

An Outlook on Role of Open Credit Enhancement Network in India's Digital Lending: MSMEs

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Abstract

The micro, small, and medium enterprises (MSME) sector of India is a key source of generating employment and entrepreneurship there by contributing to the country's economic and social development. Despite all these features, MSMEs struggles to access credit for financial requirement and the credit demand gap is increasing year after year. To meet such credit demand, Indian Government has launched the Open Credit Enablement Network, or OCEN, a step to move towards democratization of credit and financial inclusion. The present study throws light on the need for OCEN and the role of OCEN in digital lending ecosystem of MSMEs in India. The paper also discusses the challenges and the opportunities for OCEN in the financial inclusion status of the economic system.

Keywords: Open Credit Enablement Network (OCEN), MSMEs, Digital Lending

Introduction

MSMEs are considered as the heart of India's economy, accounting for over 30% of India's GDP growth and employing over 100 million people. Yet only 11% of MSMEs have access to formal credit and more than 60% of all credit demand is unmet. Across the globe, small businesses struggle to access credit and tap into formal financial markets. In India specifically, the micro small & medium enterprises (MSME) credit gap also knowns as credit demand are unmet by the financial system. The credit demand is estimated to be about \$250B which is almost 10% of GDP. MSMEs have very specific credit needs. MSMEs need smaller loan amounts, shorter repayment timelines, and quick access to funds, on a repetitive basis. Since MSMEs is complex and expensive, banks can't afford to do small ticket size loans, and usually take a long time to process their applications. Hence, the launch of the Open Credit Enablement Network, or OCEN, was the definitive step for India to move towards democratization of credit and financial inclusion.

Importance of OCEN

Open Credit Enablement Network (OCEN) was first introduced as a part of IndiaStack by Infosys CEO Nandan Nilekani in 2020 and is still a hot topic today. Simply defined, OCEN (open credit enabled network) is an application that intends to bring together loan service providers and lenders to provide MSMEs with easy finance.

The Open Credit Enablement Network (OCEN) is an open network which codifies the flow of credit between borrowers, lenders, and credit distributors under a common set of standards. It was created by

iSPIRT, a non-profit think tank that was key in implementing public digital infrastructure such as Aadhar and UPI which have reached over 1 billion Indians. By allowing platforms and marketplaces to connect with banks and non-banking lenders to digitize the process of originating, underwriting and servicing a loan, OCEN aims to democratize credit access to small business and vendors, across the country.

The Open Credit Enablement Network (OCEN) is an emerging digital public good (DPG) that has the potential to democratise and transform India's digital lending landscape. Designed as a framework of Application Programming Interfaces (APIs), OCEN could be integrated with a wide range of digital platforms and apps. It aims to empower individuals and micro, small, and medium enterprises (MSMEs) by directly delivering financial products to them, thereby eliminating their dependence on traditional lenders. OCEN developed by iSPIRT, an Indian software industry think tank, and could be instrumental in building a credit marketplace, or more broadly, a digital ecosystem of lenders and loan service providers (LSPs).

Position of India as digital lending landscape

India has already emerged as a leader when it comes to creating digital public infrastructure and goods that provide development solutions at the population scale. Aadhaar has provided Indians with a foundational identity, the Unified Payments Interface (UPI) has accelerated financial inclusion, and the CoWIN platform has helped drive India's COVID inoculation programme. In April 2022, Aadhaar enrolment reached 1.33 billion, and the number of Aadhaar-based transactions crossed 73.5 billion.

By the end of 2023, India's digital lending business will be more than the \$350 million. Its market share is predicted to increase to 48% in 2023, up from 23% in 2018. OCEN is meant to address current loan processing issues like verification, data interchange, and other aspects of the lending cycle. Lenders should anticipate seeing a fivefold increase in revenue. The Open Credit Enablement Network (OCEN) is a technology framework that enables the seamless exchange of credit-related information between lenders and borrowers. While OCEN primarily focuses on credit enablement, its application can also enhance visibility in financial flow of supply chain, providing greater transparency and efficiency in managing financial transactions within the supply chain.

Objectives of the study:

To analyse the role of OCEN in digital lending landscape of India with special reference to MSMEs

To analyse the opportunities and challenges of OCEN in India

Need for the establishment of OCEN TO MSMEs Of India

The lack of 'expansionability' of the traditional lenders has created a credit gap of around US \$380 billion in the Indian MSME sector. Even the credit card industry has not sufficiently been able to penetrate the massive Indian market. Despite the industry's impressive growth in recent years, only 3 percent of the population has a formal credit card today, and this number is largely limited to the country's tier 1 cities. Acquiring a loan currently requires Loan Service Providers (LSPs) to shoulder a host of responsibilities. These include sourcing, identity verification, underwriting, disbursement, recollections and dispute management. Each of these is a process unto itself and their execution impacts the profits earned by an LSP. Taking these processes online would reduce the time and cost of loan disbursements and could reflect in more favourable interest rates charged by lenders.

Only 11% of India's 63 million MSMEs (Micro Small and Medium Enterprises) have access to formal credit. The rest must turn to non-banking financial companies (NBFCs) or money lenders to obtain money at a hefty interest rate. OCEN will be a digital platform that will solve this problem.

Role of OCEN in accelerating digital lending

Open Credit Enablement Networks (OCEN) function by consolidating and automating the different manual processes involved in a lending value chain, such as the screening of loan-worthy customers, and the onboarding of new borrowers, thus decreasing the total operating time and costs of associated with it and thereby increasing effectiveness.

The new technology, OCEN, bundles these lending processes and executes them online. It automates screening processes to decide on loan-worthy customers and the onboarding of new borrowers. These processes are being streamlined further by integrating the verification process with Aadhaar's existing eKYC system. In September 2022, 25.25 crore eKYC transactions were done through the platform, raising the total number of transactions to 1,297.93 crore.

OCEN could eventually reach a similar scale of adoption and reach, revolutionising the credit value chain, and boosting the digital economy. Digitalising credit systems is also expected to help democratise them by connecting loan providers with customers who are not part of any formalised credit system. OCEN can also be used by non-bank small-scale lenders, thus expanding the scope of lending and borrowing.

An example on the iSPIRT website reflects the list of lenders available for a customer. The OCEN API can be integrated with e-commerce websites, digital marketplaces, and other apps to help secure a loan while making a purchase. It will provide MSMEs with inexpensive credit and that too quickly. It will also provide lenders with the borrower's consent-based verified public and private information. Lenders will give the borrower a customized loan based on this data. OCEN is an infrastructure protocol that will connect borrowers and lenders via legitimate data exchange, which will be consent-based, safe, and secure. OCEN is a protocol that allows platforms and markets called LSPs (Loan Service Providers) to link to banks and non-bank lenders to digitize the origination, underwriting, and servicing process of loans. In this context, Open Credit Enablement Network (OCEN) has emerged as a novel lending paradigm and a protocol infrastructure that would help in the facilitation of interoperability between Loan Service Providers (LSPs), like FinTechs and E-commerce players, and traditional lenders, like banks and Non-Bank Financial Companies (NBFCs). The next big opportunity for fintech through this open credit network is for lenders to get willing to interact with LSPs based on a new lending protocol infrastructure. OCEN is a part of the larger India Stack framework, which includes Aadhaar and UPI as its base. LSPs or digital platforms, (Technology service provider) TSPs or Fintechs, lenders like banks, NBFCs, and other loan providers, as well as borrowers like MSME entrepreneurs who are the end users of the credit, are some of the various stakeholders in the OCEN ecosystem. For each stage of the loan lifecycle, (Application Programming Interface) APIs are provided. It provides an end-to-end digital lending procedure and integrates processes. LSPs, TSPs, and lenders can work together to develop credit choices that are ideal for the customer.

Three Ways OCEN Works

- To borrowers: MSMEs or individual borrowers can check out the credit options available under a secured lending process.

- To lenders: Banks and NBFCs along with other lenders can provide access and capital to core banking network. The digital access can be a web app or an android app that already has a core offering and a customer base. It will help then build on and grow the business and serve the needs they may have.
- To loan services: Fintech companies and customers that have digital access can be on the same platform. Lenders can provide customized loan application options while borrowers can access them easily.

Let us consider an MSME that supplies products to a larger company. Typically, the MSME would issue an invoice to the buyer, indicating the payment terms and due date. However, the MSME may need immediate funds to meet its working capital requirements or invest in business growth.

By leveraging OCEN, the MSME can share relevant invoice data securely with financial institutions that are part of the network. These financial institutions, including banks or non-banking financial companies, can assess the creditworthiness of the MSME and its buyer based on the transaction history and other available data within the network.

After receiving permission, the financial institution can offer the MSME the required finance, such as factoring or invoice discounting. A proportion of the invoice value less a fee or interest charge often represents the financing amount. By doing this, the MSME can access funds before the buyer must make payment, enhancing its cash flow and lowering the possibility of late payments.

The entire process is made more transparent and efficient by OCEN. By submitting invoices and supporting documents digitally, the MSME may quickly cut down on paperwork and manual processing. Using the real-time data provided by OCEN, the financial institution may assess the credit risk and immediately confirm the legitimacy of the invoices.

Additionally, OCEN enables a safe and auditable record of all transactions and communications between the parties. This transparency and traceability reduce the risk of fraud or disputes, benefiting both the MSME and the financial institution.

Benefits of OCEN in Supply Chain Finance Flow Visibility

- Enhanced Transparency by providing real-time visibility into financial transactions within the supply chain.
- Supply chain finance workflow, from invoice processing to financing disbursements, becomes streamlined and automated. This reduces manual efforts, eliminates paper-based processes, and enhances efficiency in managing financial transactions.
- The real-time reporting and analytics capabilities of OCEN enable faster identification any cash flow gaps, track the status of payments, and take necessary actions to ensure smooth operations within the supply chain.
- With improved visibility and timely payments through supply chain finance, firms can strengthen its relationships with suppliers.

Challenges

There are several structural challenges that have created barriers to entry into MSMEs credit ecosystem:

- High Risk: Most potential borrowers have poor or non-existent credit scores or other relevant data, and hence collection and repayment become a challenge for lenders
- High Cost to Serve: Acquisition, underwriting, and collection costs make it cost-prohibitive for lenders to target smaller borrowers

- Limited Access: Most lenders can't even access a vast majority of prospective borrowers through existing online and offline channels

Since OCEN will involve credit and a likely increase in the number of borrowers, there may be a probable rise in the incidence of loan defaults. Resolving this may require the creation of a task force, a system for online dispute resolution, and a digital ombudsman. These mechanisms will create the confidence necessary for more private players to enter the space and for the technology to be adopted on a wider scale. Transparency with respect to loan-related data could pose a challenge. With an increase in data, companies will come to possess a list of defaulters who might then be excluded from the lending process. It is important that lending processes should not become exclusionary, and that every effort is made to provide potential borrowers the loans they seek.

Borrowing money would not be limited to the assets and incomes owned by a person, one of the biggest hurdles that has limited the growth of traditional lending.

Cybersecurity risks should not be ignored either. Recently, the data of around 110 million users of Mobiwik, a fintech startup, was sold on the dark web. The data included names, phone numbers, email addresses, addresses, GPS locations, and mobile-device-related details. Other similar instances of data breaches in India and elsewhere draw attention to the need to make digital platforms and processes more secure. In the current absence of a law on data protection in India, stakeholders will need to be especially cognizant of risks associated with data privacy, confidentiality, and security. Finally, a lack of technical know-how could lead to online theft and financial fraud. Thus, targeted digital literacy programmes must accompany the rollout of new technologies and platforms.

Opportunities

The **Open Credit Enablement Network (OCEN)** offers fascinating new opportunities for development and transformation when viewed in the broader context of the fintech industry's explosive rise in India. In plainer terms, OCEN can be thought of as a software architecture that, through APIs and clever integrations, unites the various players in the credit ecosystem under one roof, allowing lenders to create customized lending instruments and companies to streamline their access to the market that houses a wide range of credit products.

The Open Credit Enablement Network (OCEN) can enhance supply chain finance flow visibility by integrating financial systems, digitizing invoice and payment information, facilitating credit assessment, and providing real-time reporting and analytics. By leveraging OCEN for supply chain finance, MSMEs can overcome cash flow challenges, access timely funding, and strengthen their business operations. This technology-driven approach streamlines the financing process and fosters collaboration between MSMEs and financial institutions, promoting inclusive growth and supporting the development of the MSME sector. Finally, OCEN gives lenders the opportunity to expand their markets and offer innovative lending products, reducing their acquisition costs.

Conclusion

Since OCEN will involve credit and a likely increase in the number of borrowers, there may be a probable rise in the incidence of loan defaults. Resolving this may require the creation of a task force, a system for online dispute resolution, and a digital ombudsman. These mechanisms will create the confidence necessary for more private players to enter the space and for the technology to be adopted on a wider scale.

At the broader context of the rapid growth of fintech seen in India, OCEN presents exciting new possibilities for growth and transformation. Fintech is among the fastest growing sectors in India, with startups in the space receiving funding worth US\$9.8 billion in 2021. Around 10 fintech companies have scaled up as unicorns in 2021, and the fintech market is expected to grow to US\$ 84 billion by 2025. India's other major instances of DPGs—the Aadhaar and UPI—have experienced massive scale and success. There are all possibilities to estimate that OCEN too will emerge as another uniquely Indian success story in strengthening the digital lending ecosystem of the country in the future.

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