How lenders use AI and machine learning to boost financial inclusion

Rajat Dayal 3 min read 18 Oct 2023, 12:08 PM IST

A person may not have proof of identity but their online activity can still help predict their behaviour and determine their creditworthiness (Photo: iStock)

SUMMARY

- *Two billion people around the world remain unbanked or underbanked, but a technological revolution is changing the lives of such individuals, who previously had no hope of ascending the economic ladder*

People today are actively engaged in fascinating pursuits through the wonders of mobile and laptop screens. According to a 2020 study by the Ministry of Human Resource Development, younger adults spend an average of 8.8 hours a day on their phones, while the elderly (over 65) indulge for 5.2 hours.

Technology has taken over the world and artificial intelligence has become a household term even in a developing nation like India. The technological and AI revolution is transforming industries, and traditional banking is no exception.

One area in this sector that has experienced significant changes is lending. Borrowing has undergone a remarkable transformation with the advent of digital lending, which makes financial services more accessible, efficient and inclusive. This article delves into the digital-lending revolution and explores its potential to unlock financial opportunities for all.

The digital revolution

In the past, borrowers faced the challenges of daunting paperwork, long approval processes and limited options when accessing credit. But with digital lending, individuals can now apply for loans easily from the comfort of their homes.

What this profound transformation actually represents is the inclusion of the entire spectrum of borrowers around the world. Financial inclusion means any person in any corner of the world can access formal financial banking systems. Two billion people around the world still remain unbanked or underbanked, but the technological revolution is changing the lives of such individuals, who previously had no hope of ascending the economic ladder.

The primary value proposition of a bank is to provide credit to its customers. Until now, financial institutions could only provide loans to individuals or businesses whose intent and ability to pay could be validated through multiple human checkpoints. The primary way to get a loan in times of need is to provide official documentation and proof of identity to the bank or microfinance institution. Another way is to offer up some kind of collateral like gold or property.

But what about those who have neither of these? So far the answer has been, “Tough luck."

At the start of this article, I mentioned how technology has taken over our lives, giving each of us a massive digital footprint. A person may not have proof of identity but their online activity can still help predict their behaviour and assess their creditworthiness.

Let’s take the example of some cloud-based digital lending solutions to explain how this works in reality. Digital lending platforms that harness AI and machine learning (ML) connect networks of unbanked or underbanked customers with banks and other lenders. All the biggest industry players, including telecom operators, mobile wallet providers, banks and so on, work together to analyse the digital footprints of customers, run AI/ML algorithms on them, and build detailed financial identities. I am emphasizing the word ‘financial’ because the platform doesn’t need any personal information of the borrower. It doesn’t need to know the name, gender, or occupation of the person, only their online behaviour, to decide if they are a good candidate for a loan.

The most interesting point here is that the consumer doesn’t even need to own a smartphone. Even with a feature phone, they will leave a digital footprint large enough to be assigned a credit score.

The potential impact of platforms like this is huge. For example, a mother in a remote village in Ivory Coast can instantly get access to a loan to buy medicine for her five-year-old’s treatment. It would also give millions of small and medium businesses a financial safety net to fight unforeseen events.

Digital lending platforms build a bridge between banks, customer networks and captive audiences, automating the loan life cycle for millions of customers in real-time. This means borrowers do not have wait weeks or even days for credit. ML-based platforms are also better than humans at distinguishing good borrowers from bad, thus significantly reducing default rates over time.

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