

COMPETITIVE CREDIT MARKETS IN ECONOMIES WITH NO RECENT CREDIT BUREAU RATING, FUNCTIONAL CHARACTERISTICS AND MULTIPLE LOAN BEHAVIOUR

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ABSTRACT

There is credit information asymmetry between lenders and borrowers which is generally bridged by credit registries or credit bureaus who normally provide financial credit information to the lending decision-makers. Such credit information assists lenders across all disciplines with much-needed decision input, however, not every country has a credit registry or credit bureaus that provide this vital information. This report reviews the list of countries that do not have access to credit information and provides insights into some of the issues and characteristics that are encountered by the credit markets

Key Words: Bureau, Credit information, Lending costs, Operational risk, Registry.

Introduction

Emerging and developing economies face major challenges in accessing finance, mainly due to the information asymmetry between lenders and borrowers that encourages adverse selection and moral hazard (Thouraya Triki and Ousman Gajigo, 2012). One of the main ways that credit institutions can make well-informed and important lending decisions is on the basis of the credit information they are able to obtain about the prospective client. Credit registries and bureaus have therefore been established around the world to serve as information brokers. In more developed and advanced financial services economies, there will be regulatory and supervisory bodies that operate a Prudential or Macroprudential financial framework and controls under which credit institutions operate (Villar 2017). The Macroprudential regulation and controls are the regulatory regulation that aims to reduce the financial system risk as a whole while a Microprudential policy focusing on ensuring that individual institutions apply appropriate risk management frameworks that makes them resilient to shocks (Borio 2014). Macroprudential policies have been quite effective in stabilizing credit cycles. The propagation of the effects to credit growth is more rapid for policies aimed at curbing the cycle than for policies aimed at fostering resilience ; and macroprudential tools have a greater effect on credit growth when reinforced by the use of monetary policy (Gambacorta Leonardo and Murcia Andrés, 2020). The operating mechanism of an effective credit registry market will include the credit registry

institution system, the credit registry product system, the credit registry supervision system, the information-sharing mechanism, and the credit incentive constraint mechanism (QIU, XIAO, and Xi, 2014).

The regulatory environment in many of the advanced and developed countries will include regulatory reserves from the lending institutions for various risk reserves like liquidity requirements, foreign currency position requirement, solvency, capital adequacy, deposit-to-liabilities ratio controls. In underdeveloped regions of the world, the credit and lending activities of the lending institutions are under much less regulation, supervision, and requirements. The bulk of commercial credit consists of four distinct types of loans : asset-based loans (ABL), cash-flow loans, trade finance agreements, and leases (Ivashina Victoria, Laeven Luc, Moral-Benito Enrique, 2021). Large and well-capitalized banks with low-risk indicators, stable sources of funding, and a commercial business model generally supply more credit. Such banks are also more sheltered from monetary and global shocks, with the role of specific characteristics varying by the type of shock (Cantú Carlos, Claessens Stijn, and Gambacorta Leonardo, 2020). The effects of monetary policy propagating through banks' balance sheets are primarily driven by cash flow loans, whereas asset-based credit is mostly insensitive to these types of effects, consistent with theories on the pledgeability of hard assets (Ivashina Victoria, Laeven Luc, Moral-Benito Enrique, 2021). Much of the research

focus has been on the competition between the lending institutions for information on the borrower and its impact on the cost of borrowing and has been on markets that generally have credit registries or bureaus. Others have been on using the different datasets to calculate the credit score of customers (Kyeong, S. ; Kim, D.; Shin, J. Can, 2022,)

Thus the findings have suggested that information sharing between lenders by means of a credit bureau or credit registry whether public or private does not affect access to credit or the cost of credit, but rather improves loan performance mainly by disciplining borrowers to repay in their concern about future access to credit (Behr and Sonnekalb 2012). The sudden introduction of a credit registry, an information-sharing mechanism across banks, for a subset of borrowers also corroborated the finding (Liberti, Jose Maria, and Seru, Amit and Vig, Vikrant, 2016). There is also an aggregate portion of the world's financial services and lending institutions that have to operate under an environment that does not yet have credit bureaus or registries. That world also needs attention with regards to how credit is provided, the extent to which the lack of a credit bureau or registry impacts the borrowing access and costs, and how they stay competitive. Research on this theme is limited in academic literature to date (Simovic et al 2014). A further study into the credit market behaviors in the absence of credit information bureaus like this report contributes to that unique gap and will encourage the setting up of these important contributors in the economies that do not have them as yet. A major problem of multiple loan behavior due to the credit information asymmetry and irresponsible borrowing by some borrowers in addition to lending institutions receiving the much-needed valuable inputs to decision making on their lending institutions will be realized.

Characteristics of the credit market

Behavioral economics studies the non-traditional preferences, beliefs, and decision-making or the deviations from the standard economic model (Milde C. 2008). The decision to borrow in some cases will be considered a non-standard preference deviation from the traditional and standard theory of economics in which the individual and households are considered to make rational choices. The activity of borrowing automatically changes the status of the borrower into a debtor although it may be the only option when the expense requires a large

outlay that requires the need for credit institutions. Borrowing in almost every civilized society comes at a cost or premium and in most cases a potential loss to the borrower when they have to provide collateral for the amount borrowed in case of default. There is also the cost of servicing the loan. On one hand, lending is one of the main revenue earnings by the lending institutions. In fact, the profitability and survival of some of these lending institutions depend on their ability to supply money for borrowers who in turn become debtors to the institutions. The wealth of the lending institutions grows with the increase of their lending value or their receipt-to-lending ratio. One of the problems that lending institutions have to face is having to deal with borrowers that attempt to borrow without an intention of repaying it, borrowers who may borrow to meet a need, want, or desire without the means of paying back, borrowers who borrow beyond their ability to pay back and maybe some people who just borrow out of an addiction to borrowing. Lending that is progressive has a responsible payback outcome, and clients with multiple loans are associated with poor loan repayment, (Charles and Mori, 2017). Multiple borrowers face increased debt levels and thereby an increased inability to meet their repayment obligations; in contrast, progressive lending by building up a lender–client relationship helps clients to obtain higher loans with a minimum amount of screening (Charles and Mori, 2017).

The real reason why some people borrow is the reason why they may not be able to pay it back. All of these different types of people who attempt to borrow will have to be assessed on a case-by-case basis by the lending institutions. Having an information broker that provides information on the credit history and background of potential borrowers will provide the much-needed information to make a valued judgment.

In the world of growing financial innovation and digital credit, precise credit risk assessment or loan default determination is vital to lending institutions (Kisutsa 2021). Digital credit systems do come with a huge risk of hacking which if it happens can severely harm its operation. Good Loan Performance and Profit making is an important objective of all lending institutions but depends on efficient credit management, Traditional credit score models which are normally provided by the information brokers, are constructed with historical payment data, demographic characteristics, credit

bureau data, and application data (Kisutsa 2021). The borrower's fraudulent risk is higher in online mobile-based lending, hence, credit risk models based on machine learning algorithms provide a higher level of accuracy in predicting default (Kisutsa 2021).

Economies without private or public credit information

Financial, lending and credit institutions can now be found in all economies regardless of their development. They are also among the best sources of credit, student loans, mortgages, personal loans, hybrid credit, other credit-based derivatives, personal or commercial lines of credit, overdraft facilities, and credit cards or credit notes and are considered important vehicles that keep all the segments of the economy going. They provide credit products and services that employ the available factors of production to produce the goods and services necessary for households, firms, and business consumption. The credit institutions that operate in the credit markets generally take the form of public, private domestic, foreign, and branches of banks. Some are also domestic and foreign non-banking financial institutions and credit companies. The effective running of these institutions depends on successfully overcoming the primarily associated risks including operational, market, credit, and liquidity risks. Some of these risks if unmanaged or provided for often lead to major financial losses on loans and investments not limited to even the liquidation of the institution. Prudent risk management

practices and guidelines are often recommended to help improve profits and survivability whilst other ways to decrease the risks include assets diversification, improving operating systems, and using prudent practices when underwriting.

The Credit Scoring Systems theory states that all customers and their past credit history should be rated and ranked. Credit information services provide credit score for borrowers. The Information provided by financial institutions include; physical or law person, residency, private or public sector, main economic activity, SME, commercial or consumption debtor identification. Additional information on Credit also includes the credit amount, credit type (overdraft, discount, promissory note, pledge, mortgage, personal, credit card, others), performing/non-performing credit situation, guarantees, provision, interest rate, maturity. Countries with lower entry barriers into the banking market (that is, a greater threat of competition) are less likely to have a credit bureau, presumably because banks are less willing to share proprietary information when the threat of market entry is high. In addition, a credit bureau is significantly less likely to emerge in economies characterized by a high degree of bank concentration (Bruhn, Miriam, Farazi, Subika and Kanz, Martin, 2013) Although credit information services assist with the credit markets, not all countries in the world are fortunate enough to have these services. A great number of countries as of 2022 are still operating financial, credit, and credit markets without the assistance of credit information bureaus and registry per Table 1.

Table 1: Economies With No Recent Credit Bureau rating Countries Without Public credit registry coverage (% of adults)

Sr.	Country	Most Recent Year	#	Country	Most Recent Year
1	Afghanistan	2019	38	Lao PDR	2019
2	Albania	2019	39	Lebanon	2019
3	Algeria	2019	40	Liberia	2019
4	Angola	2019	41	Libya	2019
5	Antigua and Barbuda	2019	42	Liechtenstein	2019
6	The Bahamas	2019	43	Luxembourg	2019
7	Bangladesh	2019	44	Madagascar	2019
8	Barbados	2019	45	Maldives	2019
9	Belarus	2019	46	Malta	2019
10	Belgium	2019	47	Marshall Islands	2019
11	Belize	2019	48	Mauritania	2019
12	Brunei Darussalam	2019	49	Mauritius	2019
13	Bulgaria	2019	50	Micronesia, Fed. Sts.	2019
14	Burundi	2019	51	Mongolia	2019
15	Cabo Verde	2019	52	Montenegro	2019
16	Cameroon	2019	53	Mozambique	2019
17	Central African Republic	2019	54	Myanmar	2019
18	Chad	2019	55	Oman	2019
19	China	2019	56	Palau	2019
20	Comoros	2019	57	Qatar	2019
21	Congo, Dem. Rep.	2019	58	Samoa	2019

22	Congo, Rep.	2019	59	San Marino	2019
23	Djibouti	2019	60	Sao Tome and Principe	2019
24	Dominica	2019	61	Seychelles	2019
25	Equatorial Guinea	2019	62	Sierra Leone	2019
26	Eritrea	2019	63	Slovenia	2019
27	Ethiopia	2019	64	Somalia	2019
28	Fiji	2019	65	South Sudan	2019
29	France	2019	66	St. Kitts and Nevis	2019
30	Gabon	2019	67	St. Lucia	2019
31	Gambia, The	2019	68	St. Vincent and the Grenadines	2019
32	Grenada	2019	69	Suriname	2019
33	Guinea	2019	70	Syrian Arab Republic	2019
34	Haiti	2019	71	Timor-Leste	2019
35	Iraq	2019	72	Tunisia	2019
36	Kiribati	2019	73	Turkey	2019
37	Kosovo	2019	74	West Bank and Gaza	2019
			75	Yemen, Rep.	2019

Fig 1 Source: World Bank, Doing Business project (doingbusiness.org)

The following list is a list of countries without public credit registry coverage (% of adults) and no date provided on the most recent year. For the purposes of this report, we are classifying these as countries without credit information registries.; American Samoa, Andorra, Aruba, Bermuda, British Virgin Islands, Cayman Islands, Channel Islands, Cuba, Curacao, Ethiopia, French Polynesia, Gibraltar, Greenland, Guam, Isle of Man, Korea, Dem. People's Rep., Macao SAR, China, Monaco, Nauru, New, Caledonia, Northern Mariana Islands, Sint Maarten (Dutch part), St. Martin (French part), Turkmenistan, Turks and Caicos Islands, Tuvalu, and Virgin Islands (U.S.)

Source:

<https://data.worldbank.org/indicator/IC.CRD.PUBL.ZS>

Functional benefits of credit bureaus and the shortfall faced by economies that do not have credit information brokers

Essentially, the number of people who could access credit is not materially affected by the presence or absence of the credit information broker as the borrowing is based on their availability of lenders and borrowers at the premium rate for lending that the borrowers may consider appropriate. Even though the information sharing between lenders through credit bureau or credit registries does not affect access to credit or the cost of credit, they do improve loan performance (Behr and Sonnekalb 2012). A major shortfall in the absence of credit information brokers affects the operation of the lending institutions. Having lending institutions with difficulty in recouping their loans will be a major struggle for the operators.

For countries that have credit markets with functioning credit brokers like the USA, the consumer credit market is provided with the borrowers' credit histories and their credit scores. These datasets are key factors in the financial life of U.S. households and help determine their access to credit and the price at which they borrow (Lucas Nathe 2021). They are so important in countries where the government and legislatures draw up resolutions and bills regarding the control of bureaus. The credit brokers will provide credit scores for the prospective borrower which will then be the basis of determining their potential default rate. Lenders will thus use the credit score to decide the fee or cost for borrowing that they will be willing to lend to the borrower. They will be charging a lot more for the riskier borrower and relatively less for those who have a better record of repaying their obligations. The value and worth of the credit bureau are the bad lending losses that are suffered in the countries that do not have them. Credit bureaus are known to have specific functional characteristics which are able to influence the level of indebtedness (Simovic et al 2014) although these results are conditional on having market competition and institutional development. In an environment where borrowers do not have to keep a good record of credit history, some will be engaging in reckless borrowing and bad credit practices as they do not have to face any potential consequences. Their next borrowing success will have no real connection or bearing on their past activities. Their next debt will also not be provided taking into account their past and outstanding debts that they are still owing. Such an

environment will thus allow for a higher incidence of borrowing and subsequently indebtedness due to the absence of the credit information broker. Conversely, the effective operation of a credit information broker will mean that lenders will be reviewing the past and current outstanding debt that the prospective borrower has in addition to their history of paying back their debts before considering loaning any more to such a client. How much they are capable of paying back will also be calculated with regards to their existing obligations and their income to know how much more debt they can afford to take on.

Another benefit of the credit information broking service in an economy is that Credit bureau information is used by credit agents to select and service more effectively all classes and clientele of borrowers. Any lending decision will be made after referring to the past credit history of the prospective borrower. Those with a bad credit history will not be provided with lending opportunities or provided at a higher premium and or with a lot of more stringent measures. Alternatively, those who have proven to be responsible for paying back their obligations will be preferred and chosen over those with a bad credit profile. The use of the credit bureau led to a decrease in the proportion of loans in arrears as the records from the credit bureau were able to provide a near accurate prediction of which borrowers could default in their obligations (Craig, Sadoulet, and de Janvry, 2006). Credit agents were able to use the credit bureau information to better select clients from among the poor, the notably more difficult segment of potential clients to work with. This is a remarkable result that demonstrates the importance of credit bureau information in servicing more effectively a clientele of poor borrowers. Economy-wide, with the presence of Credit Bureau, control of banking sector liquidity is realized, control of credit activities, and the maintenance of optimal economy indebtedness (Simović, Vasković, and Poznanović 2009).

The ideal environment for multiple loan behaviour

A credit market that has more than one lender will face asymmetric information between lenders and borrowers without a credit information broker. In the absence of credit bureaus, lenders will have to operate their lending businesses without the assistance and support of the credit profile of the borrowers being shared amongst the lenders. The

gap of information will allow borrowers to borrow from more than one institution who will be unaware of their credit history, default history, or other important decision-making information (Casini 2015). Some of the borrowers will also potentially borrow from one lender to pay the other within the market without having to service their original loan. This practice will not survive an effective bureaus screening strategy.

Some borrowers are addicted to borrowing and operating on credit (Koomson I. and James Atta Peprah J., 2018). Borrowing for them will extend from meeting a need to an interest in, condition of ; a direction, towards Addiction, opposite from cultivation); or a medium (whose existence creates the type of situation that is represented by the pattern (Karabeg 2001). Some of the supply-side causes of Addiction to microcredit include Microfinance institutions' upscaling intentions, unhealthy competition among Microfinance institutions, group lending methodology, compulsory savings, and high-interest rates and transactions costs (Koomson I. and James Atta Peprah J., 2018). On the demand side, causes of Addiction to microcredit include clients' inability to save for the future, clients' satisfaction with Microfinance institutions' products and services, and multiple borrowing behavior. If Microfinance institutions do not fail in the delivery of their core mandate regarding poverty reduction, clients' addiction to micro-credit will be reduced substantially (Koomson I. and James Atta Peprah J., 2018).

Conclusion

The global credit market needs a reliable flow of information that may be provided either by public or private credit information brokers. Such information provides the prospective lenders with the necessary history and profile of the borrower on their history and credit score which serves as the basis of deciding to provide them with credit or to reject their request for credit. Although there is a high number of lending institutions across the world, every country does not yet have credit information brokers. The absence of a credit bureau has not stopped the countries from providing these valuable services to their economy. Economies that have functioning credit registries have seen an increase in their loan performance which will be absent in countries that do not have these services. Credit registries reduce the non/bad-performing

loan ratio of lending institutions but also equip the lending institutions with appropriate and sufficient information when lending. The absence of credit information brokers do provide the ideal environment for borrowers to operate a multiple borrowing behavior due to the asymmetric information. Further research into the various costs associated with instituting a credit registry and other reasons why some of these nations do not have these may aid in providing this service. The value

added by the introduction of the registries in the countries that do not yet have them may also be a valuable input into the decision to institute one. Much of the research has stated that the presence or absence of credit information brokers does not materially impact the cost of borrowing and access to borrowing. It will be quite useful to look into what has happened to countries that used to have the registries that made a decision to get rid of them to see that impact and contribution as well.

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