How credit bureaus and credit scoring help to fill the credit gap for MSME and formalize the “Informals”
1988: the real story of an SME masterpiece...

A prototype “Missing Middle” SME

- The tee-shirt... with a... printed, fake seat-belt!
- Over 1 million sold
Would you lend credit to the “Missing Middle?"

**Profile**
- Small entrepreneur
- New client
- Textile sector
- Annual turnover US$ 285,000
- 3 employees (including himself)
- No account with your bank
- Not reliable data/docs on the SME
- No tax file return
- No collateral (real estate)

**Loan applied for**
- US$ 10,000
- Working capital

**Questions**
- Would you grant him a $ 10,000 loan?
- If yes, how long to process it?
- Would you need documentation?
- Would you request collateral from him?
- How many department would work on that?
- Who would take a decision (a person)?
- How much would it cost to grant such loan?

**Answers (MENA)**
- NO (90%)
- 3 weeks
- YES
- YES
- 4-8
- Credit committee
- $ 300 – $ 800
Somebody dares to do it! And successfully
Case study: Wells Fargo (USA)

- From Collateral to "Reputational collateral"
  - In 1994 Wells Fargo starts Business Direct (SME credit division)
  - Client profile: sales <US$ 325,000 year; employ <5 people
  - Average loan amount US$15,000; max loan amount US$ 100,000

- Results:
  - Portfolio: by 1999 US$ 9.9 billion; by 2003 US$ 15bn
  - In 2002 WF rated number 1 SME lender in the USA

- Success factors?
  - Loan applications by Internet, phone, mail (or branch)
  - No tax return or financial / income statements required;
  - No collateral required (about 94% of loans unsecured)
  - Fully automated decisions (70% of total)
  - Taken with credit bureau + bureau scores + WF scoring)
  - Decision based mainly on SME owner’s consumer loans data
  - Very low processing costs (US$ 30)
  - Very low processing time (max 15 minutes)
THE PROBLEM/OPPORTUNITY:
- SMEs with <250 workers = 77% of jobs and 56% of exports in Turkey (2010)
- However, slowest-growing group in the economy, lagging peers in ECA
- Main obstacle to SME growth: lack of working capital
- Collateral always required of SMEs, exceeding 90% of loan
- SME loan applications frequently rejected, underwriting slow / cumbersome / paper-based
- Opportunity for banks with innovative products and more efficient delivery models

THE PIONEER: GARANTI BANKASI:
- 2nd largest bank / 856 branches
- Covers 96% of the country
- Largest POS network (190,000)
- 2007: launch of P.O.S SME loans
- 17TH different SME segments
- POS + Scoring + credit bureau

THE RESULTS (in 2010):
- SME loans: + 38% (US$ 12.9 bn)
- NPL: 3.3% (peers 7.5%)
- 157,000 new SME clients (US$ 4.3 bn)
- Total SME clients 1.27 million
- No collateral
- Build “REPUTATIONAL COLLATERAL”
What is “reputational collateral”?

- Is an intangible reputation
- Not based on assets but...
- ...based on individual repayment behavior
- It is “certified” by the credit bureau
- It is validated by the credit report

- Replaces: collateral, financials, tax files
- It is:
  - free and...
  - easily available to every good payer
How can the “informals” build reputational collateral?

• The “CATCH-22” situation:
  • Poor consumers, micro / informal entrepreneurs pay cash
  • Have no credit history = (“no file” or “thin file”)
  • No reputational collateral
  • Are not “scorable”
  • Therefore difficulty in accessing credit
  • Their transactions defined as “credit like / cash-like”
  • Even in the US estimated in 35-50 million

• Answer: alternative (non-traditional) data
  • Includes: utilities, rentals, cable TV, insurance
  • Utilities are the most helpful since universal, homogeneous, reliable
  • This data is very predictive
  • Payment regularity is a strong risk indicator
  • It is a shortcut to build a credit history
Cases study: Water Score (Italy - 2010)

Scoring the “unscorables”

1. THE CHALLENGE
   - can a good payment track on water bills be considered as good as credit data to build a scoring model for MSME, informal economy, and individuals without credit history?

2. THE OBJECTIVE
   - increase credit access for non bankable applicants or without a credit history thanks to the utilization of water score by lenders.

3. THE PLAYERS
   - Local Administration (South of Italy region)
   - CRIF Private Credit Bureau (PCB)
   - The Water Company (public utility)

4. DATA USED FOR DEVELOPMENT
   - Historical data on water bills only
   - Payments executed from 2006 to 2008
   - Population analyzed: 154,000 payers
     - 112,000 with a credit history in the PCB
     - 42,000 without credit history in the PCB
The answer is **yes**, the scoring model developed on water payment data allows a **robust risk assessment** of those clients that pay their water bills **regularly and punctually**.

In particular, among the 42,000 with **no credit history**, roughly 37,000 borrowers (83%) can become eligible for credit.

If appropriately fine tuned the model can easily be extended to other utilities / or municipalities.

In conclusion, a potential 'good' customer that finds it difficult to access credit through traditional channels and traditional information, could vastly benefit from the utilization of alternative data.
1. THE CHALLENGE
• Can scoring models built on pre-paid mobile phone usage data, predict MSME credit risk?

2. THE PLAYERS
• Developed by Experian MicroAnalytics
• A few banks partners (users)
• SMART, largest mobile operator (68%)

3. THE OBJECTIVE
• create a scoring model that allows banks to offer unsecured loans to MSME in a country where practically everybody holds a mobile phone

3. DATA USED FOR DEVELOPMENT
• Only data on pre-paid mobile telephone (no credit data)
• Available practically for every Filipino
• Supplied by SMART (anonymous data)
• Including: mobile usage, SMS usage, number and value of calls, top-up amounts and number
• The answer is yes
• The airtime score predicts risk very well
• SMART clients apply for loans directly from mobile
• If score is positive, they are granted a loan
• No collateral requested
• Paperless on-line application
• NO tax files, financials, papers
• Approval time: instant
• Initial loans between 50 / 200 euro (score based)
• Automatically increased for good payers
• Cost of risk very contained: NPL low single digit

1. Banks partners of SMART can grant unsecured loans based only on the airtime scoring model
2. Bank’s target: clients too small to be profitably served by MFI/bank, due to location and loan size
3. Transaction costs are risible: loans are granted using SMART’s airtime network
4. Airtime score allows financial inclusion for millions of otherwise “non-bankable” Filipinos
5. Builds reputational collateral / credit histories
Granting credit is not enough: credit must be granted responsibly!

How bureau scores preempt portfolio risk deterioration

- In Egypt 1 PCB operating only with banks (mandated by law to share data and inquire)
- MFIs refused to share data (not mandated by law)
- **TEST**: comparison of MFIs clients with the data in the Credit Bureau (all the Egyptian banks)

<table>
<thead>
<tr>
<th>SAME CLIENTS</th>
<th>MFIs loan volumes</th>
<th>Credit bureau Loan volumes (banks)</th>
<th>Other MFIs Loan volumes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding Balance (LE)</td>
<td>149,309,665</td>
<td>494,702,958</td>
<td>5,019,795</td>
</tr>
</tbody>
</table>

Outstanding Balance details

- Micro Finance Companies
- Credit bureau
- Other MF. Companies
The role of Bureau Scores in the Egyptian case

- Worst still to come when...

Score distribution

<table>
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<tr>
<th>Score Distribution</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-DEFAULTING (300-400)</td>
<td>2%</td>
</tr>
<tr>
<td>2-HIGH RISK (401-625)</td>
<td>22%</td>
</tr>
<tr>
<td>3-GOOD (626-700)</td>
<td>19%</td>
</tr>
<tr>
<td>4-VERY GOOD (701-750)</td>
<td>30%</td>
</tr>
<tr>
<td>5-OUTSTANDING (751-HIG)</td>
<td>21%</td>
</tr>
<tr>
<td>6-SCORE NOT AVAILABLE</td>
<td>6%</td>
</tr>
</tbody>
</table>

- ...Bureau Scores identified 24% of those clients in common with the banks to be either bad or very bad.
Guess the number….

11,000,000,000

Number of Bureau Scores sold in the US in 2011
Thank you

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