



THE COMPLETE GUIDE TO ALTERNATIVE CREDIT SCORING

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INTRODUCTION



Alternative data has become a buzzword in recent years, with the increased use of alternative sources of information within the banking and fintech world. Nevertheless, given the novelty of this dataset, there is a general misunderstanding of what alternative data is and how companies can leverage this power tool for continued growth.

For the past ten years, financial companies have been looking for reliable data sources to provide information about consumers and their behaviours. **The constant change in this digital world brings a great advantage not formally registered before - analysing people's digital behaviour.** Alternative data provides a revolutionary understanding of creditworthiness, opening up a new set of credit models that can accurately rate people, with other than just traditional methods.

Alternative credit scoring arises from the need to serve thin-file customers, forming the majority of under and unbanked potential borrowers in emerging markets. Unlike traditional data, this

advanced credit scoring includes new data sources related to people's behaviours such as rental payment and subscriptions, emails, social networks behaviours, financial reports, geolocation, among others. The rapid generation of alternative data from improved artificial intelligence models has introduced a great **new opportunity to improve profits in the market.**

Thanks to alternative data and machine learning, companies have a fascinating advantage: access to valuable information about customers' behaviour - and future customers - allowing companies to grow rapidly.

In this ebook, we'll help you understand what alternative data is and, more specifically, how certain tools such as alternative credit scoring can help your business grow by tapping new unexplored market segments.

WHAT IS ALTERNATIVE DATA?

Alternative data is the set of information on behaviours, habits, interests and transactions carried out by a person and obtained from non-traditional sources. These sources include social networks, data obtained from satellites, sensors, credit card transactions, purchase receipts stored in emails, among others.

Alternative data has grown rapidly in recent years, given the improved sophistication of machine learning and the availability of big data. **The growth of alternative data is exponential, powered by the fact that more and more users are storing information on the network, generating new data every day.**

The rapid generation of alternative data has introduced a new, unexplored opportunity to improve profits in the market. The correct use of alternative data through machine learning gives companies a fascinating advantage; access to valuable information about the behaviour of customers - and future customers - allowing companies to grow rapidly. Nevertheless, its advantages come along with several challenges, and only some companies have been able to incorporate this type of data.



BENEFITS AND CHALLENGES OF ALTERNATIVE DATA



Benefits of Alternative Data

In the first place, it is important to note that, thanks to alternative data, companies can **compare and measure information in real-time**, generating truly innovative indicators. For example, in this way, credits can be offered on the spot to applicants with an alternative credit score.

Alternative data **improves the self-knowledge of a company**. A large amount of existing alternative data allows institutions to have a more accurate perception of their performance. The connection of these insights enables companies to correctly interpret how they are perceived by people, comparing themselves against competitors, suppliers, and other secure connection networks.

Another important benefit to be considered is the capacity to **operate predictively using alternative data**. Through this novel source of information and in conjunction with traditional sources, companies can more reliably predict long-term results. In addition, alternative data allows companies to predict clients' behaviours, and in this way, growth projections become more effective, optimising decision-making and reducing the probability of risk.

Alternative data has been broadly welcomed by companies looking to improve prediction rates, maximise returns and decrease unforeseen risks. In addition, this new source of data provides security, offering businesses more than just big data.



Challenges of Alternative Data

Alternative data is relatively new, so it can raise several questions at first glance. There is a lack of historical records, plus not all alternative data is publicly accessible. Therefore, it is essential to accurately understand **where information is coming from** and the limitations of usage.

Currently, there is a **wide variety of alternative data sources**, so companies need to organise them and clearly distinguish between those most relevant for the business. Furthermore, as there is no standard pattern of use, it is of utmost importance to understand how they work holistically and completely with all sources of information.

Added to this scenario, companies face the challenge of **data interpretation**. With a wide variety of sources, it can be challenging to distinguish and judge the quality of each source to choose the correct one. Any corruption of this data can result in incorrect decision making and great harm to the company.

Another important aspect to be considered is the accurate knowledge of the private **legal terms of each source**. This knowledge includes understanding where the information is coming from, the implementation limitations, and correct and ethical use of its storage.

Finally, it is vital to highlight that as some data may be unstructured and incomplete, its **usage is limited**. For example, by having an incomplete history record without the necessary backup of information, sometimes more time is needed to continue collecting data that will allow us to generate definitive patterns of behaviour in the future.



ALTERNATIVE CREDIT SCORING VS. TRADITIONAL CREDIT SCORING

Up until a few years back, a credit score was only obtained through traditional credit scoring methods. Traditional credit scores or ratings result from a credit analysis performed by different credit bureaus, indicating whether or not a person or institution is soluble enough to obtain a loan. Previously, these traditional institutions were the only ones that had the ability to analyse and score the financial history of a person.

With the rise of alternative scoring, it is now viable to carry out a much more complete and updated credit analysis on clients and potential clients through behaviour prediction. With alternative data, it is possible to anticipate movements and obtain more accurate patterns on an applicant's willingness to pay. In this way, banks and financial institutions can secure a reduction in the risk of credit default, strengthening algorithms that previously were solely based on traditional data.

The conjunction of alternative data sources and traditional sources has achieved a perfect optimisation of results that traditional data by itself could not have reached. Among the traditional sources we find that sources like SEC filings and customer credit scores, even though they add significant value to the market, are unable to provide or anticipate users' future behaviour patterns. The combination of both types of data allows companies to anticipate users and technology changes.

For that reason, Fintechs worldwide have begun to innovate within alternative credit scoring to capture this segment of the market currently ignored but constituting a big opportunity for growth. These technological innovators are focusing on ways of analysing data beyond the traditional system, and alternative data is trending as the new solution to the ever-present problem of financial exclusion.



HOW ALTERNATIVE DATA CAN OPEN UP FINANCIAL OPPORTUNITIES FOR CREDIT INVISIBLES



Applying for credit has historically been challenging to achieve. It is even more so for people who have little to no opportunities to build their credit scores. These people typically consist of young adults who have yet to build their credit history, immigrants who can't transfer their credit report from their previous home country, and people of colour, disadvantaged by racial inequality from accessing financial services.

These individuals cannot purchase productive assets such as a car or a house or build their wealth with their own resources. Thus, access to credit plays a vital role in strengthening financial power. However, the downside of the traditional credit scoring system is that it provides little to no opportunities for credit invisibles to prove themselves.

Today, there are over 2 billion people globally without formal financial services access because their data is not held on traditional sources. A lack of regular, fixed wages and formal savings adds to the financial inconsistency. Existing credit models do not serve the needs of economically active lower-income households and enterprises, which is why many lenders are seeking out an alternative approach.

Integrating alternative data sources in credit scoring and lending processes can significantly help credit invisibles build their credit history and scores. These sources can include bills for utilities, telecommunications, and rent; alternative lending payments; and demand deposit account information such as recurring payroll deposits and payments all of which are already part of people's regular financial commitments.

With new alternative scoring, data enrichment systems can complete, in real-time, a person's profile with information from multiple sources, allowing companies to understand in a better way their prospects and make substantially more informed decisions.

The evolution of new ways of evaluating credit profiles through alternative data and machine learning mechanisms has generated a **popular and positive impact in the financial circuit.** Thanks to these new credit review processes, the credit approval rates have significantly increased and thus have a new client portfolio.





USING ALTERNATIVE DATA TO CREDIT SCORE MILLENNIALS

At first glance, the financial profiles of millennials may seem incomplete or complex to banks and financial institutions. young people in their 20s and 30s are sometimes affected by the lack of credit history and disabled to meet their goals of buying a home, car, obtaining credit or making an investment. on many occasions, their loan applications are rejected or are imposed high interest rates that prevent them from obtaining profitable loans.

The lack of a traditional credit history does not mean that these young people are unreliable or not eligible for credit. on the contrary, many of them are the ideal clients financial institutions need.

Millennials are now the largest adult cohort in the world with 1.8 billion people around the world, equal to 23% of the global population. plus, they live in a 100% online world. millennials are highly dependent on their smartphone usage, spending an average of 3.7 hours a day on their phones, and when you factor out average sleeping time, millennials spend nearly a quarter of the day (23.1%) on their phones!*

*Source:<https://www.entrepreneur.com/article/360098>

With this in mind, it's no surprise that millennials are also largely involved in financial technology or fintech as well, with e-wallets and other mobile fintech apps helping them complete transactions in their daily lives. Unlike their parents, **their first contact and interaction with banks and money flows is completely digital.** With millennials making up nearly half of the world's working population in the next 10 years, their generation's spending power will continuously increase over time, making them highly influential consumers.

Millennials often opt for fintech startups that meet their credit expectations when faced with the great demand in the banking market. These new companies have a closer relationship with young people, adapting to their needs in the entire evaluation process: from their credit assessment to how they communicate. They also use **alternative data and score apps to conduct evaluations, making it more likely to grant loans to millennials who do not have a traditional credit history.**





ALTERNATIVE CREDIT SCORING, AN ALLY FOR MANY INDUSTRIES

The utility of alternative data is so broad that it reaches multiple industries such as: Bank & Consumer Finance, Buy Now Pay Later, Digital Lending, Neobanks & Challenger Banks and Ride-Hailing. Its wide use explains the success of alternative data in recent years and how new sources of information are redefining the game.

For **Banks and Consumer Finance** companies, alternative credit scores enable customer creditworthiness predictions like never before. By applying scoring algorithms to anonymous metadata, companies can obtain robust personalised models of human behaviour in social, spatial and sequential contexts. This dramatically improves companies' access to new market segments, such as the new-to-credit (NTC), new-to-bank, thin file, millennials and self-employed.

Digital Lenders are also benefiting from alternative data. Micro, small and medium-sized digital lenders can struggle big time to achieve business growth; all the metrics might be aligned, but access to capital may be lacking giving larger companies an unfair advantage. Alternative credit scoring can help digital lenders to create more accurate credit ratings and provide more loans to new customers, thus achieving the desired growth.

Thanks to alternative data, companies can obtain preciser credit profiles, make informed decisions, and incorporate these currently forgotten people into the financial market.

“**Buy Now Pay Later**” (BNPL) has had huge success in recent years as a tactic for acquisition and customer loyalty. Alternative information is essential to segment potential clients that would most likely meet their debts. The travel industry is one of the many industries that can benefit from this charging system. For example, companies can retain customers who have fulfilled a purchase by offering more payment and credit options.

Alternative data can also help **NeoBanks and Challenger Banks** to discover an untapped source of data to de-risk a whole new market, such as Unbanked, new-to-credit, Gen-Zs, Gig-Economy workers and small business owners that despite their creditworthiness, might have failed the traditional credit test. By using alternative data scores, NeoBanks and Challenger Banks can create a path for these individuals to access mainstream financial services.

The use of new credit rating models integrated with artificial intelligence impacts a wide variety of industries by modifying the rules of the game.



CREDOLAB: DEMOCRATISING CREDIT SCORING

We believe loans improve lives. We also believe traditional banking processes leave a lot of people out of the process. That's why credolab is changing the way the world looks at credit. Our pioneering technology calculates credit scores based on people's mobile and web behavioural data— so lenders can make decisions based on the way people live and work in the modern world.

Existing credit models do not serve the needs of economically active lower-income households and small businesses, which is why many lenders are seeking out an alternative approach. At **credolab we offer a unique alternative credit scoring solution aimed at serving exactly these people.** Thanks **to the most sophisticated embedded scoring tool available on the market, credolab helps you collect alternative data from smartphone and web devices. In a seamless and privacy-consented way, we help you collect anonymous metadata - not personal data - while your customers apply for a BNPL product, any cash loan or a credit card.**

Smartphones are in the hands of a large majority of users and leave an enormous digital footprint, with tens of thousands of data points that can be used to predict user behaviour. The sheer amount of Big Data is exactly **why credolab's statistical models are so impressively predictive and stable.**

Credolab's know-how, expertise and experience convert metadata into credit insights. Insights can be gained from the most unlikely sources: for example, the number of contacts, how much storage is utilised, and the



time of day that phone calls are made – these “features” can be entered into models to determine credit scores. Without adding any friction to your user journey, we calculate a very predictive alternative risk score that complements your existing models. Models that also already include information from the credit bureau and improves your ability to approve more customers, more confidently.

Despite being a promising resource, mobile phone data acquisition draws scepticism from customers with regards to security and authenticity. **What differentiates credoSDK from all other solutions is that the data is collected in a completely anonymous way, only after having received the privacy consent of the user, and also processed in the form of metadata, not personal data.** Credolab converts non-personal and consented (all above board, legal and proper) digital footprints into behavioural insights for greater predictivity.

Companies can now calculate real-time credit scores based on evidence; shown in behavioural data from mobiles and web use. This previously untapped data means lenders can make decisions based on the way people behave in the modern world – not just how they look on paper.

[Learn more about credoSDK.](#)

ABOUT CREDOLAB:

**CREDOLAB IS COMMITTED TO
MAKING CREDIT AVAILABLE
TO ALL.**

We do this by giving businesses access to an untapped, highly-predictive source of behavioural data to make faster, better credit scoring decisions with zero error rates.

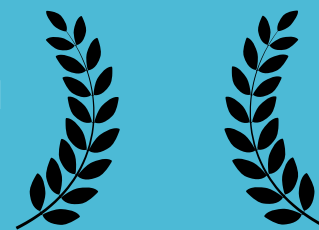
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[Talk to us today.](#)

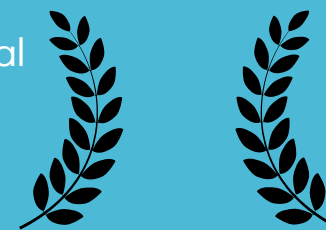




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Newtech Watchlist
2021



Winner of 2021 Financial
Newtech Challenge
"Banking-Scale up"
Award



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in the world
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Singapore's Top 10 Fintech
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