26 estimate is left out because it is mechanical. The time index t is 0 in FY 2017–18. The reported t-statistics are conventional OLS statistics, checked against Newey–West standard errors with one lag, and Durbin–Watson statistics are noted where they matter.

Curvature: $\ln Y(t) = a + b \cdot t + c \cdot t^2 + e$; a negative c indicates decelerating growth.

Structural break: $\ln Y(t) = a + b \cdot t + d \cdot \max(0, t - t^*) + e$, with t* fixed at FY 2020–21, the pandemic year, before estimation; a negative d indicates a slower post-break trend.

Convergence: $\Delta \ln Y(t) = a + \beta \cdot \ln Y(t-1) + e$; a negative β indicates that growth slows as the sector grows.

Funding linkage and error correction: $\Delta \ln \text{Adv}(t) = a + b \cdot \Delta \ln \text{Dep}(t) + e$; an Engle–Granger test on the residuals of $\ln \text{Adv} = a + b \cdot \ln \text{Dep}$; and an error-correction model $\Delta \ln \text{Adv}(t) = a + b \cdot \Delta \ln \text{Dep}(t) + \lambda \cdot u(t-1) + e$.

Network productivity and linkage: trends in ln(Y per office) with a kink at FY 2019–20, and first-difference elasticities of business with respect to offices.

Forecast backtest: one-year-ahead forecasts for FY 2021–22 to FY 2024–25 from five methods, scored by mean absolute percentage error (MAPE).

5. RESULTS

5.1 Scale and reach

Table 2: Core indicators, business per office and network productivity (₹ crore unless stated)

Panel A: Levels and business per functioning office							
Financial year	**Deposits**	**Advances**	**Total assets**	**Offices**	**Deposits per office**	**Advances per office**	**Assets per office**
2016–17	4,960	16,820	27,630	397†	12.5	42.4	69.6
2017–18	26,470	46,760	69,950	1,740	15.2	26.9	40.2
2018–19	55,686	69,857	98,884	3,419	16.3	20.4	28.9
2019–20	82,488	90,576	1,32,768	4,494	18.4	20.2	29.5
2020–21	1,09,473	1,08,613	1,63,553	5,127	21.4	21.2	31.9
2021–22	1,49,552	1,38,221	2,13,887	5,933	25.2	23.3	36.1
2022–23	1,91,372	1,77,887	2,67,517	6,720	28.5	26.5	39.8
2023–24	2,50,896	2,26,148	3,35,280	7,370	34.0	30.7	45.5
2024–25	3,15,401	2,72,481	4,05,463	7,647	41.2	35.6	53.0

2025–26 (E)	3,96,459	3,28,340	4,90,205	8,133	48.7	40.4	60.3
Multiple, FY 2016–17 to FY 2024–25	63.6×	16.2×	14.7×	19.3×	3.3×	—	—
Multiple, FY 2016–17 to FY 2025–26 (E)	79.9×	19.5×	17.7×	20.5×	3.9×	—	—

Panel B: Per-office productivity, log trends (% a year) with a kink at FY 2019–20

Series per office	Full-period trend (t; HAC t)	Growth before kink	Growth after kink	Kink t-statistic
Deposits	15.6 (22.8; 18.0)	9.6	17.4	4.58
Advances	6.0 (2.4; 1.9)	−14.7	13.0	6.89
Total assets	6.4 (2.5; 2.0)	−14.2	13.3	5.60

Panel C: Elasticity of business to offices, first differences (n = 7)

Relationship	Estimate	Fit
Elasticity of deposits to offices, first differences (n = 7)	0.825 (t = 20.8)	R^2 0.989
Elasticity of advances to offices, first differences (n = 7)	0.316 (t = 6.06)	R^2 0.880
Elasticity of total assets to offices, first differences (n = 7)	0.231 (t = 4.91)	R^2 0.828

†Early figure, to be verified against the original historical series. Offices were 8,133 on 31 March 2026 (actual). (E) = estimate: FY 2024–25 growth rates applied to FY 2024–25 values.

Every indicator has grown by one to two orders of magnitude. Deposits grew far faster than advances and assets, which is the first sign of the change in funding analysed in Section 5.3.

5.2 Growth dynamics and deceleration (P1)

Table 3: Growth dynamics

Panel A: Year-on-year growth (%)

Financial year	Deposits	Advances	Assets	Offices	Deposit growth minus advance growth (pp)
2017–18	433.7	178.0	153.2	338.3	255.7
2018–19	110.4	49.4	41.4	96.5	61.0
2019–20	48.1	29.7	34.3	31.4	18.4
2020–21	32.7	19.9	23.2	14.1	12.8
2021–22	36.6	27.3	30.8	15.7	9.3
2022–23	28.0	28.7	25.1	13.3	−0.7

2023–24	31.1	27.1	25.3	9.7	4.0
2024–25	25.7	20.5	20.9	3.8	5.2
2025–26 (E)	25.7	20.5	20.9	6.4	5.2
Panel B: Compound annual growth rate by window (%)					
Window	**Deposits**	**Advances**		**Assets**	**Offices**
Published data: FY 2016–17 to FY 2024–25 (8 yrs)	68.0	41.6		39.9	44.7
Published data: FY 2017–18 to FY 2024–25 (7 yrs)	42.5	28.6		28.5	23.6
Published data: FY 2019–20 to FY 2024–25 (5 yrs)	30.8	24.6		25.0	11.2
Published data: FY 2021–22 to FY 2024–25 (3 yrs)	28.2	25.4		23.8	8.8
With estimate: FY 2016–17 to FY 2025–26 (9 yrs)	62.7	39.1		37.7	39.9
With estimate: FY 2017–18 to FY 2025–26 (8 yrs)	40.3	27.6		27.6	21.3
With estimate: FY 2019–20 to FY 2025–26 (6 yrs)	29.9	23.9		24.3	10.4
With estimate: FY 2022–23 to FY 2025–26 (3 yrs)	27.5	22.7		22.4	6.6
Panel C: Log-linear trend growth and elasticities, FY 2017–18 start					
Series or relationship	**Published data to FY 2024–25**	**R^2**		**Including FY 2025–26 (E)**	**R^2**
Deposits, trend growth (% a year)	39.1	0.962		36.8	0.964
Advances, trend growth (% a year)	27.6	0.992		26.7	0.992
Assets, trend growth (% a year)	28.1	0.993		27.1	0.992
Elasticity of advances to deposits	0.72	0.986		0.74	0.988
Elasticity of deposits to assets	1.35	0.986		1.32	0.988
Panel D: Trend curvature, structural break and convergence					

Series	Quadratic term c (t; p)	Trend growth before FY 2020–21 (% a year)	Trend growth after (% a year)	Break p-value	Convergence β (t; p)	R^2 (conv.)
Deposits	−0.0284 (−3.81; 0.012)	58.3	27.3	0.021	−0.207 (−4.38; 0.007)	0.793
Advances	−0.0078 (−2.16; 0.083)	31.7	24.9	0.160	−0.096 (−2.29; 0.070)	0.513
Total assets	−0.0093 (−5.15; 0.004)	33.3	24.6	0.021	−0.085 (−3.76; 0.013)	0.739
Offices	−0.0354 (−4.20; 0.008)	41.3	7.9	0.018	−0.423 (−8.61; <0.001)	0.937

Panel D convergence regressions: Δln Y(t) on ln Y(t−1), FY 2018–19 to FY 2024–25 (n = 7); break date fixed at FY 2020–21.

Two results stand out. First, CAGRs depend heavily on the base year. Deposit CAGR falls from 68.0% to 28.2% as the window moves from the start-up base to the last three years, so headline CAGRs that include FY 2016–17 describe the formation of the sector, not its underlying growth. Second, offices slow down faster than financial aggregates: the three-year office CAGR is 8.8% against 23.8% for assets. Business is growing much faster than the network.

Including the FY 2025–26 estimate changes little. The FY 2017–18 to FY 2025–26 CAGRs are 40.3% (deposits), 27.6% (advances), 27.6% (assets) and 21.3% (offices), compared with 42.5%, 28.6%, 28.5% and 23.6% to FY 2024–25. The estimated growth rates for the financial series simply repeat those of FY 2024–25, so they add no new information. The one observed FY 2025–26 figure, office growth of 6.4%, is above the 3.8% of FY 2024–25 but well below the 13–16% of FY 2020–21 to FY 2022–23.

The log-linear trend estimates (Table 3, Panel C) start from FY 2017–18 to avoid the start-up base. On published data to FY 2024–25 they give trend growth of 39.1% for deposits (R^2 = 0.962), 27.6% for advances (R^2 = 0.992) and 28.1% for assets (R^2 = 0.993). Adding the FY 2025–26 estimate lowers these to 36.8%, 26.7% and 27.1%. **P1 is supported:** growth is high but fading, with advances and assets growing 27–28% a year and deposits growing faster.

The elasticity of advances to deposits is below one (0.72 on published data and 0.74 with the estimate), which fits a falling reliance on funding that does not come from deposits. The elasticity of deposits to assets is above one (1.35 and 1.32), so deposits are growing faster than the balance sheet. The level correlation between deposits and advances is 0.999, but that mostly reflects the shared trend. The correlation of year-on-year growth rates from FY 2018–19 onward, 0.94, is more informative.

5.3 Funding transition (P2)

Table 4: Funding structure, credit–deposit ratios and funding linkage

Panel A: Funding structure and credit–deposit ratios					
Financial year	**Deposits / assets (%)**	**Advances / assets (%)**	**CD ratio (%)**	**Incremental CD ratio (%)**	**Deposits added (₹ crore)**
2016–17	18.0	60.9	339.1	—	—
2017–18	37.8	66.8	176.7	139.2	21,510
2018–19	56.3	70.6	125.4	79.1	29,216
2019–20	62.1	68.2	109.8	77.3	26,802
2020–21	66.9	66.4	99.2	66.8	26,985

2021–22	69.9	64.6	92.4	73.9	40,080
2022–23	71.5	66.5	93.0	94.8	41,820
2023–24	74.8	67.5	90.1	81.1	59,524
2024–25	77.8	67.2	86.4	71.8	64,505
2025–26 (E)	80.9	67.0	82.8	68.9	81,058

Panel B: Funding linkage and error correction (advances on deposits)

Model	**Estimate**	**Fit and notes**
Δln advances on Δln deposits, FY 2018–19 to FY 2024–25 (n = 7)	slope 0.377 (t = 5.62), intercept 0.119	R^2 0.863; slope significantly below 1 (t = −9.3)
Same, excluding FY 2018–19 (n = 6)	slope 0.300 (t = 1.20), intercept 0.140	R^2 0.27; the link is not significant
Engle–Granger residual test, ln advances on ln deposits (n = 8)	Dickey–Fuller τ = −1.75; long-run slope 0.723	No rejection of no cointegration; residual DW 0.81
Error-correction model (n = 7)	short-run slope 0.388 (t = 4.08); adjustment coefficient −0.049 (t = −0.20)	R^2 0.865; no significant error correction

The deposit share of assets rose from 18.0% to 77.8%, while the advances share stayed within a narrow 65–71% band from FY 2017–18 onward. The asset side of the balance sheet stayed stable while the liability side was rebuilt. **P2 is supported.** The credit–deposit ratio has been below 100% since FY 2020–21 and reached 86.4% in FY 2024–25.

The incremental CD ratio shows what the stock ratio hides. It rose to 94.8% in FY 2022–23, then fell to 81.1% in FY 2023–24 and to 71.8% in FY 2024–25, when deposit additions of ₹64,505 crore outpaced the ₹46,333 crore increase in advances. In rupee terms, deposit additions keep growing, from ₹21,510 crore in FY 2017–18 to ₹64,505 crore in FY 2024–25, even though the percentage growth is slowing.

The effect on resilience cuts both ways. Deposit funding lowers refinancing risk. But term deposits made up 73.9% of SFB deposits at end-March 2025, so the extra deposits mostly come at market-linked cost. That adds to the cost-of-funds pressure that Arora and Arora (2025) identify as a driver of inefficiency.

On the FY 2025–26 estimate, deposits would reach 80.9% of assets, the CD ratio would fall to 82.8%, and the incremental CD ratio would drop to 68.9%, the lowest in the series. This result is mechanical, because deposits are assumed to outgrow advances by 5.2 percentage points, as they did in FY 2024–25. External expectations are more cautious about credit: Crisil Ratings expected SFB advances to grow 16–17% in FY 2025–26 and stressed that raising liabilities would be the key constraint (Crisil Ratings, 2025). In none of the scenarios in Section 6 does the CD ratio rise above its FY 2024–25 level.

5.4 Extensive versus intensive growth (P3)

Deposits per office grew 3.3-fold from FY 2016–17, at 15.3% a year from FY 2017–18. Advances per office followed a U-shape. They fell from ₹42.4 crore to ₹20.2 crore by FY 2019–20 and then recovered to ₹35.6 crore. The high early value probably reflects loan books inherited from predecessor institutions spread over a small network, and the fall reflects the rapid opening of offices through FY 2019–20. Since then, business per office has risen every year, while office growth has fallen to 3.8% (FY 2024–25). These per-office values divide RBI financial totals by DFS functioning offices, which are different sources. For FY 2024–25, CARE Ratings reports 7,641 branches against the DFS count of 7,647, so the mismatch looks small (CARE Ratings, 2025).

On the FY 2025–26 estimate, deposits per office would reach ₹48.7 crore (18.2% above FY 2024–25) and advances per office ₹40.4 crore, because estimated business growth of 20–26% is spread over only 6.4% more offices. These values combine an estimated numerator with an actual denominator, and they would be lower if business growth slows (Section 6).

P3 is supported: the sector has moved from building branches to filling them. Higher productivity helps cover costs, but slower office growth can also mean slower reach into new underserved areas. Office growth of 6.4% in FY 2025–26 (8,133 offices at March 2026) suggests the slowdown may have eased, but FY 2025–26 financial data are needed to confirm that.

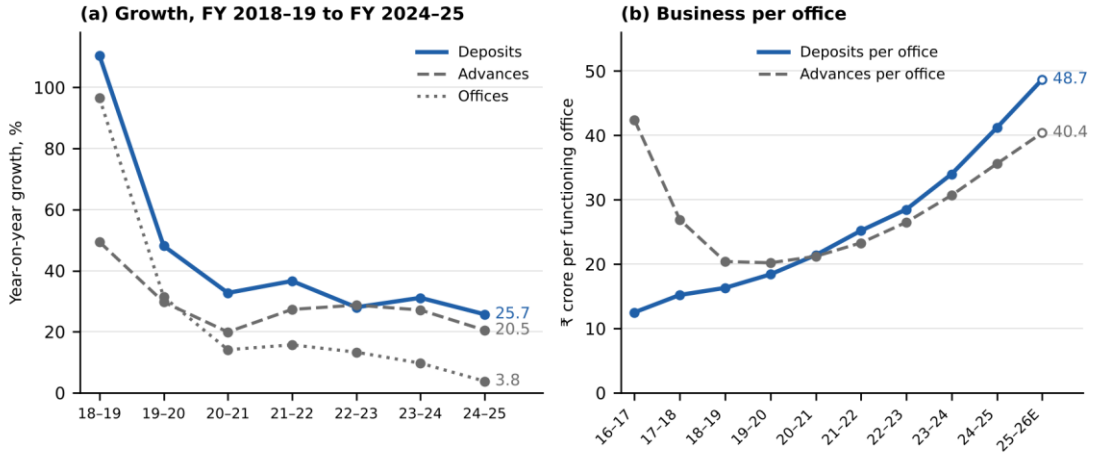


Figure 1. (a) Year-on-year growth of deposits, advances and offices, FY 2018–19 to FY 2024–25; (b) deposits and advances per functioning office (₹ crore), FY 2016–17 to FY 2025–26 (E). Source: RBI; DFS Banking Analytics; author's calculations (Table 3, Panel A, and Table 2). Hollow markers = FY 2025–26 estimate.

5.5 Profitability and cost structure (P4)

Table 5: Profitability decomposition and comparison with scheduled commercial banks (₹ crore unless stated)

Panel A: Profitability decomposition of Small Finance Banks				
Indicator	**FY 2021–22**	**FY 2022–23**	**FY 2023–24**	**FY 2024–25**
Total income	25,033	33,827	45,400	54,223
Total expenditure	24,053	29,665	39,181	50,727
Net profit	973	4,162	6,219	3,496
Income growth (%)	—	35.1	34.2	19.4
Expenditure growth (%)	—	23.3	32.1	29.5
Net profit growth (%)	—	327.7	49.4	−43.8
Cost ratio (expenditure / income, %)	96.1	87.7	86.3	93.6
Net profit margin (%)	3.9	12.3	13.7	6.5
Income yield on average assets (%)	13.26	14.05	15.06	14.64
Expenditure yield on average assets (%)	12.75	12.32	13.00	13.70
ROA on average assets (%)	0.52	1.73	2.06	0.94
Panel B: Small Finance Banks (SFBs) and scheduled commercial banks (SCBs)				
Indicator	**SFBs FY 2023–24**	**SCBs FY 2023–24**	**SFBs FY 2024–25**	**SCBs FY 2024–25**
Deposit growth (%)	31.1	13.4	25.7	11.4
Credit growth (%)	27.1	16.0	20.5	12.5
Balance sheet growth (%)	25.3	15.5	20.9	11.2
Net profit growth (%)	49.4	32.8	−43.8	14.8

GNPA ratio (%, end-March)	2.4	n.a.	3.6	2.2
Return on assets (%)	2.06	n.a.	0.94	1.4
CRAR (%, end-March 2025)	n.a.	n.a.	21.5	17.4

SCB deposit and credit growth exclude the effect of the bank merger; SCB balance-sheet growth for FY 2023–24 includes it. SCB figures are as reported in the RBI Report on Trend and Progress of Banking in India 2024–25. SFB return on assets is on average total assets (Panel A). n.a. = not collected.

Profitability improved sharply from FY 2021–22 to FY 2023–24 and then turned around. In FY 2024–25, income rose by ₹8,823 crore but expenditure rose by ₹11,546 crore, so net profit fell by ₹2,723 crore (−43.8%) even though income grew 19.4%. The cost ratio rose 7.3 percentage points to 93.6%, which means that out of every ₹100 of income, ₹93.6 went to expenditure.

The 1.12-point fall in ROA (from 2.06% to 0.94%) splits exactly into a 0.42-point fall in the income yield on average assets (15.06% to 14.64%) and a 0.70-point rise in the expenditure yield (13.00% to 13.70%). Rising costs therefore explain about 62% of the fall. The RBI attributes the weaker profit to higher provisions and contingencies, which fits with GNPA rising to 3.6%. The data do not separate interest expense, operating expense and provisions, so their relative weights cannot be measured here.

The elasticity of profit to income was 9.3 in FY 2022–23, 1.4 in FY 2023–24 and −2.3 in FY 2024–25. Profit rises quickly when income grows faster than costs and is just as sensitive when costs outgrow income. Profit per office followed the same path (₹16.4 lakh in FY 2021–22, then ₹61.9 lakh, ₹84.4 lakh and ₹45.7 lakh), even though income per office kept rising from ₹4.2 crore to ₹7.1 crore. **P4 is supported:** gains in scale and productivity did not lead to steadily rising profit.

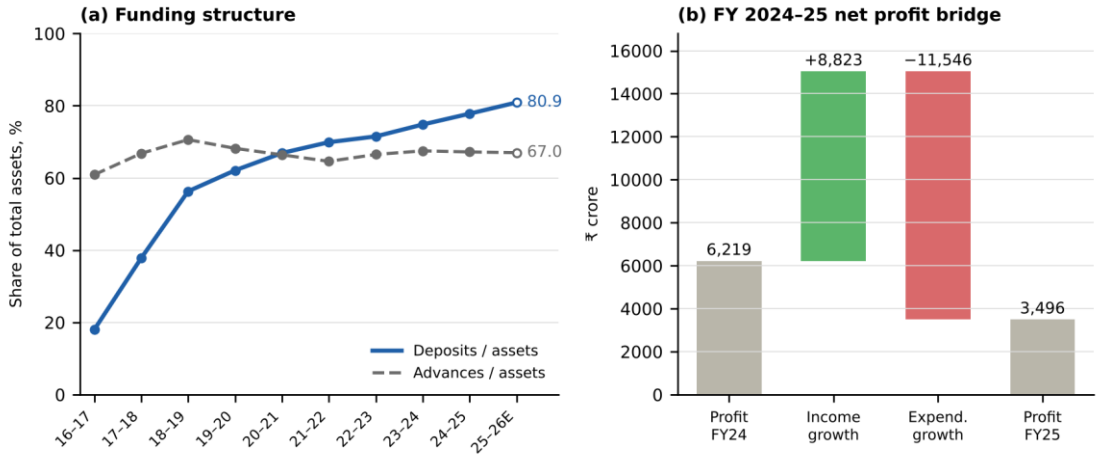


Figure 2. (a) Deposits and advances as a share of total assets, FY 2016–17 to FY 2025–26 (E); (b) bridge from FY 2023–24 to FY 2024–25 net profit of Small Finance Banks (₹ crore). Source: RBI, Report on Trend and Progress of Banking in India; author's calculations (Tables 4 and 5). Hollow markers = FY 2025–26 estimate.

On capital, the RBI-reported CRAR of 21.5% and core CRAR of 18.8% at end-March 2025 give a substantial cushion against losses, compared with the 15% minimum prescribed for SFBs (RBI, 2016). Capital is therefore a strength. The pressure is in earnings and credit quality.

Comparison with scheduled commercial banks. Panel B of Table 5 sets SFBs beside scheduled commercial banks (SCBs) for the two years with comparable RBI figures. In FY 2024–25, SFBs grew deposits 2.3 times as fast as SCBs (25.7% against 11.4%, excluding the effect of the bank merger) and credit 1.6 times as fast (20.5% against 12.5%). The multiples were similar in FY 2023–24 (2.3 and 1.7 times). SFBs grow faster, but their growth has slowed in step with the wider system. The sharper contrast is in resilience. SCB net profit rose 14.8% in FY 2024–25 while SFB profit fell 43.8%. The SFB GNPA ratio (3.6%) was well above the SCB ratio (2.2%), and SFB return on assets (0.94%) was below the SCB figure (1.4%), although SFB capital (CRAR 21.5% against 17.4%) was higher (RBI, 2025a). The comparison covers two years and uses published growth rates, so it describes the gap but does not test it.

Outlook for FY 2025–26. FY 2025–26 profitability, GNPA and CRAR are not estimated here, but outside evidence points to continued pressure on earnings. CARE Ratings reports that SFBs' cost of funds was 7.3% in FY 2024–25 against about 5.3% for the wider banking sector, and that CASA was 26.2% in March 2025. It expects return on average assets of about 0.9% in FY 2025–26 (1.0% in FY 2024–25 on its measure), with credit costs of 1.8–2.0% (CARE Ratings, 2025). ICRA also expected profitability to remain under pressure (ICRA, 2025). Two developments affect comparability. The RBI cut the priority-sector lending requirement for SFBs from 75% to 60% as of 20 June 2025, and AU Small Finance Bank received in-principle approval on 7 August 2025 to become a universal bank (PTI, 2025). It was still an SFB at the end of FY 2025–26, but later totals will not be

comparable with this series unless the RBI restates it.

5.6 Sustainability scorecard

Table 6: Assessment of sustainable financial inclusion

Dimension	Evidence	Assessment
Reach	Offices rose 19.3-fold to 7,647 in FY 2024–25 and to 8,133 by March 2026 (20.5-fold); office growth slowed to 3.8% before recovering to 6.4%	Strong build-out, now in a densification phase; location-level inclusion not observable
Depth	Deposits 63.6× and advances 16.2× by FY 2024–25 (79.9× and 19.5× on the FY 2025–26 estimate); per-office deposits ₹41.2 crore (₹48.7 crore, E); CD ratio 86.4% (82.8%, E)	Strong and increasingly deposit-funded; usage and affordability not observable
Resilience	FY 2024–25: CRAR 21.5%; deposits 77.8% of assets; ROA 0.94%, cost ratio 93.6%, GNPA 3.6%. FY 2025–26: not available; external reports point to a 7.3% cost of funds against about 5.3% for the banking system	Mixed: strong capital and funding, weakening earnings and asset quality; FY 2025–26 outlook unconfirmed

The scorecard shows that SFBs do well on reach and depth. Whether their inclusion lasts depends on resilience, and that has weakened in the latest year.

5.7 Growth accounting: extensive versus intensive sources

About two-thirds of deposit growth since FY 2021–22 has come from more business per office, not from more offices. The decomposition writes ln(Y) = ln(offices) + ln(Y per office), so the two components' shares of log growth add up to 100%.

Table 7: Sources of growth, share of log growth (%)

Period	Deposit growth (%)	From more offices	From higher deposits per office	Advance growth (%)	From more offices	From higher advances per office
FY 2017–18 to FY 2019–20	211.6	83.5	16.5	93.7	143.5	−43.5
FY 2019–20 to FY 2021–22	81.3	46.7	53.3	52.6	65.7	34.3
FY 2021–22 to FY 2024–25	110.9	34.0	66.0	97.1	37.4	62.6
FY 2024–25 to FY 2025–26 (E)	25.7	26.9	73.1	20.5	33.0	67.0
FY 2017–18 to FY 2024–25	1,091.5	59.7	40.3	482.7	84.0	16.0

In the early period, offices explained 83.5% of deposit growth and more than all of advance growth (143.5%), because advances per office fell as offices were opened. From FY 2021–22 to FY 2024–25, offices explained only 34.0% of deposit growth and 37.4% of advance growth. On the FY 2025–26 estimate, business per office would explain about 73% and 67%. This puts numbers on P3: the sector now grows mainly by deepening its existing offices. That helps absorb costs, but it also means that reaching new locations is no longer the main driver of expansion.

5.8 Profit sensitivity and break-even

The FY 2024–25 profit decline comes down to the cost ratio, and the margin of safety is thin. If the cost ratio had stayed at its FY 2023–24 level of 86.3%, FY 2024–25 net profit would have been about ₹7,428 crore, not ₹3,496 crore

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Table 8: Sensitivity of FY 2024–25 profitability

Measure	Value
Net profit at the FY 2023–24 cost ratio (₹ crore)	7,428 (actual 3,496; gap 3,932)
Profit effect of a 1 percentage point change in the cost ratio (₹ crore)	542 (15.5% of FY 2024–25 profit)
ROA effect of a 1 percentage point change in the cost ratio (pp)	0.15
Fall in income that would eliminate profit at FY 2024–25 expenditure (%)	6.4
Income growth needed to hold FY 2023–24 profit at actual expenditure (%)	25.4 (actual 19.4)
Expenditure growth consistent with holding FY 2023–24 profit at actual income (%)	22.5 (actual 29.5)
Profit decline as a share of average FY 2024–25 advances (%)	1.09

A 6.4% fall in income, with expenditure unchanged, would wipe out sector profit. Each percentage point on the cost ratio is worth ₹542 crore, or 15.5% of FY 2024–25 profit. Expenditure grew 7 percentage points faster than the rate that would have preserved FY 2023–24 profit. If the whole ₹2,723 crore profit decline came from higher provisions, credit cost would have risen by about 1.1% of average advances. The RBI attributes the weaker profit mainly to provisions, so this is a plausible order of magnitude, not an estimate. Sector profit is highly sensitive to credit cost and funding cost, so watching asset quality and the cost of funds matters more for sustainability than further balance-sheet growth.

5.9 Econometric analysis

The models confirm that growth is slowing and that deposit growth is tied to the network. They find no stable link between deposit growth and credit growth once the start-up years are set aside. All estimates use published data for FY 2017–18 to FY 2024–25 (n = 8, or 7 for growth-rate models) and are exploratory. Full regression results are in Table 2 (Panels B–C), Table 3 (Panels C–D) and Table 4 (Panel B).

5.9.1 Curvature and structural break (P1)

The quadratic term is negative for all four series. It is significant at 5% for deposits, assets and offices and at 10% for advances. Trend growth of deposits falls from 58.3% to 27.3% after FY 2020–21, and that of offices from 41.3% to 7.9%. The break in advances is not significant ($p = 0.16$), so the slowdown is concentrated in deposits and the network. The break date was fixed in advance at the pandemic year. The quadratic model also overstates the slowdown at the end of the sample, implying deposit growth of 17.3% in FY 2024–25 against 25.7% observed, which is why it forecasts poorly in Section 5.9.4.

5.9.2 Growth convergence (P1)

All the coefficients are negative: the bigger the sector, the slower its growth. Convergence is fastest for offices ($\beta = -0.42$) and slowest for advances and assets (about −0.09). This supports P1 and the finding that the network has matured faster than the balance sheet. Because the series trend, β partly reflects the early high-growth years and should not be read as a structural law.

5.9.3 Funding linkage, error correction and network productivity (P2, P3)

Three results matter. First, the apparent link between credit growth and deposit growth (slope 0.38, $R^2 = 0.86$) comes from a single early year, FY 2018–19. Without it the slope falls to 0.30 and is not significant, and credit grows at an underlying 14% log-rate whatever deposits do. Advances therefore have a growth component of their own that is not funded year by year from new deposits, which fits with continued use of borrowings and the equity base. Second, there is no evidence of error correction: the adjustment coefficient is −0.05 and statistically zero. With eight observations, though, the Engle–Granger test has very low power, so this is inconclusive. Third, deposit growth is closely tied to network growth (elasticity 0.83), while credit (0.32) and assets (0.23) are much less so. That fits with offices being the main way banks gather deposits.

Deposits per office grow 15.6% a year, speeding up from 9.6% to 17.4% after FY 2019–20. Advances and assets per office fall about 14–15% a year before the kink and then rise about 13% a year, which confirms the U-shape in Table 2. The kink date was chosen after seeing the U-shape, so these t-statistics describe the break and are not formal tests. The HAC t-statistics are more reliable.

5.9.4 Forecast backtest and the FY 2025–26 estimate

Table 9: One-year-ahead forecast accuracy, targets FY 2021–22 to FY 2024–25 (MAPE, %)

Method	Deposits	Advances	Total assets	Average
Mean of last two growth rates	2.94	3.21	2.18	2.78
Carry forward last growth rate (the FY 2025–26 estimate rule)	4.07	3.41	3.55	3.68
Rolling 4-year log-linear trend	11.67	5.38	3.80	6.95
Expanding log-quadratic trend	21.23	10.72	5.59	12.51
Expanding log-linear trend	28.60	6.56	7.79	14.3

In this short backtest, with only four forecast years, simple growth-persistence rules forecast about four to five times better than trend regressions. Four test points are too few for a formal test of accuracy, though. The trend models fit well in sample (R^2 above 0.96) but forecast with a bias, because the start-up years pull the fitted slope above current growth (log-linear) or the curvature below it (log-quadratic). This supports the carry-forward rule used for the FY 2025–26 estimate. The rule did over-forecast FY 2024–25 deposits by 4.3% and advances by 5.5%, so it tends to overshoot when growth is slowing.

The backtest errors give an empirical range for the FY 2025–26 estimate: ₹3,71,216 to ₹4,08,300 crore for deposits, ₹3,11,223 to ₹3,48,556 crore for advances and ₹4,68,647 to ₹5,20,387 crore for total assets. Scenario B (Table 10) lies inside all three ranges, and Scenario A sits in the upper half of the deposit range. Scenarios C and D fall below the deposit range, so they are less likely. The mean of the last two growth rates, the best-performing rule, gives higher values (deposits ₹4,04,907 crore, advances ₹3,37,235 crore, assets ₹4,99,173 crore), so Scenario A is not an upward-biased central estimate. Independent projections also fall inside the ranges: CARE Ratings' March 2026 projections (deposits ₹3,77,765 crore, advances ₹3,23,659 crore) and Crisil's expected 16–17% advances growth (about ₹3.16–3.19 lakh crore). The upper end of the range is best treated as a ceiling.

5.9.5 Summary of the econometric evidence

Proposition	Econometric evidence	Strength
P1: growth matures	Negative curvature in all four series; deposit trend growth 58.3% to 27.3% after FY 2020–21; negative convergence coefficients	Supported (deposits, assets, offices); weaker for advances
P2: funding transition	Credit growth is not significantly tied to deposit growth once FY 2018–19 is excluded; no error correction; slope below one	Consistent, but low-power tests
P3: intensive growth	Deposits per office grow 15.6% a year and accelerate after FY 2019–20; advances per office show a U-shape	Supported
Forecasting	In a four-year backtest, growth-persistence rules beat trend models	Suggestive (four test years)

The main limitation is sample size. With eight annual observations, sector-level models cannot support errors-in-variables, dynamic-panel or unit-root testing.

6. ROBUSTNESS AND SENSITIVITY

6.1 Sensitivity of the FY 2025–26 estimates

The FY 2025–26 financial figures are estimates, so the conclusions should not depend on a single growth assumption. Four scenarios are examined: FY 2024–25 growth rates continue (A, used in the main tables), growth slows moderately (B), growth slows more sharply (C) and growth is low (D). Two outside benchmarks help to place them. Crisil Ratings expected sector advances to grow 16–17% in FY 2025–26 (Crisil Ratings, 2025), which is close to the 17% in Scenario B. CARE Ratings projected March 2026 deposits of ₹3,77,765 crore and advances of ₹3,23,659 crore (CARE Ratings, 2025). Its deposit projection is within 0.2% of Scenario B, and its advances projection lies between Scenarios A and B. CARE's FY 2021–22 to FY 2024–25 figures agree with the RBI series to within 0.1%, so the two are comparable. Crisil's coverage differs (it reports 13% advances growth for FY 2024–25 against 20.5% here), so only its growth expectation is used. These are illustrative sensitivities, not forecasts.

Table 10: FY 2025–26 scenario analysis (₹ crore unless stated)

Item	A: continuation (25.7 / 20.5 / 20.9%)	B: moderate (20 / 17 / 17%)	C: strong fade (15 / 14 / 14%)	D: low (10 / 10 / 10%)
Deposits	3,96,459	3,78,481	3,62,711	3,46,941
Advances	3,28,340	3,18,803	3,10,628	2,99,729
Total assets	4,90,205	4,74,392	4,62,228	4,46,009
CD ratio (%)	82.8	84.2	85.6	86.4
Incremental CD ratio (%)	68.9	73.4	80.6	86.4
Deposits / assets (%)	80.9	79.8	78.5	77.8
Deposits per office (₹ crore)	48.7	46.5	44.6	42.7
Advances per office (₹ crore)	40.4	39.2	38.2	36.9
Deposits CAGR, FY 2017–18 to FY 2025–26 (%)	40.3	39.4	38.7	37.9
Advances CAGR, FY 2017–18 to FY 2025–26 (%)	27.6	27.1	26.7	26.1
Assets CAGR, FY 2017–18 to FY 2025–26 (%)	27.6	27.0	26.6	26.1
Deposits CAGR, FY 2016–17 to FY 2025–26 (%)	62.7	61.9	61.1	60.3
Advances CAGR, FY 2016–17 to FY 2025–26 (%)	39.1	38.7	38.3	37.7
Assets CAGR, FY 2016–17 to FY 2025–26 (%)	37.7	37.2	36.8	36.2

Growth rates in each column are for deposits, advances and assets respectively.

Three conclusions follow. First, the nine-year CAGRs move by less than 2.5 percentage points across scenarios because the start-up base dominates, so the estimate adds little to the growth findings. Second, the CD ratio stays between 82.8% and 86.4%, and the deposit share of assets between 77.8% and 80.9%, in every scenario, so the finding that deposits now fund the sector holds up. Third, the scenarios differ most in the incremental CD ratio (68.9% to 86.4%) and in deposits per office (₹42.7 to ₹48.7 crore). These are the first indicators to check when the RBI publishes FY 2025–26 data.

6.2 Base-year and window sensitivity

Table 3 (Panel B) shows that deposit CAGR ranges from 68.0% to 28.2% depending on the window. Any claim of rapid growth should therefore state its window, and comparisons with other studies should use matched windows.

6.3 Arithmetic and consistency checks

The credit–deposit ratios recomputed from the underlying series match the RBI-reported 90.1% (FY 2023–24) and 86.4% (FY 2024–25). Total income less total expenditure reproduces reported net profit exactly for FY 2022–23 to FY 2024–25. For FY 2021–22 it differs by ₹7 crore (₹980 crore computed against ₹973 crore reported). That is immaterial to the results but should be reconciled with the source table.

7. DISCUSSION

7.1 What the evidence says about sustainable inclusion

The results describe a sector that has finished a formation phase and entered a maturation phase. The formation phase (FY 2016–17 to FY 2019–20) was driven by new entrants, conversions and rapid office openings. In the maturation phase, from FY 2020–21, advances and assets grow in the mid-twenties while deposits and business per office keep building.

For inclusion, the central tension is between depth and resilience. Depth indicators are strong and improving, and capital and funding are strong, but margins have narrowed, costs are outgrowing income and asset quality has weakened. A sector whose profit falls 43.8% while income still grows almost 20% has little room to absorb a

more severe shock without cutting lending to its most vulnerable borrowers.

7.2 Theoretical implications

The findings support a life-cycle view of these banks. The change in funding (P2) and the shift from adding offices to deepening them (P3) are what a start-up banking model would produce. P4 shows that maturity does not remove the structural cost of serving small, high-touch customers. The results are consistent with studies that identify the cost of funds and operating cost as binding constraints on SFB performance (Arora and Arora, 2025). They also argue against using asset or deposit size alone as a measure of how much a bank contributes to inclusion.

7.3 Implications for banks

Manage the cost of funds. With term deposits at 73.9% of deposits, deposit growth is a mixed blessing unless it is matched by low-cost current and savings balances.

Treat provisioning as an early signal. Provisions drove the FY 2024–25 profit decline, so banks need early-warning systems at portfolio level, especially for unsecured small-ticket lending.

Use productivity per office to pay for reach. Higher business per office gives banks room to expand into thinner, underserved locations, as long as cost-to-serve is monitored.

Invest in digital and literacy support. Whether customers use accounts and loans actively and with understanding decides whether lending leads to over-indebtedness or to productive investment (Klapper et al., 2022).

7.4 Implications for regulators and policy

Move from size-based to outcome-based monitoring, using active-account ratios, the rural and semi-urban share of credit, women borrowers, average ticket size and loan-to-income indicators.

Watch the cost–income and provisioning cycle, with detailed disclosure of interest expense, operating expense and provisions.

Track the incremental credit–deposit ratio, which shows shifts in funding earlier than the stock ratio does, as FY 2022–23 shows.

Encourage reach into underserved districts, with targeted incentives if office growth stays low.

8. CONCLUSION AND LIMITATIONS

Small Finance Banks have grown from a handful of newly licensed institutions into a sector with ₹4.05 lakh crore of assets, ₹3.15 lakh crore of deposits and over 7,600 functioning offices at the end of FY 2024–25, and 8,133 offices by March 2026. On the FY 2025–26 estimate, assets would reach about ₹4.9 lakh crore and deposits about ₹3.96 lakh crore, with the credit–deposit ratio near 83%. Growth has slowed but remains high, funding has shifted decisively to deposits, and each office now handles more than three times the deposits it did at the start.

Whether this growth lasts, however, depends on resilience, and the latest data show resilience weakening. ROA fell from 2.06% to 0.94%, the cost ratio rose to 93.6% and gross NPAs rose to 3.6%, even though capital stayed strong. The paper concludes that SFBs have strengthened India's financial-inclusion framework, but that their ability to keep playing that role depends on cost-to-serve, credit-risk management and outcome-based oversight, not on further scale alone.

Limitations. The analysis is at sector level, so it cannot capture differences across banks, regions or customer groups, and the number of institutions changed through entry, mergers and reclassification. Profitability data cover four years, expenditure components are not separated, GNPA is available only for the latest year, and outcomes for individual customers are not observed. The comparison with scheduled commercial banks covers only two years. With nine to ten observations, the estimates are descriptive. FY 2025–26 deposits, advances and total assets are estimates to be replaced with published RBI figures, and FY 2025–26 profitability and asset quality are not estimated. Any change in sector coverage, such as the reported move of AU Small Finance Bank to a universal bank, would break comparability. Several early-year figures still need to be checked against the original tables.

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