



Credit Where It's Due

Banks are falling short when it comes to meeting customer expectations around product variety and accessibility. By addressing these needs, banks can reimagine their credit products, models and corporate culture to deliver the next-generation credit experience.

In a world in which customer expectations of having their needs meet instantly are constantly rising, the credit experiences provided by most banks are falling desperately short.

Klarna and Affirm have set the standard for streamlining short-term credit in the form of “buy now, pay later” loans. Yet most legacy banks find themselves stuck with outdated data and risk models, and credit propositions and products that don't align with what people need and expect.



In short, the credit experience is antiquated. And for customers, obtaining credit—especially for homes, autos or businesses—can be a draining and confusing process. Even in credit segments which have all the necessary financial history and means, making a “yes” likely, customers face many challenges.

Terms and conditions are often difficult to understand. The process can be drawn out with seemingly endless requests for additional documents. There are lengthy processing times, with little indication of when a decision will be rendered. Credit decisions are made by faceless, nameless individuals. And despite the needs of each borrower being unique in a number of relevant ways, credit products are often one-size-fits-all.

Further, a substantial portion of the population is overlooked by traditional lenders—despite the fact they have sound money habits.

For a variety of reasons, these are individuals and small business owners who may possess a bank account but have a thin or non-existent credit file. Many adults are unable to obtain personal credit due to a lack of a robust banking and credit history.

In the US alone, 45 million people are considered “credit invisible.”¹ This means they lack enough information to generate a FICO score, which is required to obtain credit. Globally, meanwhile, roughly 1.7 billion adults with a net worth of \$10,000 to \$100,000—dubbed “the neglected middle”—lack financial products and services that adequately meet their needs.²

These neglected-middle³ customers—also known as “thin-file” or “no-file” customers—are not simply high-cost, high-risk credit seekers. Rather, they represent a pool of diverse potential borrowers, many of whom exhibit financially responsible behaviors.

This group includes, among others, immigrants and foreign workers who often lack the local financial data needed to obtain credit⁴, women⁵, and Centennials—the generation born after 1997 who have not yet developed a credit history.

The credit needs of these segments are varied yet vast—they encompass personal credit cards, unsecured personal loans, home financing, auto financing, point-of-sale financing and other short-term and long-term instruments. Small- and medium-sized businesses (SMBs) face similar challenges in acquiring financing.

Slowly but surely these segments are beginning to attract the attention of new entrants and incumbents alike. The foundation is in place for a fundamental shift of power away from banks, which were previously the only option for this segment, and toward consumers, who are now able to find dignified financing from progressive institutions like Capital One or fintech disrupters like Kabbage.



Financial institutions should also take to heart the idea that serving these segments can be good for both business and society. Consider, for example, the US Paycheck Protection Program (PPP) which, under the new administration, is likely to focus more on businesses led by women and minorities. Banks that focus on them now will be positioned to win in the future.

To close the gaps in credit provision, what is needed is nothing less than a rethink of banks' value proposition as well as the end-to-end customer journey—from application to the decisioning process to the reinforcement of loyalty.

Several promising developments in credit innovation—the use of alternative data, new risk analysis techniques and credit products, and greater automation—can, and have already started to, provide the cornerstone for the solution. UK-based OakNorth Bank, for example, leverages alternative data to keep non-performing loans at an incredible rate: just two defaults in four years of lending a net of €3 billion (\$3.6 billion) to individuals and SMBs.



Information gathered by lenders will be even more valuable over the long term. As they use greater quantities and varieties of data—spurred by API infrastructures, regulatory evolution and shifting consumer sentiments—lenders' ability to find new areas of growth will only increase.

Developing solutions for thin-file and no-file customers is possible. Lessons learned from such pursuits may ultimately provide new approaches for traditional audiences as well, as we pivot to the next-generation credit experience.

Inspiration:

Braviant Holdings looks beyond credit scores to provide lending options to those who might otherwise be shut out.⁶ Using automation, machine learning and alternative data sources, like cash flow, the lender has built models to predict both willingness and ability to pay, providing their customers a path to better credit scores.



Challenge

Building a next-generation credit experience, especially for neglected segments, requires thinking about new products, services and underwriting decision-making to leverage existing and alternative data and new technologies. The challenge can be broken down into three parts:

Understand neglected segments, scrutinize their experience of seeking credit, and use the findings to create new products and services.

- What does human-centered research tell us about the traits, behaviors and pain points of neglected segments?
- How can we develop new products, services and models for underserved borrower segments?
- How can we create seamless experiences that are transparent, inclusive and convenient?

Shift your organizational mindset and encourage new behaviors that leverage new tools and processes that extend the reach of credit.

- How can we empower employees to match the creativity of the new tools and processes?
- How can we train them and build the skills they need to make better credit decisions?
- How can we set appropriate incentives for employees to think differently about credit?

Leverage technology and existing and alternative data to reinvent credit models and processes

- How can we ensure the scale and efficiency of new credit models, and apply them to traditional segments?
- How can we leverage open banking as well as new, robust data sources to update risk models, boost predictiveness and improve services?



Solution

To address this challenge and pave the way to next-generation credit, banks can:

1. Create new credit-related products and services

Banks need to acquire both a qualitative and quantitative understanding of underserved borrower segments to design new credit products that reduce, transfer or share risk and deliver a better customer experience.

By identifying and understanding customers' beliefs and behavior patterns relating to money, banks can use their new products and services to more effectively establish credit profiles for underserved segments.

From special-purpose loans that customers truly value, for needs such as medical emergencies, auto emergencies or vacation planning, to supply-chain loans attached to small sales for businesses, the range of options is limited only by the creativity of solutions.

Amazon Lending, for example, is described as offering “working capital loans designed with your business needs in mind.” Meanwhile Prosper, a fintech that connects people looking to borrow money with individuals and institutions looking to invest in consumer credit, has facilitated more than \$12 billion in loans to more than 770,000 people.⁷

Even “buy now, pay later” (BNPL) arrangements—such as those championed by online lenders like Klarna—should be considered when factoring in credit decisions. Currently, many BNPL providers do not help customers build credit history. Yet the potential of using this information could be differentiating for traditional players aiming to attract new customer groups while managing risk.





2. Shift the decisioning mindset

By implementing a more informed decision-making process, lenders can transition from a hard “yes or no” decision based on a traditional scoring mechanism to a more nuanced “yes, but/no, but” framework.

Banks should encourage employees to adopt a new mindset, creating a corporate culture that facilitates a new customer experience, after the appropriate tools are in place.

From credit decision makers to relationship managers—and, even, chatbot coders—the principle of supporting applicants through the whole process with a mindset of “yes” will require creativity, flexibility and other skills that help transition from a rigid credit process to a new credit experience that increases new-borrower conversion and retention.

This can be achieved in many ways:

- Encourage creative thinking by loan officers, relationship managers and other employees to challenge current paradigms and shift from thinking

about whether it is possible to give credit to exploring ways to make it possible. Building a culture of ideation, experimentation and learning will help identify behaviors that can be replicated and scaled across the organization.

- Train employees, building new skills that will provide the tool set for them to ideate and operate differently. Skills such as design thinking will allow employees to gain a deep understanding of customer needs and mindsets, and design and execute new experiences based on empathy.
- Set incentives to reward innovation, and incorporate performance metrics that measure the progress towards an “always yes” mindset. Explore new ways of encouraging the search for customer needs and pain points in the credit process and how to solve them.



3. Rethink credit decisioning frameworks to increase reach and access

Lenders need to leverage years of data aggregation differently. This will reveal patterns that fundamentally change the structure and accuracy of risk models for both underserved segments and traditional customers.

Extracting meaningful information with a different perspective can expand the reach of credit and allow access to segments that currently are not served.

This can be done through a variety of means:

- More widespread use of new analytical techniques—such as association tests based on natural language processing, or other empirical testing frameworks—to extract meaningful information from existing and new data sources.
- Enriching scoring through data augmentation, given consumers' rapidly expanding options to access credit. This will provide the robust models necessary to play in a world where customers will have more and more credit alternatives.⁸
- Updating existing risk models through alternative scoring methods to complement traditional credit decisions. In a reality where historical information—the main assumption of current risk models—is failing to predict the future, many banks are finding other types of predictors, such as social or lifestyle data, to be increasingly relevant.⁹
- Leveraging bias testing frameworks to understand where new or future risk models may unnecessarily and adversely affect protected groups. These methods can leverage qualitative and empirical dimensions including biases in trust, fairness, model, data or operations, revealing practical opportunities to expand service.





4. Reinvent credit processes to ensure scale and efficiency

Automated digital workflows with built-in controls can enable the provision of credit to underserved segments at scale, with a cost to serve that is attractive to incumbents. These workflows can be created through:

- Straight-through processing design principles and segmentation of credit lines (by type or amount).
- Intelligent automation that enables automated processing and human intervention for exceptions-handling only.

We have identified four enablers that can be harnessed to achieve this:

Deliver financial education to support business development, data collection and the communities you are looking to serve.

In the current COVID-19 environment, it has become clear that technology can play a major role in the democratization of education. The case for financial education and digital literacy will be no different.

Providing financial education to potential customers is a proven way to bolster relationships and improve creditworthiness. By leveraging digital channels to deliver education at scale, banks have an opportunity to influence behavior, convert new borrowers and create new data stream.¹⁰

Inspiration:

Mosabi is a digital platform which blends fintech and edtech to provide emerging-market citizens with the skills and services to better manage their businesses and money. Rather than viewing financial education as a nice-to-have that is offered only after the provision of credit, Mosabi flips this around. Its solution uses data generated by e-learning to drive decisions for financial institutions and help match potential customers with the financial products and services they need.¹¹



Partner with external data providers to boost predictiveness.

Access to alternative data will become essential to the value chain of next-generation credit products.

The expansion of APIs has enabled partners to gain an early foothold into valuable pools of alternative data—Experian leveraging Plaid, for example. This is just the beginning; we are likely to witness an expansion of such partnerships in the near future, such as:

- Telecommunications providers (for example, data about financial transactions done via mobile phone serves as an indicator of cash flow).
- Utilities (whether and how often bills are paid, as a proxy for willingness and ability to repay).
- Wholesale suppliers (payment histories for small businesses, as a proxy for revenue estimation).
- Retailers (data about customer purchases, which can help to estimate income levels).
- Government agencies (demographic and census data, which can indicate default risk).
- Financial institutions' own, previously overlooked data (paper records that have not been digitized).

Inspiration:

The Australian government recently enabled real-time economic data monitoring across the country to visualize how the economy is performing and take action in areas that need immediate support.¹² It worked closely with the financial sector to help financial institutions use this data to assess and respond appropriately to the needs of SMEs nationwide.

Turn to social.

As social media continues to maintain its hold on our daily lives and interactions, lending instruments will need to account for and integrate social data in a meaningful way. In consumer insurance, Friendsurance has long shown the efficacy of socially structured financial instruments at scale.

By creating pooled insurance deductibles among friends, fraud can be substantially reduced. Similarly, lending circles have long leveraged the notion that social capital can build credit histories among those who would otherwise struggle to pay back loans.

Historically, community lenders have taken a similar approach, knocking on proverbial doors to understand whether peers believe

an individual or business is a good credit risk. Social data from social networks, internet service providers and telecommunications companies have the potential to be analyzed and used to create the 21st century version of this risk assessment practice, quantifying the qualitative elements of risk analysis that have thus far been elusive.

As customers become more comfortable with data sharing between third parties and scaled community-based lending becomes better documented, direct or partnership offerings are on the horizon.

Change the corporate culture.

Along with a change in bank employees' mindset, new behaviors and values will be key to driving and sustaining the changes that will shape an improved credit experience.

Initiatives that empower employees, build skills that enable creative thinking, and strengthen employees' ability to work with technology, will be key to the delivery and scaling of a new credit experience. By nurturing a corporate culture that is more empathetic, lenders will ensure that, once new tools and methods are in place, credit is given where it's due.



Inspiration:

Nubank, Brazil's biggest digital bank, has a culture articulated by mission statements such as "We are hungry and challenge the status quo" and "We want our customers to love us fanatically."¹³ The bank, which grew from 5.9 million clients in late 2018 to 25 million by June 2020, is recognized for empowering all employees to be customer-focused—to consider the customer from product development all the way through to the provision of customer services.

A Final Thought

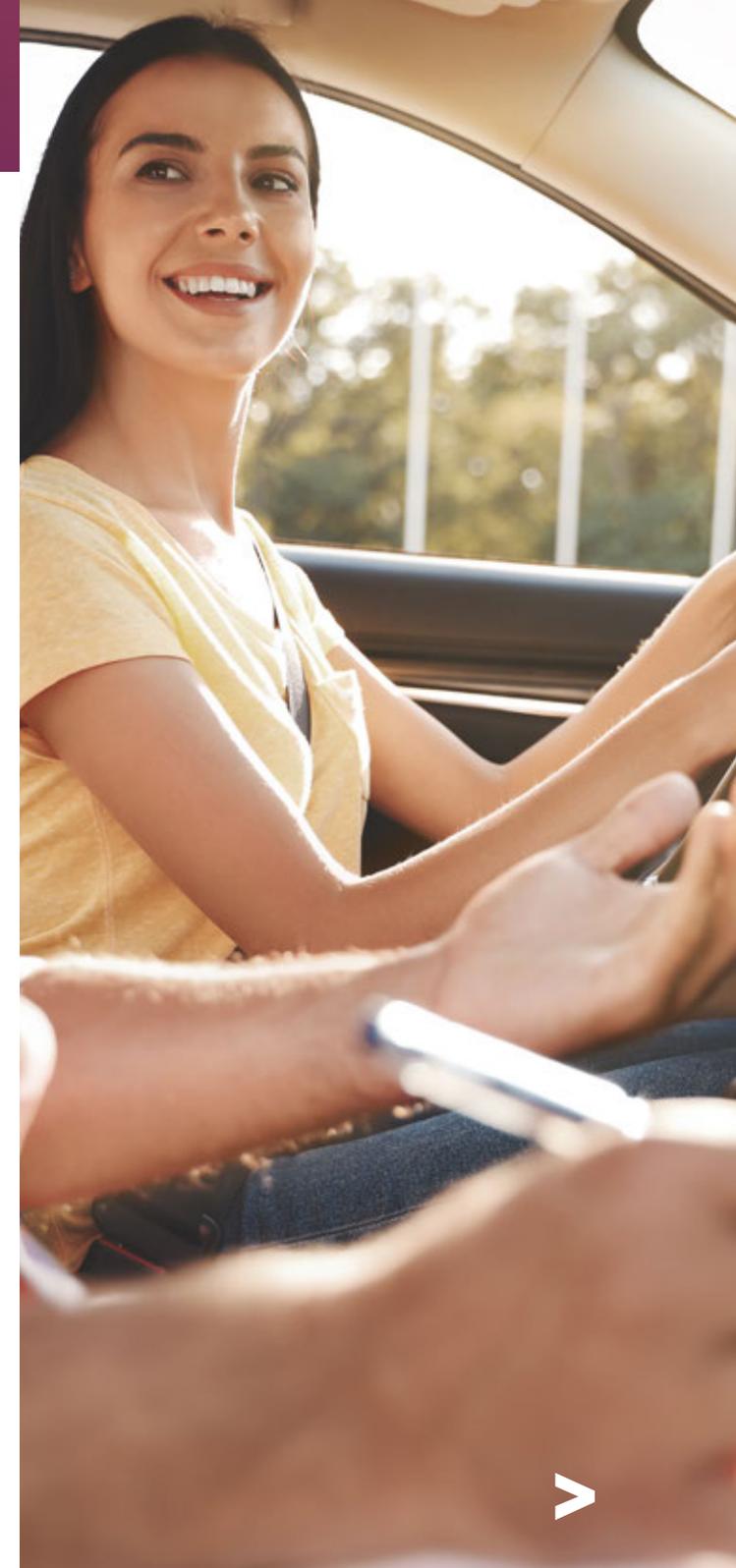
Lenders of the future have an opportunity to deliver a seamless credit experience in which customers feel able to put their best foot forward without any missteps. And they can be confident of having the insights they need since customers have shown more willingness to share the alternative data that will drive this transition¹⁴

Caution will be needed, however, as all involved will need to contribute to a responsible future.

Practices such as instant credit decisions, data augmentation and shared-responsibility or socially-backed loans have the potential to improve financial inclusion and bottom lines. But they also have the potential to be misused.

Traditional lenders will need to tread a fine line between making it easy to get credit and too easy to get into debt; between using data to make better decisions and using information that's too private; and between leveraging the community and putting the community at risk.

By accounting for these risks and starting with underserved borrower segments, lenders can achieve growth and develop a proving ground for alternative data and risk models. Using this experience, they can apply their learnings more broadly to establish efficient next-generation credit models.



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