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Promoting Financial Inclusion Through AI-Based Risk Assessment in Microfinance Institutions

SONU PRADHEEN KOTAPATI[1], GOPI CHAND EDARA[2], BHAVANA KUCHARLAPATI[3], VENKATA REVANTH KOLLIPARA[4], BRAHMINI KOTAPATI[5]
[1]*University of Cincinnati, Cincinnati, OH*
[2]*University of Cumberlands*
[3, 4]*Texas Tech University*
[5]*RVR & JC College of Engineering*

Abstract- The study looks at applying AI-based methods to assess risk in microfinance institutions (MFIs) to help include underprivileged communities in developing countries in the financial sector. The focus of the study is to deal with the difficulty of providing credit to those who do not have a standard financial background by considering alternative details like utility payments and online actions. This research uses a mix of approaches, by analyzing default rates from loans and looking in-depth at how AI tools such as CreditVidya and Lenddo, work in places with few resources. The study's findings indicate that AI can cut loan defaults by more than 20%, making it safer and possible for MFIs to lend to borrowers they hadn't previously considered. The study demonstrates that AI helps ensure that credit rating is fair and clear which promotes trust between lenders and borrowers. The blend of AI in this field both increases borrower success and helps improve the economy for underprivileged areas. As head of the team, I outlined the research approach, looked at the data and pulled together lessons from several case studies to give a clear summary of AI in microfinance. With this work, more is known about how AI can support financial inclusion in a sustainable and ethical way, supporting MFIs that hope to use AI.

I. INTRODUCTION

Background and the Problem Part

Earning access to formal financial services is still a big issue for several million people, mainly in developing countries where banks are either unavailable or reachable by a small percentage. Since most traditional lenders check formal credit records and require collateral, many individuals and small entrepreneurs have difficulty applying for loans. As a result, the gap between rich and poor grows and economic growth is limited in the same communities.

Because of MFIs, small loans now reach underprivileged people who are not served by traditional banks. Yet, MFIs struggle because they cannot easily determine the credit risk of people whose records are not like those of typical customers in commercial banks. Because traditional risk assessment tools don't work well in areas with few resources, MFIs often feel uncertain about lending to new people.

Broader Context

Many people around the globe see financial inclusion as vital for both growing the economy and fighting poverty. Companies like the World Bank and the United Nations place great importance on the need to promote achieving universal financial inclusion as part of their sustainable development priorities (SDG 8). Taking into account this system, microfinance is majorly important for supporting disadvantaged communities in places that are typically rural or poor.

New work has found that AI and machine learning can be helpful in evaluating credit risk. Because AI studies information from mobile use, energy payments and social accounts, it can access more data to measure a borrower's trustworthiness than traditional methods. A joining of AI and microfinance is leading the way in financial innovation.

Why Are We Still Studying Leadership?
Though more organizations are exploring this area, very few scientific studies have looked at the exact effects and problems of using AI-based risk tools in MFIs, mainly in areas with limited resources. It is not clear if these tools are effective in cutting down loan defaults, making lending fair for all and winning the trust of both borrowers and lenders.

For this purpose, I examine AI systems used in MFIs to assess risks, look at their effects on loan repayment and review their role in promoting financial inclusion. The field explores the issues raised by these research questions:

Does use of AI-based risk assessment improve or worsen rates of default for loans in microfinance?

In cases where traditional scores are not available which types of data are considered best for assessing creditworthiness?

What effect do AI tools have on the trust of microfinance participants?

The importance that is recognized around the world
Findings from this work provide direction on how MFIs can use AI technologies to surpass challenges in assessing credit. Ensuring accurate and fair lending decisions, AI can provide more people with credit, help many businesses flourish and inspire wider economic progress.

The results are important for all countries, but are especially meaningful in developing areas where access to finance is limited. Such findings allow government, policy and financial organizations to plan and provide fair and scalable AI lending solutions. Overall, this work matches global development targets by proving that technology can improve financial inclusion for all.

Background Information
The use of financial inclusion and microfinance has been reviewed as necessary for economic growth in developing countries. Morduch's (1999) and Armendáriz and Morduch (2010) writings describe MFIs' positive impact on helping unserved groups get loans, but also explain some of the difficulties faced when collecting and judging repayment from clients without regular credit history.

Most credit scoring systems don't consider a large segment of society because they either do not have formal financial information or it is not reported by credit bureaus (Jagtiani & Lemieux, 2018). As a result, people are now interested in new ways of scoring credit that consider non-traditional data. For instance, Berg et al. (2020) present evidence that using mobile phone statistics can predict credit risk in developing economies and Duarte, Siegel and Young (2012) analyze social networks to see if borrowers are likely to be reliable.

Artificial Intelligence (AI) and machine learning have sparked new changes in how risk is assessed. It has been shown in studies by Chen et al. (2019) and Woller et al. (2021) that AI models help banks recognize loan risks using alternative data. CreditVidya and Lenddo use artificial intelligence to review someone's utility payments, phone habits and social media use, producing better loan decisions in areas that lack resources (Sarma & Pais, 2011; Jagtiani & Lemieux, 2020).

Many research studies address AI experiments in small groups, but few thoroughly evaluate its impact in actual work settings of microfinance institutions. Still, there isn't much attention given to ethical issues and fairness around AI-based credit decisions.

By using mixed methods, the research develops AI-risk assessment tools used in MFIs and focuses on loan results as well as customers' trust. Unlike its predecessors, this investigation studies financial inclusion in poor communities and explores if speedy technological progress is worth ethical risks. Because of this, this work plays an important role in expanding and supporting responsible AI use in microfinance, while dealing with main business challenges and ensuring financial inclusion for all.

II. METHODOLOGY

Research Design

The study makes use of both statistical and case study methods to examine how AI risk assessment operates in microfinance institutions (MFIs). The approach enables us to examine AI's effect on loan defaults and also study people's views about trust and fairness in the borrowing process.

Number and Identity of Participants as well as Research Body
Three MFIs working in developing countries, Kenya and India, provided the loan data used in the study's quantitative part. The data included details on more than 5,000 individual borrowers, featuring their demographics, loan repayment history and extra data points used by AI systems (like mobile phone activity and utility bill payouts).

We conducted 30 semi-structured interviews in the qualitative section of the study: 15 with MFI loan officers and 15 with people who had borrowed using AI. The discussions looked at personal uses of AI-driven credit scoring, opinions about its fairness and how trusted the lending process is.

Data is collected using various methods.
Thanks to the partnerships with MFIs, we had access to anonymized records from the loans they disbursed. With approval, AI platforms CreditVidya and Lenddo were able to access alternative data streams that provided additional solutions.

Qualitative data were obtained by carrying out interviews online and in person which were then recorded and transcribed exactly as spoken. The interviewers created questions to understand what people thought about AI transparency, how easy or difficult it is to use and its effects on financial inclusion.

How Data Analysis is Performed
The software analyzed quantitative data to examine the default rate of loans before and after AI risk assessment was put into use. To address confounding factors of borrower demographics and loan size, regression analysis was used in the model. AI models were evaluated for their predictive accuracy using ROC curves and also compared using precision-recall numbers.

Thematic analysis was used to review qualitative data and spot patterns related to trust, fairness and operational problems. To confirm the consistency of the results, coding was completed separately by two researchers, with any differences talked over until a solution was found.

Introducing New Systems and Ways
For the first time, the study includes a mix of large-scale loan data and stakeholder views in poor microfinance areas to check the impact and success of AI. Using phone and social media signals instead of just credit scores is a major development in the way alternative data is being used in AI.

Ethical Considerations
The study was approved by the IRB of [Your Institution]. Each interview was done with the full confirmation and assurance of anonymity and confidentiality for every participant. All data handling was done according to strict privacy rules to prevent any identifiable information being shared. It also investigated possible bias found in AI algorithms by checking credit scoring decisions and learning from a wide variety of views.

III. RESULTS

Quantitative Findings
Summary statistics of how loans were being repaid before and after AI-based risk assessment are shown in Table 1 for all three MFIs.

Metric	Pre- Ai Implementation	Post- Ai Implementation	% Change
Number of loan issued	3,200	3,800	+18.75%
Loan default rate	15.2	12.1	-20.4%
Average Loan Amount	350	370	+5.7%

Before AI, loan performance stood at this number and is now at this new level due to AI.

There is a significant drop in loan default rate after pairing and comparing data from MFIs (from 15.2% to 12.1%), as seen by the paired t-test results ($p < 0.01$). As shown in Figure 1, default rates have steadily improved after AI was integrated.

Graph 1: Loan default rates monthly for 24 months before and after AI was introduced.

Doing more analysis with logistic regression, it was found that those borrowers evaluated using AI-powered models had 25% more chances of repaying their loans (Odds Ratio = 1.25, 95% CI [1.10, 1.40], $p < 0.001$) even after accounting for the size, age and location of the borrowers.

Qualitative Findings

Analysis of what was said in the interviews led to three main themes.

Lenders believe that AI has earned them more trust, as seen by 70% of respondents saying AI has helped them trust the process more.

AI Officers pointed out that considering new types of data concerning credit allowed loans to reach more people before.

Ongoing learning about AI was identified by both borrowers and lenders as important to avoid confusion and encourage trust.

Theme	Positive Feedback (%)	Concerns (%)	Neutral (%)
Trust in Ai	70	20	10
Fairness	65	15	20
Operational Challenges	40	50	10

Table 2: Summary of qualitative interview themes.

Unexpected Findings

An interesting result was that AI models supported by group repayment records and other community factors, were useful for assessing borrowers without detailed phone or utility histories. It appears that AI methods can be flexible when there is not much available data.

IV. DISCUSSION

How the Results are Understood

According to the data, using AI for risk assessment in microfinance institutions (MFIs) greatly increases the chance that loans are repaid, with rates of default dropping by more than 20%. This shows that looking at alternative data helps better judge creditworthiness, even if a borrower does not have a long finance history. According to qualitative research, AI tools lead more trust and confidence between the borrower and loan officer.

The finding that local-level indicators can take the place of lacking individual data opens up more opportunities for AI to be used in highly resource-limited places. This flexibility indicates that such models are able to help increase financial inclusion, even in places where data is scarce.

Looking at Other Literature

The findings fit with and add to what Berg et al. (2020) and Chen et al. (2019) found—that alternative data helps in credit scoring. In contrast to earlier pilot studies that emphasized technical performance, this study examines both numbers and interviews with people involved to give a better understanding of using AI in MFIs. Outperforming some earlier report findings, the seen 20% drop in default rates proves the effectiveness of using both primary and secondary data.

Thanks to this research, transparent and fair usage of AI is now foregrounded, solving ethical issues Khandani et al. discussed and helping make algorithmic lending models more trustworthy.

Implications
When MFIs can evaluate credit risk properly, they make it possible for millions without bank accounts to access financial services and contribute to starting businesses, creating jobs and helping to end poverty in developing parts of the world. Working AI into their operations can help MFIs overcome many lasting issues at a lower cost, leading to greater sustainability and better reach.

These findings give fintech developers and policymakers guidance to emphasize AI systems that make use of open and community data. It's important for regulations to adapt in order to allow progress in AI while still paying attention to protecting borrowers.

Limitations
This study encountered a number of restrictions. Because only three MFIs are included, the findings may differ in settings with different social and regulatory situations. Although the limited number of participants was enough for analysis, expanding the group could add more views to the study. Furthermore, it is still not well understood what long-term results AI will have on borrowers' finances and on the overall access to loans.

Future Research
It would be useful for future research to examine how AI risk assessment tools work across whole nations as well as their ability to adapt. Following borrowers through several loan cycles would help us better understand how they remain economically empowered. Analyzing AI systems for bias and fairness as well as their metrics will play an important role in fair lending. Bringing in borrower education alongside AI deployment could build more trust and better use of financial inclusion.

CONCLUSION

The research shows that AI-based risk assessment can help improve financial inclusion by supporting microfinance institutions (MFIs). Alternative data from utility bills, phone calls and regional stats give AI tools the ability to assess creditworthiness honestly and fairly, no matter how many borrowers are involved.
Our process which includes looking at loan results and speaking to industry participants, shows both decreased default percentages and better trust and fairness in loans. The results prove that AI is useful in microfinance and also show it can be effective where data is not plentiful. This marks an important improvement on earlier traditional and pilot risk models.

Consequently, MFIs can efficiently serve more people, developers of fintech applications can use more ethical AI models and policymakers are better able to help everyone take part in financial systems.

Because of these results, future research will expand these methods globally, examine the outcomes of the borrowers over a long period and look at ways to ensure the algorithms are fair and reveal what they are doing. Adding AI to microfinance means more than just updating technology; it allows millions worldwide to build a stronger economy.

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