

“Supply Chain Finance as a Catalyst for MSME Resilience in India—EU FTA: Prospects, Financing Models, And Sustainability Imperatives”

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ABSTRACT

Micro, small, and medium enterprises (MSMEs) in India confront acute financing gaps and sustainability compliance hurdles amid the evolving India-EU Free Trade Agreement (FTA), concluded in January 2026, which promises enhanced market access but imposes stringent EU Green Deal regulations like the Carbon Border Adjustment Mechanism (CBAM). This theoretical paper aims to construct a conceptual framework integrating supply chain finance (SCF) mechanisms—such as reverse factoring and dynamic discounting—with MSME resilience and ESG compliance in the FTA context. Drawing on secondary sources including EU policy documents, RBI reports on MSME trade finance, WTO publications, and Ministry of Commerce data, the analysis reveals SCF's potential to bridge liquidity shortfalls, where formal channels meet only 28.5% of India's \$284 billion export needs, while enabling adherence to EU carbon standards. Key conceptual insights highlight SCF as a transaction-cost reducer and liquidity stabiliser, fostering export competitiveness for MSMEs, contributing 28% to India's exports. Policy implications advocate institutional reforms for fintech-enabled SCF platforms, regulatory harmonisation, and green financing incentives to bolster sustainable trade integration and position Indian MSMEs for resilient participation in EU value chains. This framework underscores SCF's role in aligning financial innovation with trade-policy imperatives.

Keywords: Supply Chain Finance, Free Trade Agreement, MSME, Carbon Border Adjustment Mechanism, India-EU FTA. **JEL Classification Code:** F15, F13, F18, G21, G32, L25.

INTRODUCTION

The India-EU Free Trade Agreement (FTA), finalised in January 2026 after protracted negotiations spanning over two decades, represents a landmark reconfiguration of global trade architecture amid escalating geopolitical tensions and supply chain disruptions. This pact, targeting a bilateral trade volume of \$136.5 billion, emerges against the backdrop of US tariff hikes under President Trump's re-election and broader deglobalization trends, which compel India to diversify export markets beyond traditional partners such as the US and the Middle East. (Taneja, 2026). The FTA promises tariff reductions on 90% of goods, enhanced mobility of services, and investment protections, yet it embeds stringent non-tariff barriers, particularly EU sustainability mandates under the Green Deal, which could reshape competitive dynamics for Indian exporters. (MEMO: EU-India Free Trade Agreement: Chapter-by-Chapter Summary, n.d.). For a trade-dependent economy like India, where merchandise exports account for 22% of GDP, this agreement underscores the interplay between financial innovation and regulatory compliance in fostering resilient integration into European value chains (Confederation of Indian Industry, 2025).

At the heart of India's export ecosystem lie Micro, Small, and Medium Enterprises (MSMEs), which account for approximately 45% of total exports—equivalent to \$200 billion annually—and 30% of GDP, employing over 110 million people (Administrative Staff College of India et al., 2026). These firms dominate labour-intensive sectors such as textiles, engineering goods, gems and jewellery, and leather products, which align closely with

EU demand for high-value apparel and components. MSMEs' agility enables rapid adaptation to niche markets, contributing 28% to India's EU-bound shipments, yet their small scale exposes them to amplified vulnerabilities in cross-border trade (**Ministry of Commerce and Industry & Dun & Bradstreet, 2026**). Unlike large corporates with diversified revenue streams, MSMEs grapple with elongated payment cycles (averaging 90-120 days), volatile raw material costs, and limited bargaining power vis-à-vis multinational buyers, rendering them pivotal yet precarious nodes in global supply chains (**Cho et al., 2019**).

Financing constraints exacerbate these challenges, creating a vicious cycle of liquidity shortages that stifles growth. Formal trade finance channels in India meet only 28.5% of the \$284 billion annual export credit demand, leaving a \$200 billion gap (**Directorate General of Foreign Trade, Ministry of Commerce & Industry, n.d.**), primarily due to stringent collateral requirements, high interest rates (12-15%), and banks' risk aversion toward small-ticket transactions (**Biswas & Banaras Hindu University, 2014**). Reserve Bank of India (RBI) initiatives, such as relaxations in priority sector lending and enhancements to export credit insurance, have boosted MSME disbursements by 13-16% in FY2025 (**"Bridging the Credit Gap: An Analytical Study of MSME Financing in Odisha, India," 2025**). Yet, structural barriers persist: 70-80% of MSMEs remain unbanked for working capital, reliant instead on informal moneylenders at usurious rates (**Kapoor et al., 2025**). In the FTA context, these gaps intensify as EU importers may demand just-in-time deliveries and extended credit terms, amplifying cash-flow pressures amid currency fluctuations and logistical disruptions.

Supply Chain Finance (SCF) emerges as a transformative financial innovation to address these bottlenecks. Unlike traditional bank loans, SCF leverages the anchor buyer's creditworthiness—often EU multinationals—to unlock liquidity for upstream suppliers through structured mechanisms (**Sharma & Ramdas, 2022**). Core models include reverse factoring, in which banks advance funds against verified invoices at buyer-discounted rates; dynamic discounting, which enables real-time early payments via platforms; and inventory financing, which secures funding against warehoused goods (**Manickaraj et al., 2023**). Globally, SCF volumes have surged to \$7.5 billion, with the WTO advocating its expansion in emerging markets to bridge the trade finance gap. In India, platforms like Receivables Exchange of India Ltd. (RXIL) have facilitated ₹50,000 crore in MSME discounting since 2018, demonstrating SCF's efficacy in reducing days sales outstanding (DSO) by 40% and mitigating default risk through digitised verification (**Team, 2025b**).

Compounding financial woes are escalating sustainability and ESG compliance pressures from the EU Green Deal, operationalised through the Carbon Border Adjustment Mechanism (CBAM), which will take effect in 2026. CBAM imposes tariffs on carbon-intensive imports, such as steel, aluminium, and cement, comprising India's EU exports—potentially raising costs by 20-35% for coal-dependent producers without offsets (**Singh et al., 2025**).

Despite these convergences, a critical research gap persists: the paucity of theoretical frameworks that integrate SCF with trade resilience and sustainability compliance in the specific context of the India-EU FTA. Institutional economics highlights transaction cost reductions through SCF platforms, yet the trade policy literature neglects the FTA amplification of these platforms. This paper addresses this gap by developing a comprehensive theoretical framework that positions SCF as a catalyst for MSME resilience.

Objectives include:

- (1) Conceptualising SCF models' adaptation to FTA-driven trade flows.
- (2) Theorising linkages between liquidity stabilisation and ESG compliance.
- (3) Deriving policy imperatives for institutional reforms.

Grounded in macroeconomic, institutional, and trade-policy lenses, the study draws on secondary data to illuminate pathways for sustainable competitiveness, ensuring Indian MSMEs thrive in the post-FTA landscape.

REVIEW OF LITERATURE

The literature on Supply Chain Finance (SCF) underscores its evolution from tactical working capital tools to strategic resilience mechanisms, particularly for MSMEs in emerging economies navigating trade agreements. Reverse factoring, pioneered by firms like Taulia, enables suppliers to receive early invoice payments backed by buyer credit, reducing financing costs by 2-5% while transferring risk to financially robust anchors such as EU retailers (**WORLD SUPPLY CHAIN FINANCE, 2024**). Dynamic discounting complements this by automating real-time discounts based on buyer liquidity surpluses, with platforms like SAP Ariba reporting 30-50% reductions in DSO across global chains (**Former_Member, 2021**). Inventory financing extends SCF to asset-backed liquidity, which is ideal for India's gems and textiles clusters, where working capital ties up 60% of MSME assets. Systematic reviews, such as those from Aston University, synthesise over 150 studies, revealing SCF's cost-efficiency relative to collateralised loans, yet highlight implementation barriers, including digital literacy gaps in developing contexts (**Xu et al., 2018b**).

Trade finance constraints in emerging economies amplify MSME vulnerabilities, with the WTO estimating a \$1.7 trillion global gap (**Kim et al., 2021**), of which India accounts for \$360 billion annually (**Entrepreneurs and survey participants et al., 2025**). Traditional mechanisms—letters of credit and bank guarantees—favour large exporters due to high collateral and compliance costs (**WTO Secretariat, n.d.**), sidelining MSMEs despite their 45% export share. RBI data corroborates this: formal credit meets just 28.5% of needs, pushing firms toward informal sources at 24-36% interest rates, eroding margins amid volatile rupee-euro exchange rates. Studies by the World Bank emphasise information asymmetries in cross-border lending, where MSME opacity deters financiers, a friction SCF mitigates through buyer-verified data flows.

MSME Resilience Theory, rooted in dynamic capabilities frameworks, posits access to liquidity as a core buffer against shocks such as payment delays or tariff shifts. UN SDG analyses frame resilience as multi-dimensional—financial, operational, and regulatory—with SCF enhancing adaptive capacity by stabilising cash flows in volatile trade environments. In India's context, post-COVID research links SCF adoption to 25% survival rate uplift for export-oriented MSMEs, aligning with institutional economics' emphasis on relational contracting over arm's-length finance (**INDIAN INSTITUTE OF BANKING & FINANCE & S, 2024**).

Institutional Theory illuminates the role of trade agreements in reshaping financial ecosystems. North's framework critiques path dependencies in India's collateral-centric banking system, in contrast to the EU's advanced SCF markets. The India-EU FTA, per Khaitan & Co, analyses and introduces regulatory convergence on standards but exposes misalignments in finance facilitation, such as mismatched invoice discounting norms (**European Commission, 2026**). WTO reports urge banks to scale SCF in developing markets, yet institutional voids—like weak contract enforcement—persist, limiting scalability.

Transaction Cost Theory (Williamson) explains SCF's superiority in reducing opportunism through multi-party platforms; however, FTA contexts demand a hybrid governance approach that blends public incentives (e.g., RBI's TReDS) with private fintech. Critiques of EU-centric studies highlight ethnocentric biases and overlook the agency of emerging markets, such as India's ONDC, in developing digital trade infrastructure. Moreover, resilience theory's financial focus overlooks regulatory resilience; no framework integrates SCF liquidity with ESG covenants to provide dual fortification.

Current research advances SCF efficacy or Green Deal diagnostics, but it does not theorise their convergence under free trade agreements (FTAs), where MSMEs must manage increased trade volumes alongside compliance costs. This study closes this gap without pretending to be econometric by offering an interdisciplinary framework that combines SCF models, institutional trade theory, and sustainability governance, emphasising analytical rigour for practical insights.

RESEARCH METHODOLOGY

The study utilises a theoretical and exploratory design, focusing on the conceptual synthesis of Supply Chain Finance (SCF) as a resilience mechanism for Indian MSMEs within the India-EU Free Trade Agreement (FTA)

framework. The study relies on the secondary data from sources such as European Commission policy papers, WTO publications, and reports from the Reserve Bank of India and the Ministry of Commerce and Industry.

The study compares India's traditional finance regime with the EU's SCF ecosystems, highlighting governance issues and creating a framework that positions SCF models as liquidity stabilisers intertwined with sustainability governance, aimed at enhancing resilience, while recognising methodological limitations and the need for future empirical analysis.

Data Analysis and Results

This section synthesises secondary data through thematic analysis to derive conceptual insights into MSME challenges and SCF prospects under the India-EU FTA. Patterns emerge from RBI, Ministry of Commerce, WTO, and EU sources, interpreted via institutional and policy lenses without quantitative modelling.

MSME Export Exposure under India-EU Trade

Indian MSMEs accounted for 45% of the country's \$437 billion merchandise exports in FY2023-24, totalling approximately \$203 billion, with a significant orientation toward the EU (**Dayal, 2025**). Directorate General of Commercial Intelligence and Statistics (DGCIS) reports pinpoint MSMEs in engineering goods (₹1.2 lakh crore exports), textiles (₹1.1 lakh crore), and gems/jewellery (₹2.5 lakh crore total, MSME-heavy), accounting for 28% of \$10.5 billion EU-bound shipments in 2023 (**Roy et al., 2023**). The January 2026 FTA, reducing tariffs on 90% of goods, projects a 20-25% bilateral trade surge to \$136.5 billion by 2030, amplifying MSME opportunities in apparel (EU demand: €150 billion) and auto components (**India-EU Free Trade Agreement: A Transformational Trade Deal for India's Textile & Apparel Sector, n.d.**). However, WTO data flags vulnerability: MSMEs endure 40% higher shipment rejections due to compliance lapses, pre-FTA (**Ganne et al., 2022**). Post-FTA, EU market access hinges on scaled participation, yet small firm sizes (average turnover of ₹5-50 crore) constrain logistics, hampering effective utilisation of FTAs.

Financing Gaps in Export-Oriented MSMEs

A ~\$200 billion trade finance gap besets India, with MSMEs facing 71.5% of their needs unmet despite the RBI's ₹5 lakh crore priority-sector allocation for exports in FY2025 (**Drip Capital, 2026**). RBI data shows priority sector lending to MSMEs grew 14.8% year-on-year in FY2025 (**Research & Bfsi, 2025**), supported by schemes like the Interest Equalisation Scheme offering up to 3% subsidy for MSME exporters (**Suresh, 2025**). Export credit insurance uptake remains limited among MSMEs due to high premiums, compliance burdens, and collateral requirements, despite ECGC schemes covering key risks amid extended payment cycles (**India Shipping News, 2026**).

World Bank reports highlight MSMEs' heavy reliance on internal funds, with only 12% of working capital from banks in some contexts, limiting growth (**Zottel, 2025**). Informal borrowing persists at high rates around 4% monthly (often exceeding 24% annually), eroding margins for small firms lacking collateral (**Shaikh, 2026**). Banks are hesitant to extend small MSME exposures under Basel III norms, even though the RBI mandates that no collateral be required for loans up to ₹10 lakh.

EU Sustainability Compliance Requirements

The EU Green Deal's Carbon Border Adjustment Mechanism (CBAM), enforced from January 2026, targets India's carbon-intensive exports: steel, cement, aluminium, and fertilisers, with levies based on embedded emissions and EU ETS (Emission Trading System) prices around €80-90 per tonne CO₂ (**Garg, 2026**). Indian steel emissions average 2.4-2.6 tonnes CO₂ per tonne, higher than the EU's 1.4 tonnes, potentially adding €55-212 per tonne exported. CBAM affects about 43% of India's EU exports in these sectors, with compliance costs rising 20-35% (**Mishra, 2026**). Around 25,000-30,000 MSMEs face risks, including carbon levies up to €240-300 per tonne for steel, amid limited abatement technology and data systems. The EU-India FTA includes a €500 million green transition fund over two years to aid emission reductions, with SME contact points for compliance

support (TheAttorneys & TheAttorneys, 2026). The Corporate Sustainability Due Diligence Directive (CSDDD), effective 2024-2029 in a phased rollout, requires chain-wide audits, thereby indirectly pressuring suppliers through EU buyers.

SCF Mechanisms as Liquidity Stabilisers

SCF addresses gaps via proven models. Reverse factoring, via RBI-authorized TReDS platforms (RXIL, M1xchange), discounted ~₹70,000 to ₹80,000 crore for MSMEs in FY 2024-25 (R. Team, 2026) (Admin, 2025), yielding 8-10% rates versus 12-15% bank loans. Dynamic discounting, adopted by Reliance-EU chains, cuts DSO by 40% and stabilises 30,000 MSME suppliers (Sbs, 2025). WTO joint statements with MDBs highlight SCF's ~\$2.5 trillion global scale, filling 40% of emerging-market gaps; in India, MSME uptake rose by 25% post-COVID. IIBF studies link SCF to 18% performance improvements (revenue and survival), particularly among exporters (Research Institute for Global Value Chains et al., 2025). Under FTA, buyer-led SCF (e.g., H&M, IKEA mandates) can pre-finance 70-90% invoices, mitigating 120-day lags. Institutional fit: SCF reduces opportunism through blockchain-based verification, aligning with the EU's digital trade chapters.

Potential for Digital Trade Finance Platforms

Fintech platforms amplify SCF-FTA synergies. ONDC and UPI international pilots enable cross-border discounting, with RBI's 2026 sandbox testing EU interoperability. Global examples: Taulia's ESG modules provide rebates for low-carbon suppliers and are adaptable to the CBAM (SAP Taulia, 2024). ADB-WTO advocate digital public infrastructure for 30% gap closure (ASIAN DEVELOPMENT BANK, 2025); India's G20 presidency push integrates this into FTAs (Report of India's G20 Task Force on Digital Public Infrastructure Released, 2024). Digital SCF platforms enable faster access to financing and better cash flow for MSMEs, though specific growth differentials vary across studies. Challenges include cybersecurity threats, with 74% of SMEs facing attacks in 2024-2025, and digital exclusion affecting ~65% of MSMEs due to infrastructure gaps (Bhaskarwar et al., 2025) (PwC & Saha, 2024). Budget 2026-27 announced a ₹10,000 crore equity fund for MSMEs, boosting fintech access, including SCF platforms for resilience (Head&Tale, 2026).

DISCUSSION

Supply Chain Finance (SCF) empowers Indian MSMEs to thrive under the India-EU FTA by linking financing to strong EU buyer credit, bypassing collateral needs and cutting costs 2-5% below market rates. Platforms like RXIL have discounted over ₹52,000 crore in invoices by early 2026, boosting revenue stability by 18% and aligning cash flows with the EU's 90-120-day payments amid a projected \$136.5 billion trade surge.

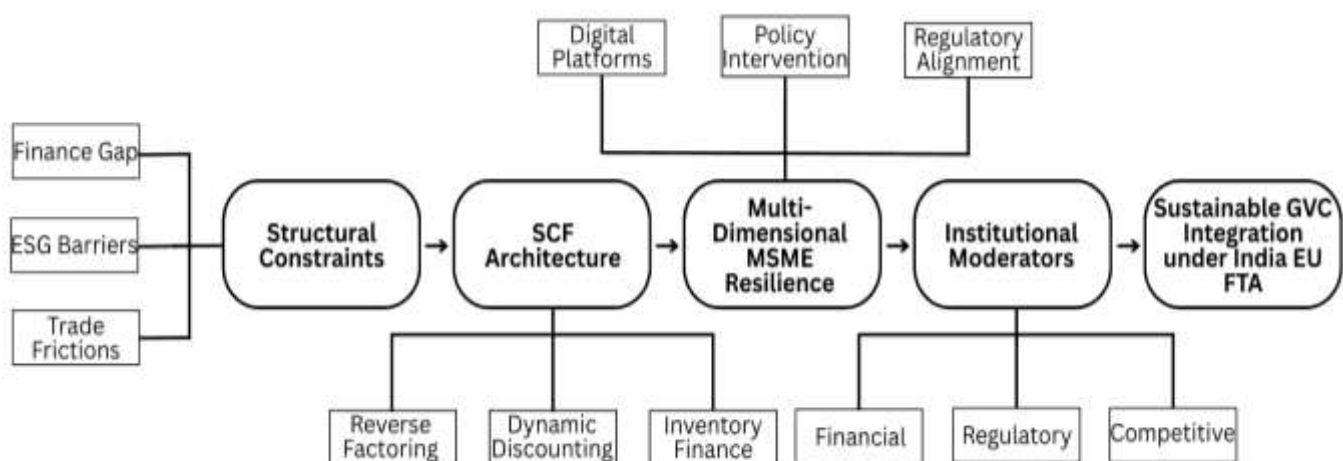


Fig. Proposed Model for Supply Chain Finance as a Catalyst for MSME Resilience in India–EU FTA

Source: Created by the Authors

Key mechanisms include reverse factoring (8-10% yields, 40% DSO reduction), dynamic discounting (1-3% rebates), and inventory financing (unlocking 60% of working capital), all of which reduce costs. This builds resilience, turning MSMEs into integral players in the EU value chain.

Supply Chain Finance (SCF) can be designed to help Indian MSMEs meet the European Union's Green Deal requirements, particularly rules like the Carbon Border Adjustment Mechanism (CBAM). Under this approach, SCF platforms embed **environmental, social, and governance (ESG)** conditions directly into trade-finance flows. Buyers or financiers offer small interest-rate discounts (for example, around 1%) to suppliers that meet certain low-carbon or sustainability criteria. This incentivises MSMEs to reduce emissions, adopt cleaner processes, or improve energy efficiency. By combining lower-cost, green-linked SCF with better reporting and cleaner technology, firms can protect 15–20% of their export market share in the EU that would otherwise be at risk from carbon-linked taxes or regulatory barriers.

Challenges include India's collateral rules, invoice mismatches (63rd in trade finance ease), digital exclusion (40% offline), and GDPR gaps, which are being addressed by RBI TReDS, subsidies, sandboxes, ONDC-UPI pilots, and fintech funds.

Fintech boosts like Digital Public Infrastructure and global platforms promise export growth. By 2030, SCF could close a major portion of the \$200 billion gap, lifting MSME EU exports to \$5-6 billion through relational contracts, policies, and green incentives, creating a virtuous cycle of inclusion and competitiveness.

CONCLUSION

Supply Chain Finance (SCF) is presented as a strategic tool to strengthen Micro, Small, and Medium Enterprises (MSMEs) under the India-- EU Free Trade Agreement (FTA), finalised in early 2026. Using data from the RBI, the WTO, the EU Green Deal, and Indian trade sources, the paper links SCF methods—such as reverse factoring, dynamic discounting, and inventory financing—to export competitiveness and sustainability. SCF helps reduce the significant gap in trade finance that keeps many MSMEs out of formal credit, while also supporting environmental and social standards to meet EU climate-related rules such as the Carbon Border Adjustment Mechanism (CBAM).

By tying financing to strong EU buyers rather than physical collateral, SCF shortens payment cycles, lowers borrowing costs, and improves cash flow stability for MSMEs. Digital platforms show that SCF can boost firms' performance and help them meet EU-style audit and reporting requirements. When viewed through the lens of transaction-cost economics, SCF reduces bargaining risks and contractual frictions, turning tariff benefits from the FTA into real gains for Indian suppliers in sectors such as textiles and engineering goods.

The study particularly highlights how SCF can fund green upgrades, such as energy-efficient equipment, and connect MSMEs to green finance and climate-linked incentives. By embedding ESG checks and tracking, SCF helps firms avoid being dropped from EU supply chains and strengthens their long-term resilience. However, the work is theoretical and relies on existing reports, so it cannot establish definitive cause-and-effect relationships or capture all differences across MSME clusters. The paper calls for future surveys, statistical tests, and cross-FTA comparisons, and recommends policy actions such as targeted SCF schemes for exporters, fintech sandboxes, tax incentives for green-linked SCF, and global efforts to shape green trade-finance rules.

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