Good user experience and AI come from proper use of data – here's how lenders do it

As the 2008 crisis made many banks quite reluctant to give away credit for those who would not pass their standards with flying colours, the economic recuperation is seeing lending companies finding new ways to assess the creditworthiness of their customers, as well as developing new ways to reach them

Henry Vilar
Junior Fintech Reporter

cnythzl /iStock

In the area of lending, the most important aspect is risk assessment, the certainty that the money that one is giving away will return in due time to its original hands. The way banks try to assess this is by knowing as much as possible from the borrower, and making an educated guess. The 2008 financial crisis made banks quite reluctant to lend money to those that did not present this certainty, and one of the most affected areas has perhaps been microlending. As opposed to business lending, consumer microlending has demanded many resources to keep up with every stage of the process. In the digital age, these obstacles are being minimise – here's how.

The cost of microlending

In the past decade, the area of microlending has been woefully underserved. When it comes to small loans, due to be paid back in the short term, they carry an inherent high risk. To cater for this market, there are two main impediments that get in the way, and in general terms are seen as a shortcoming throughout the whole of the lending landscape.

The first one has to do with data – but this is a complicated area. Access to the right kind of data, alongside the appropriate utilisation of it, can increment both the efficiency and the accuracy of risk assessment processes.

The second point is automation, which although is widely conceived as being applied in risk assessment, actually affects many stages of the lending process, enhancing efficiency and speed of delivery. Take Duologi, a finance house that provides financial products at retailers' point of sale. Stuart Taylor, director of sales and marketing at Duologi, remarks on the importance of artificial intelligence in their business: risk assessment, fraud detection, book management and forecasts, and customer engagement.

If these two areas are updated, and we see companies enlarge their investment and dedication to tech that apply directly, Eugene Danilkis, CEO at Mambu, believes that the cost of microlending will reduce considerably, even more than we have seen in the past few years, and thus will reach a wider demographic. Digital transformation reduces the operational risk and cost of most activities, if not all, involved in the process, while the interference of people at any point throughout tends to do just the opposite.

An example of companies that provide the technology to enhance the loan origination process is Divido. As a technology supplier, Divido builds and maintains the technology that allows lenders to reach customers who may need a loan at point of sale. As Christer Holloman, co-founder and CEO, tells us, the bank's ability to be at the checkout when a customer may need them is giving these retailers and lenders an edge, as well as allowing customers to access to services and products through the financial products offered by the banks.

New frontiers

This opens a new realm of possibilities beyond the geographies in which lending is already an established industry. Economically marginalised communities, or those that would be subprime borrowers and traditionally denied a loan, can now apply and be granted such loans, as lenders have more data, more tools and lower costs, thus being able to mitigate the risk. But outside developed geographies, emerging markets are also benefitting from this, throughout many parts of Africa and Asia, as lenders are finding ways to gather individuals' data.

The shift in the risk assessment process has been remarkable, and it has been a by-product of the sources and type of data that companies are now utilising. The use of data has always helped to reduce risk, but traditional lenders who have based their assessment in the information provided by credit bureaus – that being credit scores – have played the safest card available. Credit scores are a reliable

Qimono/pixabay

Emerging markets such as Africa are benefitting from the ability to gather data about potential borrowers

option indeed, which allows companies to be sure they are taking zero chances when lending money. Holloman says that for many traditional lenders (aka banks), credit ratings are the tried and tested route when it comes to risk assessment. Providing subprime loans based on social media behaviour is hard to justify in court, he argues, unlike credit ratings. But credit scores don't tell the whole picture.

Alternative data companies have been looking at other data channels, such as social media, network creditworthiness, past employment history, online and browser behaviours. Data companies have realised that there are many ways to profile a potential customer, and they are getting increasingly creative with the ways they do so – even for the commercial side. It is not only a matter of which data we look at, but the way in which we use and access this data. Jacqui Morcombe, global solutions lead at Finastra, explains that many banks throughout the world still use Excel spreadsheets to store and manage data, which is a highly inefficient and unsophisticated method.

"The world beyond credit scoring is much more exciting, but when it comes to commercial lending, banks still have many issues," Morcombe says. "Particularly when it comes to syndicate loans, for example, which are complex in nature; data needs to be ready and accessible. New systems are revamping the way we manage data, including providing market insights and the ability to control this data."

Tamas Erni, CEO at Loxon, says: "It is true that there is less data in business lending, but there is still a lot of data that banks aren't using." He says that business lending companies would have the possibility of identifying non-customers and potential leads, as well as receiving insights in current customers if they were able to sufficiently leverage the data from payments and transactions records, corporate databases, balance sheets and so on.

The foundations for the front-end demands

For consumer lending, the "bigger challenge", as Danilkis puts it, is the many ways of lending available: the aforementioned point-of-sale financial products, direct loans and so on. Mambu's CEO believes that alongside "the data problem", the industry must tackle the way in which it communicates with customers. Both in terms of transparency and financial management, as well as easy-to-use, intuitive, multichannel platforms designed for customer acquisition and retention.

Taylor explains that Duologi is focused on enhancing the customer experience throughout checkout and the application of the financial product, but that all this is based on how they gather data from the retailer's site and prepopulate the data forms that they need to make the assessment.

"After that, we ask no more than five questions to finalise the underwriting, a process that is done swiftly and in real-time, bypassing the slow, clunky and cumbersome approach of other lending platforms," he adds.

On the corporate side we are seeing a very similar development. Morcombe says those front-end demands that had been traditionally seen in the consumer area are now reaching the corporate and SME segment, meaning that people want a transparent, digital and real-time experience.

"You can't put a pretty front-end when you don't have a data back-end to support it," Morcombe points out. Erni tells a very similar story – SMEs are moving towards digitalisation, but for him, there is a slight difference. When it comes to lending, business can get much more complex than consumer, and he believes there is always a need for a more human intervention, even though it is diminishing.

On the edges

Consumer lending has traditionally faced more barriers than business lending, as there is so much data from individuals that it can be less reliable at times, although more simplified through credit scoring. But for banks, whose systems are designed to admin large loans, they are simply not well-positioned to admin short-term, small loans. As an alternative to a change of tech and a revamp of the system, smaller companies are popping up to fill in those gaps. In fact, where we see that many of these companies are starting to eat away the bank's market share, technology firms like Divido are stepping up to allow more traditional lenders to keep up with the changes and challenges.

"It is true that there is less data in business lending, but there is still a lot of data that banks aren't using

Actor Michael Sheen has founded the End High Cost Credit Alliance, which aims to minimise the cost of lending

Oakam is one of the companies that have found a demographic niche they can serve through new digital technologies. It claims to have enormously reduced its operational cost by getting rid of doorstep agents and relying solely on digital channels to grant and collect money. This has gained it a good amount of adopters in migrant communities throughout the UK.

One of the banners leading this rally is the End High Cost Credit Alliance, an organisation founded by the actor Michael Sheen, that aims to minimise the cost of lending for borrowers with poor credit rating. This initiative brings together politicians, charities, tech companies and of course, lenders, to offer a more affordable alternative than what has dominated the industry in the past few years. To name a few, some of these organisations are Moneyline, Scotcash and Toynbee Hall, among others.

At the core of this shift in the way lending is carried out, there is the aforementioned change in technology that brings down costs and thus allows companies to provide more affordable rates. Oakam is a perfect example that has been able to leverage that technological shift riding on the back of regulation. As a digital microlender, it has been able to extend its reach into other areas, and change the practices that have made lending so expensive and predatory.

In other parts of the world, such as Asia, we find that the industry is facing the same issues that the US and Europe were struggling with in the 1980s and 1990s, like credit auto loans. In Frederic Nze's view, this is a sign that these markets are maturing, and that it is only a matter of time until we see these geographies catch up with the UK, for example. In Africa, however, the landscape is slightly different, as access to the technology and the ability to reach certain areas is limited. Plus, there is a substantial lack of middle class throughout the continent, which impedes the lowering of risk in lending. However, new technologies can find ways to make it across Asia and Africa, in spite of the different circumstances and regulations that pre-condition each region. For example, in Asia, the ubiquity of 4G access makes mobile and online solutions a great option to expand the market, which in turn, makes the market very attractive for companies with similar profile to Oakam's, since loan origination can be one of the main obstacles.