

Credit Scoring Evaluation Methods Used For Credit Loan Approval of Select Banks in India

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Abstract

As India is transiting towards digital and credit payments, many individuals are opting for credit loans. Credit loans play a prominent role in banking industry as most of the revenue is generated from lending loans. Credit loans are issued based on individual's credit score which is generated by credit rating agencies considering certain parameters for calculating the score. With this increasing trend, there is a need to understand the concept of credit score, credit score evaluation methods and the parameters that are considered for credit loan approval.

Six banks were considered under this study for evaluating credit scoring methods and to find the parameters used while deciding on approving loan to an individual. The primary evaluating methods in India are CIBIL and FICO. This study uses parameters like Payment history, credit length, credit utilization, credit mix, credit type and debt level and the weights considered for each parameter under different evaluation methods.

Keywords: Credit Score, CIBIL, FICO, Equifax, Credit Evaluation Methods, credit payment history, Credit Loans, Digital Payments

Date of Submission: 09-10-2020

Date of Acceptance: 25-10-2020

I. Introduction

As India is rapidly progressing towards digital and credit payments, many individuals are opting for credit loans. Credit loans play a prominent role in banking industry as most of the revenue is generated from lending loans. Credit loans are issued based on individual's credit score which is generated by credit rating agencies considering certain parameters for calculating the score. With this increasing trend, there is a need to understand the concept of credit score, credit score evaluation methods and the parameters that are considered for credit loan approval.

Credit Score:

Credit scoring is one of the quantification methods to evaluate credit risk. Credit score gives the creditworthiness of an individual which varies between 250 and 1000. Credit score is calculated based on credit related activity. Periodically banks and other financial institutions sends their customer's credit details like all the credit card payments, missed and delinquent payments, credit limit, credit utilization and credit account status of loans taken, and loans settled or written-off. By using all this information, credit score which is in three digits is generated. Customers are classified as defaulters or non-defaulters based on the credit score; they maintain.

Credit Score Ranges and meaning

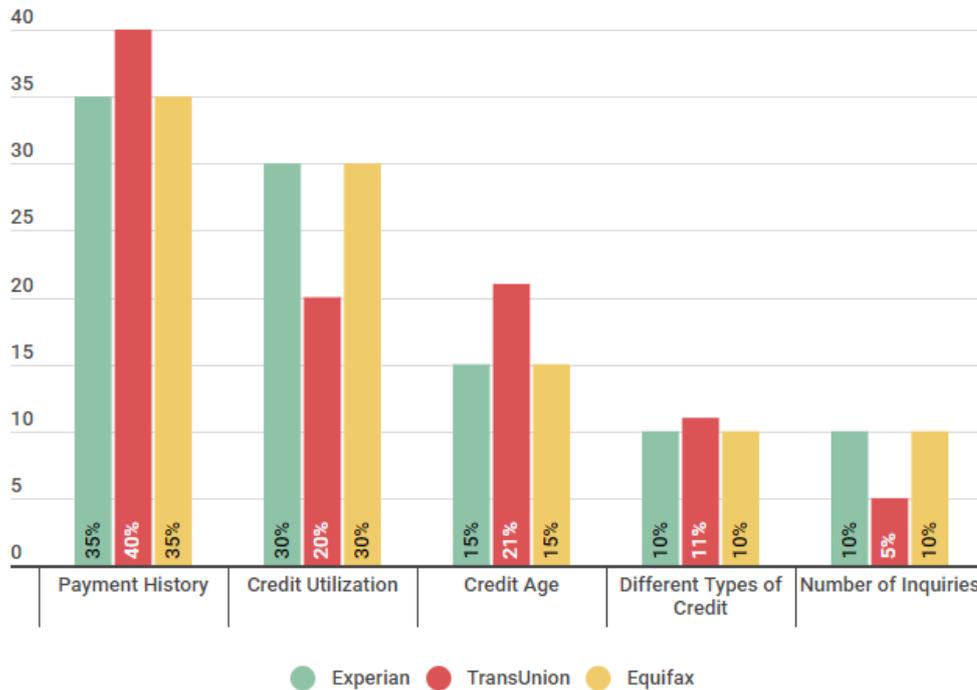
Status	CIBIL	FICO	Equifax	Experian	
Excellent	>900	800-900	800-1000	800-850	Loans with cheap interest rates. Negotiation power for rewards and benefits
Very Good	750-900	740-799	740-799	740-799	
Good	700-750	670-739	670-739	670-739	
Fair	550-700	580-669	580-669	580-669	Take measures to improve score
Poor	300-550	250-579	<579	300-579	Bad borrower and defaulted payments
Payment for Credit Report	Rs.550 for credit report and Rs 1200 per annum (4 reports)	Rs.1400 per credit report and Rs.2800 per annum	Rs.400 per credit report and Rs.1000 annual fee	Rs138 for each report	

Credit Evaluation Methods

There are many agencies that give credit scores and supply credit reports by using various credit evaluation methods to organizations and individuals. The prominent credit rated agencies all over the world are

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CIBIL, FICO, Equifax, and Experian. CIBIL and FICO are primarily used credit evaluation methods in India. The influencing parameters in credit scoring used in India are payment history, age of credit payments, type of credit payments, credit utilization ratio, lenders enquiries count, credit defaults, default severity, overdue amounts, and credit mix.

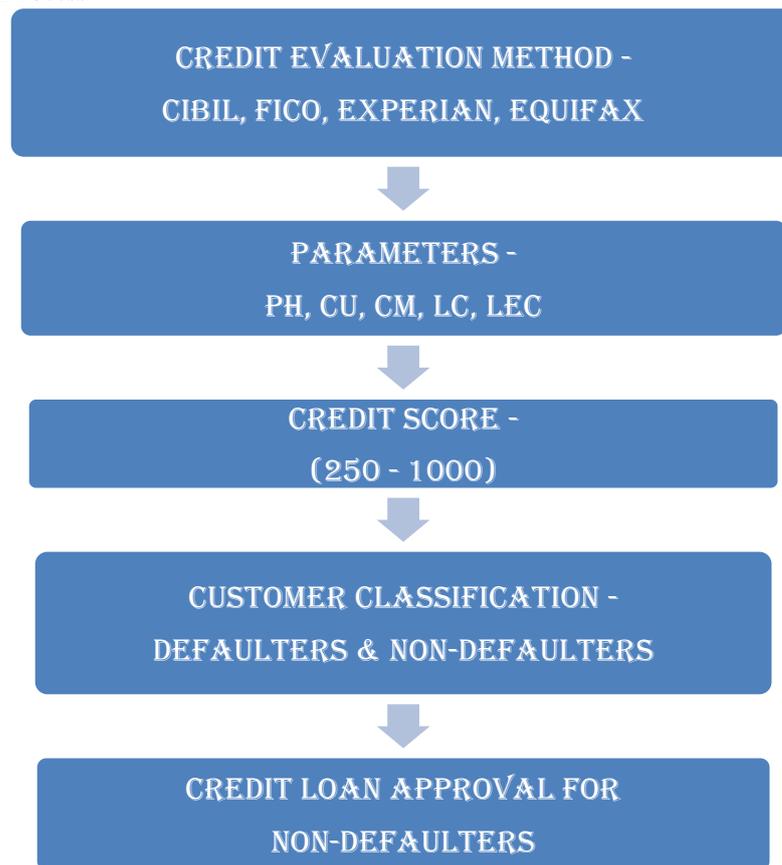


Source - <https://money.howstuffworks.com/personal-finance/debt-management/credit-score1.htm>

Terminology:

Credit Score	CS
Credit Loan Approval	CLA
Payment History	PH
Credit Utilisation	CU
Credit Mix (Types of Credit)	CM
Length of Credit (Credit Age)	LC
Lenders Enquiries Count (Number of Enquiries)	LEC

Credit Loan Approval Process



Objectives of the study:

1. To understand the concept of credit score.
2. To identify the credit scoring evaluation methods.
3. To identify the evaluation parameters for credit scoring.
4. To compare credit scoring methods of Indian banks with foreign banks.
5. To find the customers challenges opting credit loan

Data Collection: Both primary and secondary data is collected for this study. Primary data is collected using a questionnaire from 88 respondents. Some respondent's responses were not considered as they do not have awareness of how credit score is evaluated, and which evaluation techniques were used, or they never checked their credit scores.

Need of the study: As India moves towards digital payments and online transactions, many people are deferring payments using EMI (Equated Monthly Instalment) method. Many financial institutions are offering better interest rates for credit lending, easy documentation and less demand for collateral securities making many individuals are moving towards using the credit offers. In view of this major transition, there is a need to understand the concept of credit scoring, the credit evaluation methods and the parameters considered for credit evaluation.

Scope of the Study: Six banks were considered out of which three are Indian banks namely, SBI, Axis and HDFC and three foreign banks Citibank, Standard Chartered and HSBC for this study. This study evaluates credit scoring methods like FICO, CIBIL and Equifax and the parameters like credit history, credit length, debt level, credit utilization, credit mix required for evaluation.

Limitations of the study:

1. Only six banks were considered for this study.
2. With mergers of many banks, only select banks were considered.
3. Credit evaluation Parameters considered are the parameters that are used in India only.
4. Responses are considered from the respondents who are aware of credit scores and the credit evaluation methods. Other responses were discarded.

S.No.	Parameters	SBI	Axis	HDFC	Citibank	Standard Chartered	HSBC
1	Credit Evaluation Method	CIBIL	CIBIL	CIBIL	FICO	CIBIL	CIBIL
Weights for Parameters							
2	PH	30%	30%	30%	35%	30%	30%
3	CU	25%	25%	25%	30%	25%	25%
4	CM	25%	25%	25%	10%	25%	25%
5	LC	-	-	-	15%	-	-
6	LEC	20%	20%	20%	10%	20%	20%

Statistical Techniques:

Many statistical techniques can be applied to credit scoring models. Some of these techniques are linear regression model, logistic regression, discriminant analysis, weight of evidence measure, decision tree and mathematical programming.

Logistic regression technique can also be applied for credit scoring where data can be classified into two groups and a dichotomous outcome is expected like credit defaulters and non-defaulters, risky and non-risky customers. To discriminate between two groups, discriminant analysis technique can be applied. Weight of evidence measures technique is used for investigating credit scoring models. Hand & Henley, 1997 suggested “one of the classification technique decision trees is used for development of credit scoring models”.

Multiple linear regression analysis is another technique used when there is more than one independent variable.

Multiple Linear Regression Model

Credit score is the dependent variable and PH, CU, CM, LC, LEC are the independent variables in the below model. Multiple linear regression is the best applied statistical technique for this model. Chi-square test could be used to check the association between CS and Credit loan approval.

$$CS = \beta_0 + \beta_1 (PH) + \beta_2 (CU) + \beta_3 (CM) + \beta_4 (LC) + \beta_5 (LEC) + \varepsilon$$

Challenges faced by consumers opting credit loan

1. There is no common range for credit scores among different credit rating agencies. Consumers get confused with different credit scores.
2. Consumers must undergo cumbersome and expensive process to rectify the inaccurate information.
3. Consumers need to pay fee every time for generating credit score to few credit rating agencies. They pay fee to get authentic credit scores.

II. Findings:

Based on secondary sources

1. Majority of the banks operating in India uses CIBIL score as credit evaluation method.
2. Out of the selected banks, only Citibank uses FICO credit evaluation method for credit scoring.
3. Even though Standard Chartered and HSBC are from foreign category, they use CIBIL score as credit evaluation method.
4. FICO gives 35% weight to payment history while CIBIL gives a weight of 30%.
5. Equifax, Experian, FICO and CIBIL use different ranges of credit scores.
6. Higher credit scores entitle a consumer for preferential pricing and special discount rates on interest rates.

Based on Survey:

7. About 52% are aware of their credit scores which they check every quarter. Respondents in the range of 750-900 are 57.5%.
8. About 40% knows credit scoring evaluation methods and 34.5% knows how credit scores are calculated.
9. CIBIL is well known among respondents with 91.5%.
10. Majority has taken vehicle loan (38.6%) followed by house loan (34.1%) and personal loan (27.3%).
11. HDFC is preferred more while taking credit loans followed by SBI and Axis Banks. HSBC and Standard Chartered were not preferred by the respondents.
12. About 70.5% are satisfied with the credit loan process and 42.2% felt it is an easier process.
13. Unnecessary Documentation has been identified as major problem during credit loan process.
14. Majority observed Timely Payments (70.6%) followed by Payment History (45.1%) helps in getting better credit score.

III. Conclusion:

Credit loans play a prominent role in bank industry as revenue is generated through credit payments. Credit score is evaluated using various parameters. Good and excellent credit scores help an individual and entities to get a credit loan approval. Credit rating bureaus use different score ranges which creates confusion for customers. It is advisable to use common credit score ranges for calculating credit score as Equifax (280-850), Experian (0-1000), FICO and CIBIL (300-900) use different ranges of credit scores. Out of the six select banks,

five banks are using CIBIL evaluation and one bank (Citibank) is using FICO evaluation method. Higher credit scores entitle a consumer for preferential pricing and special discount rates on interest rates. The first preferred credit loan is vehicle loan followed by house loan. Majority considered HDFC bank as their first choice while going with credit loans. SBI and Axis banks are considered after HDFC. The parameters 'Timely Payments' and 'Payment History' are identified to boost the credit score of an individual.

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E SaraswatiRamaniSallaVimal Kumar. "Credit Scoring Evaluation Methods Used For Credit Loan Approval of Select Banks in India." *IOSR Journal of Economics and Finance (IOSR-JEF)*, 11(5), 2020, pp. 01-05.