New trends in credit analysis: The same customer, new data

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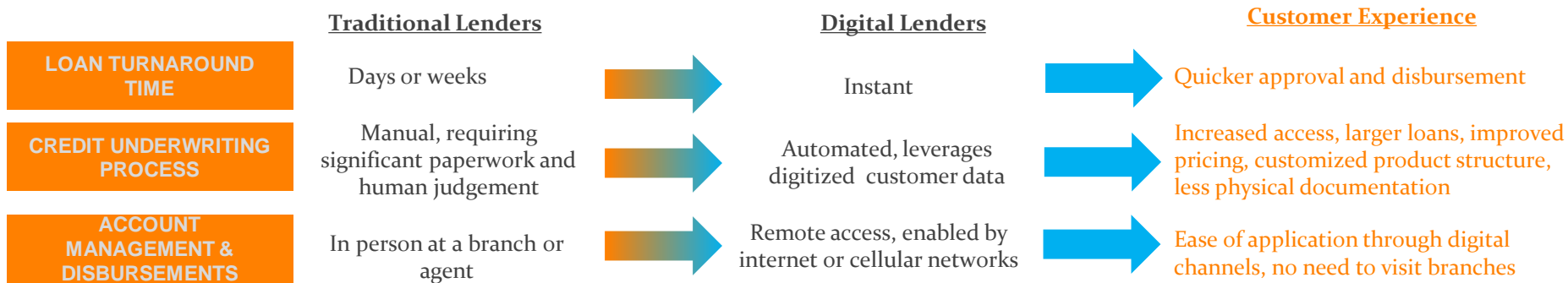*Accion*

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Defining Digital Lending

> *Digital lending refers to offering loans that are <u>applied for, disbursed and managed through digital channels</u>, where lenders use digitized data to <u>inform credit decisions </u> and <u>build intelligent customer engagement</u>.*

Digital lending offers a unique customer value proposition centered around three key areas in the lending process:

	Traditional Lenders		**Digital Lenders**		**Customer Experience**
LOAN TURNAROUND TIME	Days or weeks	→	Instant	→	Quicker approval and disbursement
CREDIT UNDERWRITING PROCESS	Manual, requiring significant paperwork and human judgement	→	Automated, leverages digitized customer data	→	Increased access, larger loans, improved pricing, customized product structure, less physical documentation
ACCOUNT MANAGEMENT & DISBURSEMENTS	In person at a branch or agent	→	Remote access, enabled by internet or cellular networks	→	Ease of application through digital channels, no need to visit branches

Source: CGAP

We define digital lending from the *customer's perspective i.e. how it improves the customer journey*

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The Data-Driven Lender

- At the heart of digital lending is the ability for lenders to **access and use digital data** to make quicker, automated, more accurate underwriting decisions:

...Implications for Credit Scoring

- ✓ Improve accuracy of decision-making
- ✓ Manage risk at scale

...which requires more data-driven operations...

- ✓ Automated risk management processes
- ✓ Remote account opening, payments and customer management

....which requires digitization of customer data throughout organization

Enables a more **targeted customer value proposition** and longer customer lifetime value

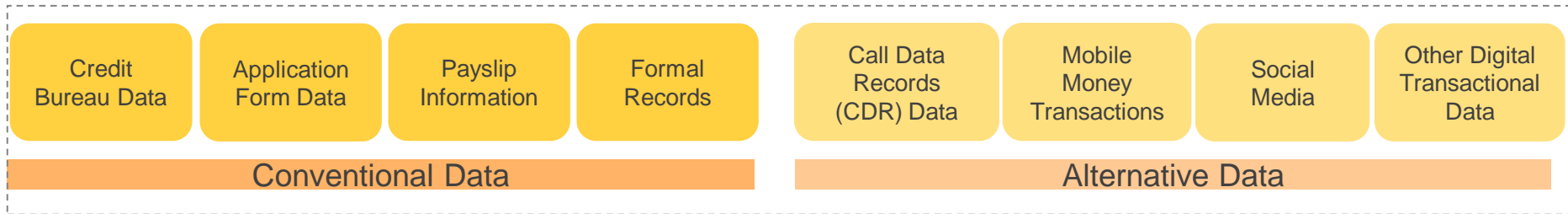**...leading to lender profitability**

↓ Bad debts

↓ Per Loan Opex (scale)

↓ Cost of funds

- **Customized scorecards** that use specific customer data and often employ advanced data analytics, are enabling lenders to better understand customers

Lenders must focus on the right data sources to support digital lending

- The data sources that can be used in digital lending include both conventional and alternative data:

Credit Bureau Data	Application Form Data	Payslip Information	Formal Records		Call Data Records (CDR) Data	Mobile Money Transactions	Social Media	Other Digital Transactional Data
Conventional Data					**Alternative Data**			

Reality Check:
Use of alternative data is not a prerequisite for digital lending – it merely supplements the scoring process. The diligent use of business rules using conventional data and use of decision trees to approve a loan would constitute digital lending as well

- **Sourcing data,** particularly for the acquisition of new customers, can be a challenge for digital lenders in emerging markets

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Digital Channels Drive Lending Models

- Customer acquisition channels dictate the lender's nature of data on and type of relationship with the customer, which has direct influence on lending models:

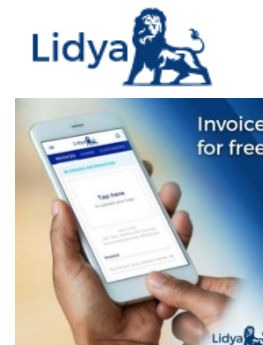|	Direct to customer	Indirect through Merchant Acquirer or Distributor	Indirect through Value Chain Aggregator
Example	branch — *Mobile app-based consumer loans*	TIENDA PAGO — *SME working capital loans for settling invoices with suppliers*	KOPO KOPO — *SME loans to merchants based off mobile money transactions*
Customer Acquisition	• Directly via their android phone app	• Targets merchants in wholesaler networks	• Targets merchants in Safaricom's Mpesa network
Credit Scoring	• Detailed data points scraped from phone	• Validates business volumes with wholesaler	• Has sight of all businesses' Mpesa receipts
Customer Engagement	• Directly via their android phone app	• Physical sales agents, mobile and online portal	• Physical sales agents, mobile and online portal

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A Few Interesting Business Models….What stands out?
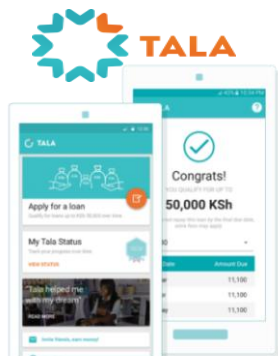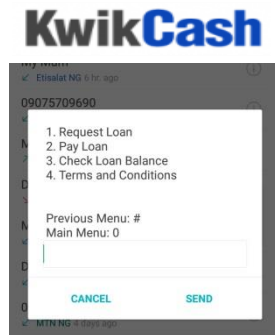
	Online Lender	P2P Platform	Supply Chain Lender
Customer Acquisition	Customer decides data access on phone, but influences loan terms.	Partner FSPs provide customer data	Sources data provided from SME as well as supply chain partners
Scoring & Analytics	1000's of data points scraped off phone. Small loan sizes first (~$4) with aggressive credit limit increases on repayment.	Significant access to customer's phone/ bank/ MNO data.	Scores SME with over 100 data points from multiple sources.
Disbursement & Repayment	Mobile money disbursement < 1min from completing application	Bank account disbursement ($1-$200) ~1min from completing application.	Has access to key performance data on business, such as electronic revenue that helps to manage repayment, early risk factors & renewals
Collections	Due to small initial loan sizes, simply writes off loans. Model heavily reliant on quality of scoring.	Customers have to agree access to mobile phone book and can theoretically notify friends and family on loan default.	Distributor penalties can be more meaningful to clients (and thus more effective) than negative credit ratings
Customer Engagement	No face-to-face or telephonic contact possible – in app messaging, email, SMS	SMS -based	Fully online account management through online portal.

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Where are you on the Digital Maturity Scale?

	Examples	Customer Acquisition	Scoring & Analytics	Disbursement & Repayment	Collections Process	Customer Engagement
DIGITAL LENDING MATURITY MATRIX						
Bronze Maturity	FINCA, ACCION Microfinance Bank	Some parts of acqusition process digitised provision of physical.	Manual processes with little or no use of advanced analytics or scorecards.	May involve digital repayment but **cash payments within branch/ agent network common.**	Limited data analytics in delinquency mangement.	Customer can **manage core components of account through digital channels.**
Silver Maturity	M-Shwari	Majority of customer acqusition is through digital channels, some manual interventions.	First generation scorecards for application and renewals, using **basic data sources and available bureau data.** Underwriting process has **very few manual interventions.**	Digital only.	**Data-driven** delinquency management with use of basic analytics.	**Account management solely digital.** Outbound communication by lender is data-driven and customised.
Gold Maturity	TALA, Lulalend, KwikCash	**Completely digital onboarding process** with no need for physical interactions.	**Best-of-breed data analytics** and scoring algorithms using multiple alternative data sources.	Digital only.	Data-driven delinquency management with **use of advanced analytics and scorecards.**	**Data-driven customer interactions** throughout customer management process, **customised cross-selling and communication.**

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How to Start the Digital Lending Journey…

First steps in the Digital Lending journey can start with some basic steps…

To reach…	Bronze Level Maturity
Customer Acquisition	• Initiate basic digital customer onboarding such as USSD • Look to remove onerous paper processes through digital automation • Source product skills to design and market digital lending products
Scoring & Analytics	• Centralise credit underwriting • Standardise processes in evaluation • Manually apply supplementary data to decisioning
Disbursements & Repayments	• Potentially partner with payments business to facilitate digital payments or enable remote account set up
Collections	• Review collections process and implement basic CD-level customer management
Customer Engagement	• Ensure customer communication is automated at every stage of the customer journey – simple SMS works

Reality Check: Some Considerations of Digital Lending

The importance of digital readiness
- Enables data use and various aspects of digital lending.
- Implications for infrastructure, skills, culture

Start with the low-lying fruit
- Intuitive and efficient processes
- Sourcing and using easily available data, both internal and external

The human touch is still important
- Driven by cultural preference and/ or customer education
- Supports loyalty and customer repayment behaviour
- Will this change as digital becomes more prominent?

Digital does not mean profitable
- Some fintechs have poor unit economics - low Opex models require significant scale which can be expensive
- FSPs should build digital maturity over time – heavily reliant on lender's target customer

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Thank you!

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