EVOLVING LANDSCAPE OF SUPPLY CHAIN FINANCING IN INDIA: AN OPPORTUNITY FOR MSME FIRMS

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Abstract

In India, MSMEs are regarded as engines of growth and employment. But they are plagued by a set of constraints, availability of finance is one of them. This brief article explores the evolving landscape of supply chain finance and discusses its potential for removing the financial challenges of MSMEs, particularly, in respect to working capital. The article describes the different phases of supply chain financing, gains from evolving products and finally puts suggests scope for further studies.

Introduction

Across the world, the Micro, Small & Medium Enterprises (MSMEs) are known for their potential to contribute to GDP, generate employment and help in broad basing economic development. The incremental employment comes with a low investment in capital. This fact has a lot of relevance for those economies that are characterized by surplus labour, paucity of capital and problems associated with unemployment (Patel, Sharma, & Gupta, 2020). Past research also indicates that MSME firms add to the flexibility of the industrial structure, promote economic dynamism, and can become seats of innovation (Acs & Audretsch, 1990).

The Government of India (GOI) recognizes MSMEs as the "backbone of the Indian economy" (GOI, 2026). Highlights of the MSME space in India is presented in Table 1. It is evident that the Indian MSMEs considerably to the economy. Despite their importance, these firms continue to operate under multiple constraints, access to finance being one of them (Rao, Kumar, & Madhavan, 2019). Weaker bargaining power vis-à-vis large customers results in delays in realizing receivables. The resultant pressure on cashflow compels MSME firms to hold on to thin inventories and hence to miss out on opportunities for incremental business. Chronic working capital shortages pose an existential threat for these firms (Athaide & Pradhan, 2020).[1]

MSMEs in India generally miss out on harnessing the power of leverage as access to debt capital is often scarce. Information opacity surrounding these firms give rise to the problems of adverse selection and moral hazard. Hence, institutional lenders perceive MSMEs to be 'too risky to lend'. Therefore, the price of debt is high. Further, to mitigate the credit risk faced by the institutional lenders resort to security-based lending. Consequently, institutional debt is collateral-heavy.

Table 1 MSME Data for India

Number of MSME enterprises	7.47 crores
Employment generation	32.82 crores persons
Share in country's manufacturing	35.4%
Share in country's GDP	31.1%
Share in country's exports	48.58%
Source: (GOI, 2026)	

This short article explores how the emerging developments in supply chain financing (SCF) in India is trying to ease the pressure on working capital constraints of Indian MSME firms. The scope of the discussion is limited to domestic business only. Further, this article does not intend to expound on SCF solutions. Also, the article does not propose to focus on legal, actuarial, technical and governance issues impacting SCF.

[1] The operating cycle of many small firms can often become too high, primarily because of long debtors' cycle. The first strategy to overcome this problem is finding ways to increase the payables cycle. But this strategy leads to a shock in the backward channel of MSME firms leading to discontent among its suppliers. There is often an attempt to ease the pressure on working capital by using internal sources of funds as institutional debt is often scarce. However, for small firms, paucity of equity is also a chronic issue (Athaide & Pradhan, 2020).

SCF: What it signifies?

SCF encompasses a set of structured short-term financing solutions, provided by financial intermediaries with an eye on easing the pressure on working capital.[2] The goal is to align cashflows with the physical flow of goods and services and restore optimality in operations of firms. A generic SCF arrangement has three core participants (Figure 1). Some customized SCF arrangements may have more participants according to the need. The three core participants are:

a. Anchors: Buyers/sellers who are essentially large and reputed companies, with an acceptable credit history.
b. Counterparties: Sellers/buyers who are smaller entities (the MSME firms)
c. Financiers: Banks and non-banking financial companies (NBFCs)

SCF is typically an anchor-centric arrangement. The financier either finances the inventories that an MSME purchases from the anchor or finances receivables of a MSME counterparty for the supplies it has made to an anchor. Financing decisions are taken based on the credit history, credit rating and reputation of the anchors and not of the smaller counterparties (MSME firms). Thus, the problems associated with the information opacity of MSMEs are eliminated. And financial support flows to these small firms. In certain cases, it is the anchor that helps the financial intermediaries cherry-pick the counterparties. The arrangements are light on collateral requirement and focuses largely on transactional information like invoices, purchase orders, good receipt notes, etc. These features of SCF solutions ease credit decision of the financiers and lowers the transaction cost of loans made by them. Together, the financier gets access to a set of diversified set of assets that reduces their credit risk. Hence, the risk-premium associated with SCF products are low, when compared with plain vanilla credit products like overdraft, cash credit, working capital demand loans, etc. SCF, therefore, represents a win-win situation for all the three core participants.

[2] Some variants of SCF (e.g. Forfaiting) do include long-term financing solutions. However, in this article, we concentrate on the short-term financing solutions.

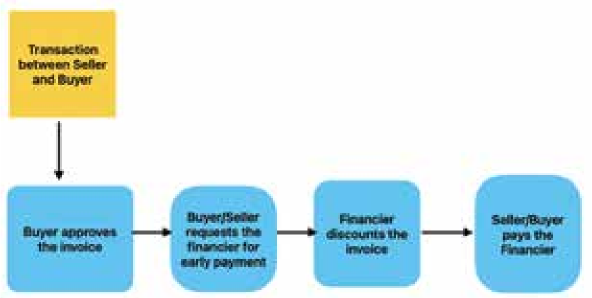

Figure 1 SCF: Schematic Diagram of SCF

Evolution of SCF in India

In the last few decades, the SCF mechanism in India has been continuously evolving. Banking sector reforms in the 1990s, deepening and adoption of information technology (e.g. enterprise resource planning, core banking solutions, etc.) and the emergence of NBFCs and FinTech companies have lent momentum to this evolutionary process. This section briefly outlines the trajectory of this evolution.

Early phase (pre- 1990s)

In the late 1980s and early 1990s, simple and traditional SCF solutions like bill discounting and inland letters of credit were prevalent. These were mostly offered by commercial banks. The arrangements were generally over-the-counter contracts between the banks and the MSME borrowers. Banks' credit decisions were largely discretionary - based on their assessment of the borrowers' business and financial health. The facilities often attracted high risk-premium and collateral requirements.

Intermediate Phase (1990 – 2010)

The intermediate phase was marked by the advent of channel financing and factoring services which complemented the solutions prevalent in the early phase. These new services offered structured solutions to cater to the business needs of anchors who were from different sectors of the economy.

The Kalyanasundaram Committee Report (1989) submitted to the Reserve Bank of India (RBI) laid the foundation of factoring services in the country (RBI, 2013). Only subsidiaries of scheduled commercial banks were allowed to provide these services.[3] Much later, with the passing of the Factoring Regulation Act, 2011, the services came to be guided by the directives of RBI. Further, the amendments to the Act in 2021 paved the way for both banks and NBFCs to provide factoring services.

Channel financing (both upstream and downstream) became popular in the 1990s. In its initial phase, the financiers were foreign banks operating in India and select Indian banks, mostly those from the private sector. Manufacturers in the iron and steel industries, automobiles, auto ancillaries, fast moving consumer goods, etc. quickly realized the gains from this solution. This financing arrangement reduced the friction between the large manufacturers and their vendors (and/or dealers) by easing the cashflow of the latter. After 2010-11, NBFCs also started providing channel financing services.

Current Phase (2011 – present)

Since 2011, the SCF landscape in India oversaw a significant paradigm shift when information technology made inroads into the space. The objective was to shorten receivables cycles through 'a multi-financier receivables financing platform' (RBI, 2013). This phase also marked the entry of the FinTech firms in SCF. It was expected that competition among financiers in this multi-financier setup would lower the cost of funds for MSMEs.

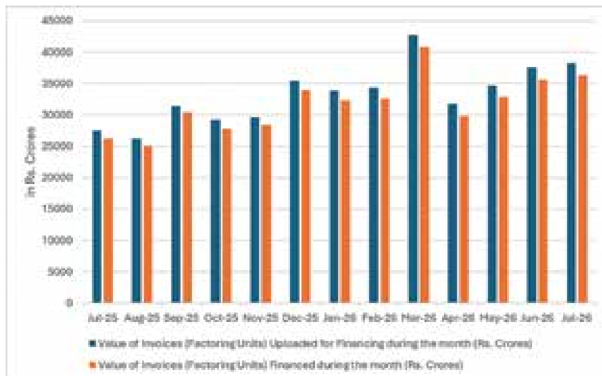

Figure 2 TReDS Statistics: July 2025-July 2026

The most recent development in the SCF landscape in India is Trade Receivables Discounting

[3] In 1991, SBI Factors and Commercials Limited (subsidiary of State Bank of India) and Canbank Factors (subsidiary of Canara Bank) were set up.

System (TReDS) in 2014. It is a system for securitization of receivables of MSME firms. In 2016, the Receivables Exchange of India Limited (RXIL) was set up as a digital platform where firms can auction their anchor-specific receivables. Many other platforms – KredX®, InvoiceMart®, etc. have since emerged. In each platform, invoices (factoring units) that are accepted by large buyers attract alternative discounting rates from several financiers participating in the platform. The best quote is selected by a small firm who registers on this platform. Once a contract between a firm (seller) and the financier is made, the settlement is made within 24-48 hours. In effect, TReDS represents a platform where financiers buy receivables of MSME firms through a competitive bidding process. The claims of the financiers are settled by payments received from the anchors. Since July 2025, the settlements have increased at a crate of 2.70% per month (Figure 2). On an average, about 95% of the factoring units uploaded have been financed by the financiers[4].Some researchers have found due to the adoption of TReDS, the interest cost of MSMEs has reduced (Sanati, Ramakrishnan, & Kakarlapudi, 2026). This has led to improved financial performance of these firms (Marak & Pillai, 2026). To this extent TReDS has largely achieved its objective of removing financial challenges facing small firms in India.

Closing thoughts

Over the last three and half decades, the SCF landscape in India has transformed – from being isolated products offered by banks to an integrated system where multitude of financial intermediaries offer a plethora of structured solutions. The transactional nature of the SCF products has lowered the cost of monitoring for financiers. This has addressed of the crucial issue of removing barriers to MSME financing. However, given the largeness of the MSME space in India, it needs to be ascertained as to what percentage of the MSME firms have been able to take advantage of SCF. We may assume that smaller firms are generally unaware of the SCF solutions and has been left out. Further, the system is gradually becoming heavy in technology adoption. Consequently, it is imperative for MSMEs to overcome its inherent technological barriers. These issues may be taken up for future research and consequent rethinking and reengineering of the SCF solutions. MA

[4] There may have been cases where the factoring unit is up-loaded in a particular month, but settlement has taken place in the subsequent month(s). From the data available it is difficult to identify such cases and make necessary adjustments.

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