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Alternative Credit Score-Hitching the Digital Bandwagon

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INTRODUCTION

Credit is an important function of a banking and non banking credit institution. It is so because, it is the credit function which gives the banking and non banking lenders a major chunk of the profits of their business. But being in credit business is also risky. Credit involves providing loans to the borrowers. A commercial lender receives several loan applications during the course of their business. These applications are scrutinized and necessary action taken. In the case of a bank, more so, if it is a public sector bank, several hundred loan applications are received per month. However, the processing of these loan applications is not easy as will be vouched by any credit officer in bank or a non banking finance company. There could be hundreds of applications which may not warrant a second look. The table below gives a taste of what the credit departments of a few banks do:

Fig 1: Loan application processing by sample banks

Name of Bank	Total no. of Loan Applications Received	Total no. of Loan proposals sanctioned out of the total received	Percentage of Loans Sanctioned
Allahabad Bank	1912	1243	65.01%
Andhra Bank	870	354	40.69%
Bank of Baroda	6351	3666	57.72%
Bank of Maharashtra	1887	763	40.43%
Canara Bank	2134	1518	71.13%
Corporation Bank	1138	426	37.43%
Indian Bank	1429	335	23.44%
Indian Overseas Bank	1819	1058	58.16%
IDBI Bank	3655	1655	45.28%
Oriental Bank of Commerce	2421	1124	46.43%
Punjab and Sind Bank	1067	599	56.14%
Punjab National Bank	4043	1693	41.87%
State Bank of India	13984	5993	42.86%
Syndicate Bank	660	288	43.64%
UCO Bank	1343	635	47.28%
United Bank of India	448	234	52.23%
Total	**45,161**	**21,584**	**47.79%**

Source: psbloansin59minutes.com

The above figures pertain only to SME loans applied through the web portal www.psbloansin 59minutes.comlaunched by SIDBI and others. It is anyone's guess as to the total number of applications received and rejected by various banks and non banking lenders from retail and other segments, because, no records are publicly available regarding these details. But, how do these credit institutions process these huge quantities of loan applications? Simple. The initial screening is based on Credit Scores. Based on certainpre determined criteria of credit scores, the applications are sent to the second stage of the processing or rejected at the screening stage.

A credit score is an index of the behavior of the borrower/potential borrower for several credit institutions the credit score model was first introduced by Fair Isaac Corporation (FICO) in the US. In India, a popular model of the credit score is given by CIBIL called the CIBIL score. This score ranges from 300-900. Nearer the score to 900, the better the chances of getting the loan faster and at better terms.

CIBIL, an acronym for Credit Information Bureau of India Limited, was incorporated in 2000 and started its generic risk scoring model in 2007. The traditional CIBIL score, as stated above, is based on historical factors associated with the loan seekers' past credit history like loan enquiries, loans availed, loan repayment, disputes raised, number of applications, frequency of applications etc. The weight age given to various factors are:

Table 2: CIBIL score weight age

S No	Factor	Weight age (%)
1	Credit exposure	25
2	Past performance of the loan accounts	30
3	Credit type & Duration	25
4	Other factors	20

Source: CIBIL.com

The major issues associated with the CIBIL score and its usage by the Commercial banks and Non banking lending companies are

Model: The credit score model is based heavily on the prior history of the loans taken by the prospective borrower (80%) . In other words, a credit score would be generated only when a person has taken a loan before the proposed transaction. This is the classic Chicken and Egg Case. Unless a loan transaction takes place, credit history and the consequent credit score will not be developed. But loan will be granted only when the person has a credit score.

Methodology: The credit scoring methodology was formalized at a time when many developments like data analytics, mobile phones, social media etc had not been developed. Hence the stress on past credit performance.

Usage: The usage of credit score to consider granting of loans started at a time when only PAN apart from personal details like name, date of birth were available for cross verification.

Today's society has changed drastically compared to what it was about, say, 10 years back. The models adopted at that point of time may or may not be relevant anymore. Further, the range of data capturing opportunities have increased manifold in the recent past. This, coupled with the power to analyze huge volumes of data in the form of numbers, texts, pictures, graphs have increased tremendously due to developments in the field of big data analytics. All these developments calls for modifications to the credit score models. There is a need for an alternatives to the existing credit scores

Alternate Credit Score

Alternate Credit Score (ACS), as we know it, is to arrive at a score to check for desirability of credit application, by getting data from sources *other than* traditional sources. Traditional sources means data collected based on past credit history.

Why Alternate Credit Score

There are several reason why alternate credit scores are fast becoming imperative:

1 *Unbanked and Underbanked*: According to a World Bank report, there are about 190 million[1] people in India who do not have a bank account. In addition, according to the government of India, about 330 million[2] bank accounts have been opened under PMJDY scheme as of end 2018. These two figures put together indicates a sizeable chunk of the potential borrowers who maybe credit invisible. Most of them may not have a formal credit history and consequently no credit score. But many in this category may have an impeccable record of paying the utility bills on time, recharging their mobiles, transacting on e commerce platforms, meeting their other expenses in timely manner and also maintaining a fairly decent lifestyle.

2 Many retired people who may be willing to avail loans to go abroad, meeting medical expenses, renovation of their properties etc may not have CIBIL credit score because they may not have availed any loans in the last few years. Hence their credit score may show "data not available"

3 Hundreds and thousands of people are joining the workforce in the formal and informal sector. Most of these people may not have credit history and loan repayment track record.

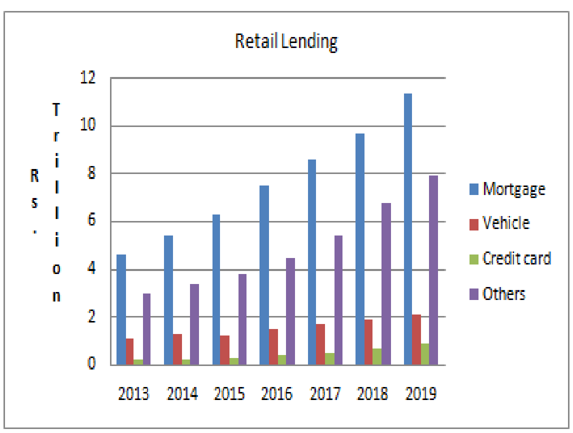
4 The COVID 19 has pushed several MSME players, especially the micro segment, into a liquidity crisis. For instance, small establishments like a stationery store or a fabricator have been

forced to close their establishments leading to loss of revenue. Post demonetization, many of these establishments had migrated to digital payments platform like Paytm or Gpay with a linked bank account. They may have never availed any loans from the formal sector, except for maintaining a bank account for operational convenience. Hence in these cases also, records may not be available for computing a credit score.

5 The rising growth of Financial Technologies (Fintech) companies. These are companies which rely mainly on technology to achieve size and critical mass. Many of these fintech companies are engaged in some credit activity like peer to peer lending. These fintechs are nimble footed and at the same time do not have access to the database of traditional credit scores but rely on alternatives to grow in their lending business. These fintechs have had a fairly decent run going by the growth of digital lending business in India. The fintechs pose a significant challenge to the traditional Bank / non banking lending entities without relying on credit scores like CIBIL scores.

In all these cases, an alternative to the existing credit score model is required if these potential loan seekers are to be converted into customers. As already mentioned, loans granted generates profits to credit institutions but also runs the risk of NPAs. The slower growth expected in the corporate credit in post COVID 19 environment will turn the focus of lenders on retail loans. Even before COVID19, the retail loans portfolio have been growing at a healthy Compounded Annual Growth Rate of about 16% during the period 2013-2018[3].

Table 3: Growth of Retail loans in India



Source: The Asian Banker

Alternate Credit Score – The way forward

Demonetization in India has served as a booster dose for digitization of our financial transactions. Added to this, is the developments in the number crunching and pattern recognition abilities of computers. This provides a good framework for going ahead with alternate credit scoring mechanisms. The various sources from which alternative credit scores can be computed are:

- Online Buying Behaviour including products and services
- Payment of utility bills
- Social media posts, followers
- Bank balances maintained and frequency of transactions
- GST Data
- Spending Pattern

These are factors which are not considered in the traditional credit scoring model developed years ago but are available today.

Commercial lenders who wish to tap the retail market with potential borrowers not having formal credit history would be at an advantageous position. A faster route to adoption of alternate credit score would be to tie up with a fintech company and join the bandwagon with minimal processing time. The lenders may start with smaller loans, say around Rs.25,000 till they get used to these new method of screening the application and develop their own capabilities to use both traditional and alternate scoring models.

Banks and bigger NBFCs may find the size of the small loans not financially viable for their processing. But since the entire loan processing would be digitized, the cost also would come down drastically. Of course, the conflict between chasing 1000 customers for follow up with an average ticket size of Rs.25000/- or a few customers for Rs.250 lacs will continue to be debated. But sooner or later, all commercial lenders will have to start looking at data generated by past behavior from conventional sources (prior credit history) and non conventional sources (digital platforms) in respect of their potential borrowers.

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