Report on the German credit dataset

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Executive Summary

Data analysis is now a fundamental tool in the general understanding of business. In the current case, the objective would be to understand and profile the different historical and current customers of a bank, in order to better identify them. For this, we need to proceed in several steps: The first is to collect available data, check its relevance and see if it is accurate. Indeed, it is possible to deal with erroneous data. Therefore, it is necessary to check each feature and instance collected. The second step is to clean and understand the data in order to proceed to a more complete analysis. Finally, the goal is to answer the problem by using different analytical methods and synthesising the best model to provide a solution.

Introduction

In the bank industry many bankers have to decided whether or not they should issue a loan to a new coming applicant. In this report, we will use the data set called **German Credit data** which was given to us.

The German credit data set contains 1000 observations of past credit applicants, described by 30 variables. The applicants are described as **Good Credit** risk or **Bad Credit** risk: Therefore, the response variable, studied, is the credit rating.

Response variable: **RESPONSE** in the dataset:

- 0 : Bad credit. In case of bad credit, the banker would not want to issue loan to this person.
- 1 : Good credit. In case of good credit, the banker will want to issue loan to this applicant as it is more likely that the company will benefit from it.

All the other observations are features of the applicants that are going to be studied. It will allow us to perform several machine learning models and deploy a CRISP-DM model to come up with the best classifying model with the highest accuracy as possible. We want to determine whether the new applicant has a 'Good' credit risk, in which case the loan should be issued, or a 'Bad' credit risk, in which case it is not advisable to give him a loan.

The tasks required to perform our analysis is stated as follow.

1/ We first proceeded to some data cleaning, meaning that we sorted the dataset to make it ready for the analysis.

2/ Then we followed by an exploratory data analysis (EDA) where we studied the dataset and the different variables, one by one, and we made an principal component analysis.

3/ Next, came the models analysis, the steps are listed below:

a) Splitting the dataset
b) Balancing the data
c) Fitting the models
d) Accuracy study (scoring)
e) Variable selection and importance
f) Cross-validation / Bootstrap

g) Final Best model

Our very first steps once we received the **German Credit data** was to dig into it and get to know the observations and features we were going to work with.

Get to know the data

The title of the dataset is *German credit data* and the name of the file is **GermanCredit.cvs**.

As said in the introduction, the German Credit data has data on 1000 observations on past credit applicants and it is described by 30 attributes. Each applicant is rated as “Good” or “Bad” credit (encoded as 1 and 0 respectively in the **RESPONSE** variable).

We looked at the attribute Information :

Table 1: Table continues below

OBS.	CHK_ACCT	DURATION	HISTORY	NEW_CAR	USED_CAR	FURNITURE	RADIO.TV	EDUCATION	RETRAINING	AMOUNT	SAV_ACCT
Min. : 1.0	Min. :0.000	Min. : 4.0	Min. :0.000	Min. :0.000	Min. :0.000	Min. :0.000	Min. :0.00	Min. :-1.000	Min. :0.000	Min. : 250	Min. :0.000
1st Qu.: 250.8	1st Qu.:0.000	1st Qu.:12.0	1st Qu.:2.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:0.00	1st Qu.: 0.000	1st Qu.:0.000	1st Qu.: 1366	1st Qu.:0.000
Median : 500.5	Median :1.000	Median :18.0	Median :2.000	Median :0.000	Median :0.000	Median :0.000	Median :0.00	Median : 0.000	Median :0.000	Median : 2320	Median :0.000
Mean : 500.5	Mean :1.577	Mean :20.9	Mean :2.545	Mean :0.234	Mean :0.103	Mean :0.181	Mean :0.28	Mean : 0.048	Mean :0.097	Mean : 3271	Mean :1.105
3rd Qu.: 750.2	3rd Qu.:3.000	3rd Qu.:24.0	3rd Qu.:4.000	3rd Qu.:0.000	3rd Qu.:0.000	3rd Qu.:0.000	3rd Qu.:1.00	3rd Qu.: 0.000	3rd Qu.:0.000	3rd Qu.: 3972	3rd Qu.:2.000
Max. :1000.0	Max. :3.000	Max. :72.0	Max. :4.000	Max. :1.000	Max. :1.000	Max. :1.000	Max. :1.00	Max. : 1.000	Max. :1.000	Max. :18424	Max. :4.000

Table 2: Table continues below

EMPLOYMENT	INSTALL_RATE	MALE_DIV	MALE_SINGLE	MALE_MAR_or_WID	CO.APPLICANT	GUARANTOR	PRESENT_RESIDENT	REAL_ESTATE	PROP_UNKN_NONE	AGE	OTHER_INSTALL
Min. :0.000	Min. :1.000	Min. :0.00	Min. :0.000	Min. :0.000	Min. :0.000	Min. :0.000	Min. :1.000	Min. :0.000	Min. :0.000	Min. : 19.0	Min. :0.000
1st Qu.:2.000	1st Qu.:2.000	1st Qu.:0.00	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:2.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.: 27.0	1st Qu.:0.000
Median :2.000	Median :3.000	Median :0.00	Median :1.000	Median :0.000	Median :0.000	Median :0.000	Median :3.000	Median :0.000	Median :0.000	Median : 33.0	Median :0.000
Mean :2.384	Mean :2.973	Mean :0.05	Mean :0.548	Mean :0.092	Mean :0.041	Mean :0.053	Mean :2.845	Mean :0.282	Mean :0.154	Mean : 35.6	Mean :0.186
3rd Qu.:4.000	3rd Qu.:4.000	3rd Qu.:0.00	3rd Qu.:1.000	3rd Qu.:0.000	3rd Qu.:0.000	3rd Qu.:0.000	3rd Qu.:4.000	3rd Qu.:1.000	3rd Qu.:0.000	3rd Qu.: 42.0	3rd Qu.:0.000
Max. :4.000	Max. :4.000	Max. :1.00	Max. :1.000	Max. :1.000	Max. :1.000	Max. :2.000	Max. :4.000	Max. :1.000	Max. :1.000	Max. :125.0	Max. :1.000

RENT	OWN_RES	NUM_CREDITS	JOB	NUM_DEPENDENTS	TELEPHONE	FOREIGN	RESPONSE
Min. :0.000	Min. :0.000	Min. :1.000	Min. :0.000	Min. :1.000	Min. :0.000	Min. :0.000	Min. :0.0
1st Qu.:0.000	1st Qu.:0.000	1st Qu.:1.000	1st Qu.:2.000	1st Qu.:1.000	1st Qu.:0.000	1st Qu.:0.000	1st Qu.:0.0
Median :0.000	Median :1.000	Median :1.000	Median :2.000	Median :1.000	Median :0.000	Median :0.000	Median :1.0
Mean :0.179	Mean :0.713	Mean :1.407	Mean :1.904	Mean :1.155	Mean :0.404	Mean :0.037	Mean :0.7
3rd Qu.:0.000	3rd Qu.:1.000	3rd Qu.:2.000	3rd Qu.:2.000	3rd Qu.:1.000	3rd Qu.:1.000	3rd Qu.:0.000	3rd Qu.:1.0
Max. :1.000	Max. :1.000	Max. :4.000	Max. :3.000	Max. :2.000	Max. :1.000	Max. :1.000	Max. :1.0

We noticed that the variable **EDUCATION** has a minimum value of '-1' but it should be '0' since there are only 2 levels (0 and 1). Indeed, the observation 37 indicate a value of '-1' for **EDUCATION**. We notice another strange value, in the variable **GUARANTOR**, the maximum value is of '2' while it does not mean anything in our data set.

After discussion with the Banker, he gave us the correct values to these 2 mistakes. Observation 37 of **EDUCATION** and observation 234 of **GUARANTOR** should be equal to 1. We corrected these two values.

We also saw that the variable **AGE** has a maximum of 125. This is strange because it is very unlikely that someone lives to the age of 125. We talked to the banker again and he confirmed our doubts by telling us that a mistake has been made. At the observation 537, the correct age of the client is 75 years old. He asked us to correct this value in our data set.

After looking at the different attributes, we concluded that there were no missing values.

The response variable is identified as being the column named '**Response**' and it apprears to be the last column on the data.

It is a dummy variable with 0/1.

1. 0 : No, the credit rating is bad.
2. 1 : Yes, the credit rating is good.

We had to make sure that the class of the variables are correct. As described above, all the variables are defined as *integer* but we know that we should have numerical and categorical variables in our dataset. Therefore, we have to transform the class of some of them.

```
## 'data.frame':    1000 obs. of  32 variables:
##  $ OBS.            : Factor w/ 1000 levels "1","2","3","4",..: 1 2 3 4 5 6 7 8 9 10 ...
##  $ CHK_ACCT        : Factor w/ 4 levels "0","1","2","3": 1 2 4 1 1 4 4 2 4 2 ...
##  $ DURATION        : num  6 48 12 42 24 36 24 36 12 30 ...
##  $ HISTORY         : Factor w/ 5 levels "0","1","2","3",..: 5 3 5 3 4 3 3 3 3 5 ...
##  $ NEW_CAR         : Factor w/ 2 levels "0","1": 1 1 1 1 2 1 1 1 1 2 ...
##  $ USED_CAR        : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 2 1 1 ...
##  $ FURNITURE       : Factor w/ 2 levels "0","1": 1 1 1 2 1 1 2 1 1 1 ...
##  $ RADIO.TV        : Factor w/ 2 levels "0","1": 2 2 1 1 1 1 1 1 2 1 ...
##  $ EDUCATION       : Factor w/ 2 levels "0","1": 1 1 2 1 1 2 1 1 1 1 ...
##  $ RETRAINING      : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 1 1 ...
##  $ AMOUNT          : num  1169 5951 2096 7882 4870 ...
##  $ SAV_ACCT        : Factor w/ 5 levels "0","1","2","3",..: 5 1 1 1 1 5 3 1 4 1 ...
##  $ EMPLOYMENT      : Factor w/ 5 levels "0","1","2","3",..: 5 3 4 4 3 3 5 3 4 1 ...
```

```
##  $ INSTALL_RATE    : num  4 2 2 2 3 2 3 2 2 4 ...
##  $ MALE_DIV        : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 2 1 ...
##  $ MALE_SINGLE     : Factor w/ 2 levels "0","1": 2 1 2 2 2 2 2 2 1 1 ...
##  $ MALE_MAR_or_WID : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 1 2 ...
##  $ CO.APPLICANT    : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 1 1 ...
##  $ GUARANTOR       : Factor w/ 2 levels "0","1": 1 1 1 2 1 1 1 1 1 1 ...
##  $ PRESENT_RESIDENT: Factor w/ 4 levels "1","2","3","4": 4 2 3 4 4 4 4 2 4 2 ...
##  $ REAL_ESTATE     : Factor w/ 2 levels "0","1": 2 2 2 1 1 1 1 1 2 1 ...
##  $ PROP_UNKN_NONE  : Factor w/ 2 levels "0","1": 1 1 1 1 2 2 1 1 1 1 ...
##  $ AGE             : num  67 22 49 45 53 35 53 35 61 28 ...
##  $ OTHER_INSTALL   : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 1 1 ...
##  $ RENT            : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 2 1 1 ...
##  $ OWN_RES         : Factor w/ 2 levels "0","1": 2 2 2 1 1 1 2 1 2 2 ...
##  $ NUM_CREDITS     : num  2 1 1 1 2 1 1 1 1 2 ...
##  $ JOB             : Factor w/ 4 levels "0","1","2","3": 3 3 2 3 3 2 3 4 2 4 ...
##  $ NUM_DEPENDENTS  : num  1 1 2 2 2 2 1 1 1 1 ...
##  $ TELEPHONE       : Factor w/ 2 levels "0","1": 2 1 1 1 1 2 1 2 1 1 ...
##  $ FOREIGN         : Factor w/ 2 levels "0","1": 1 1 1 1 1 1 1 1 1 1 ...
##  $ RESPONSE        : Factor w/ 2 levels "0","1": 2 1 2 2 1 2 2 2 2 1 ...
```

The binomial data are set as factors and the others as numerical.

We then described the variables one more time and we should get better results.

```
## German_credit
##
##  32  Variables      1000  Observations
## ---------------------------------------------------------------------------
## OBS.
##        n  missing distinct
##     1000        0     1000
##
## lowest : 1    2    3    4    5   , highest: 996  997  998  999  1000
## ---------------------------------------------------------------------------
## CHK_ACCT
##        n  missing distinct
##     1000        0        4
##
## Value          0     1     2     3
## Frequency    274   269    63   394
## Proportion 0.274 0.269 0.063 0.394
## ---------------------------------------------------------------------------
## DURATION
##        n  missing distinct     Info     Mean      Gmd      .05      .10
##     1000        0       33    0.985     20.9    12.98        6        9
##      .25      .50      .75      .90      .95
##       12       18       24       36       48
##
## lowest :  4  5  6  7  8, highest: 47 48 54 60 72
## ---------------------------------------------------------------------------
## HISTORY
##        n  missing distinct
##     1000        0        5
##
## lowest : 0 1 2 3 4, highest: 0 1 2 3 4
```

```
##
## Value          0     1     2     3     4
## Frequency     40    49   530    88   293
## Proportion 0.040 0.049 0.530 0.088 0.293
## ---------------------------------------------------------------------------------
## NEW_CAR
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    766   234
## Proportion 0.766 0.234
## ---------------------------------------------------------------------------------
## USED_CAR
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    897   103
## Proportion 0.897 0.103
## ---------------------------------------------------------------------------------
## FURNITURE
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    819   181
## Proportion 0.819 0.181
## ---------------------------------------------------------------------------------
## RADIO.TV
##        n  missing distinct
##     1000        0        2
##
## Value         0    1
## Frequency   720  280
## Proportion 0.72 0.28
## ---------------------------------------------------------------------------------
## EDUCATION
##        n  missing distinct
##     1000        0        2
##
## Value         0    1
## Frequency   950   50
## Proportion 0.95 0.05
## ---------------------------------------------------------------------------------
## RETRAINING
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    903    97
## Proportion 0.903 0.097
## ---------------------------------------------------------------------------------
## AMOUNT
```

```
##        n  missing distinct     Info     Mean      Gmd      .05      .10
##     1000        0      921        1     3271     2773      709      932
##      .25      .50      .75      .90      .95
##     1366     2320     3972     7179     9163
##
## lowest :   250   276   338   339   343, highest: 15653 15672 15857 15945 18424
## ---------------------------------------------------------------------------
## SAV_ACCT
##        n  missing distinct
##     1000        0        5
##
## lowest : 0 1 2 3 4, highest: 0 1 2 3 4
##
## Value          0     1     2     3     4
## Frequency    603   103    63    48   183
## Proportion 0.603 0.103 0.063 0.048 0.183
## ---------------------------------------------------------------------------
## EMPLOYMENT
##        n  missing distinct
##     1000        0        5
##
## lowest : 0 1 2 3 4, highest: 0 1 2 3 4
##
## Value          0     1     2     3     4
## Frequency     62   172   339   174   253
## Proportion 0.062 0.172 0.339 0.174 0.253
## ---------------------------------------------------------------------------
## INSTALL_RATE
##        n  missing distinct     Info     Mean      Gmd
##     1000        0        4    0.873    2.973      1.2
##
## Value          1     2     3     4
## Frequency    136   231   157   476
## Proportion 0.136 0.231 0.157 0.476
## ---------------------------------------------------------------------------
## MALE_DIV
##        n  missing distinct
##     1000        0        2
##
## Value         0    1
## Frequency   950   50
## Proportion 0.95 0.05
## ---------------------------------------------------------------------------
## MALE_SINGLE
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    452   548
## Proportion 0.452 0.548
## ---------------------------------------------------------------------------
## MALE_MAR_or_WID
##        n  missing distinct
##     1000        0        2
```

```
##
## Value          0     1
## Frequency    908    92
## Proportion 0.908 0.092
## ---------------------------------------------------------------------------
## CO.APPLICANT
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    959    41
## Proportion 0.959 0.041
## ---------------------------------------------------------------------------
## GUARANTOR
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    948    52
## Proportion 0.948 0.052
## ---------------------------------------------------------------------------
## PRESENT_RESIDENT
##        n  missing distinct
##     1000        0        4
##
## Value          1     2     3     4
## Frequency    130   308   149   413
## Proportion 0.130 0.308 0.149 0.413
## ---------------------------------------------------------------------------
## REAL_ESTATE
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    718   282
## Proportion 0.718 0.282
## ---------------------------------------------------------------------------
## PROP_UNKN_NONE
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    846   154
## Proportion 0.846 0.154
## ---------------------------------------------------------------------------
## AGE
##        n  missing distinct     Info     Mean      Gmd      .05      .10
##     1000        0       53    0.999    35.55    12.41       22       23
##      .25      .50      .75      .90      .95
##       27       33       42       52       60
##
## lowest : 19 20 21 22 23, highest: 67 68 70 74 75
## ---------------------------------------------------------------------------
## OTHER_INSTALL
```

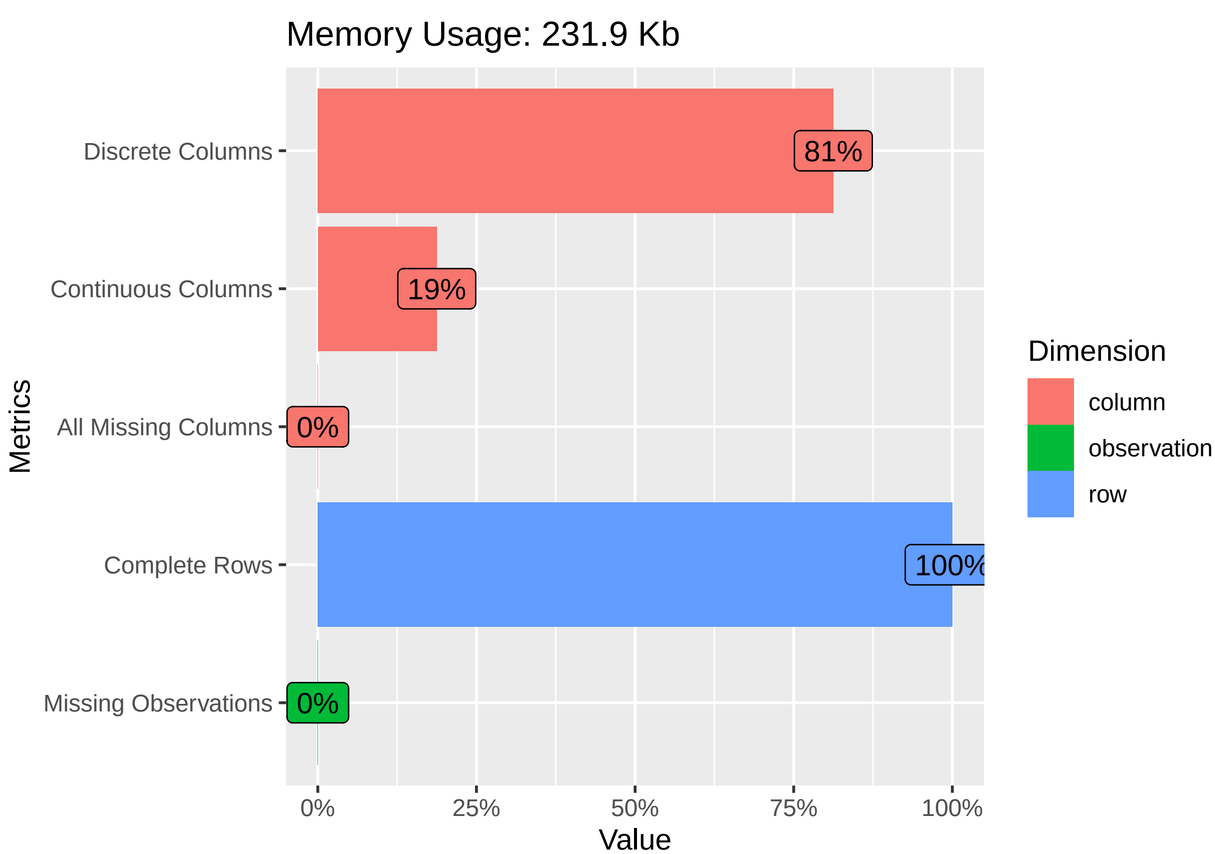
```
##        n  missing distinct 
##     1000        0        2 
## 
## Value          0     1
## Frequency    814   186
## Proportion 0.814 0.186
## ---------------------------------------------------------------------------
## RENT 
##        n  missing distinct 
##     1000        0        2 
## 
## Value          0     1
## Frequency    821   179
## Proportion 0.821 0.179
## ---------------------------------------------------------------------------
## OWN_RES 
##        n  missing distinct 
##     1000        0        2 
## 
## Value          0     1
## Frequency    287   713
## Proportion 0.287 0.713
## ---------------------------------------------------------------------------
## NUM_CREDITS 
##        n  missing distinct     Info     Mean      Gmd 
##     1000        0        4    0.709    1.407   0.5428 
## 
## Value          1     2     3     4
## Frequency    633   333    28     6
## Proportion 0.633 0.333 0.028 0.006
## ---------------------------------------------------------------------------
## JOB 
##        n  missing distinct 
##     1000        0        4 
## 
## Value          0     1     2     3
## Frequency     22   200   630   148
## Proportion 0.022 0.200 0.630 0.148
## ---------------------------------------------------------------------------
## NUM_DEPENDENTS 
##        n  missing distinct     Info     Mean      Gmd 
##     1000        0        2    0.393    1.155   0.2622 
## 
## Value          1     2
## Frequency    845   155
## Proportion 0.845 0.155
## ---------------------------------------------------------------------------
## TELEPHONE 
##        n  missing distinct 
##     1000        0        2 
## 
## Value          0     1
## Frequency    596   404
## Proportion 0.596 0.404
```

```
## ---------------------------------------------------------------------------
## FOREIGN
##        n  missing distinct
##     1000        0        2
##
## Value          0     1
## Frequency    963    37
## Proportion 0.963 0.037
## ---------------------------------------------------------------------------
## RESPONSE
##        n  missing distinct
##     1000        0        2
##
## Value        0   1
## Frequency  300 700
## Proportion 0.3 0.7
## ---------------------------------------------------------------------------
```

Table 4: Table continues below

rows	columns	discrete_columns	continuous_columns	all_missing_columns
1000	32	26	6	0

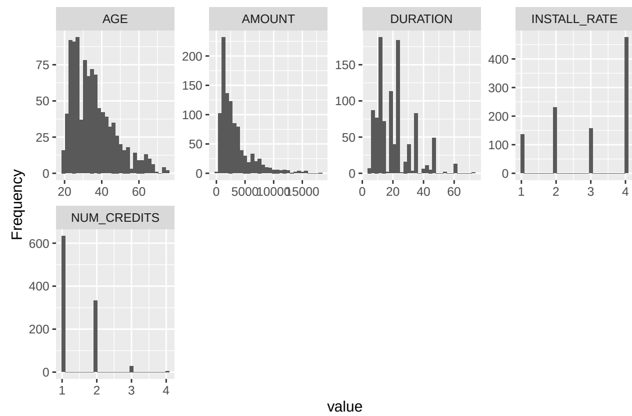
total_missing_values	complete_rows	total_observations	memory_usage
0	1000	32000	237424

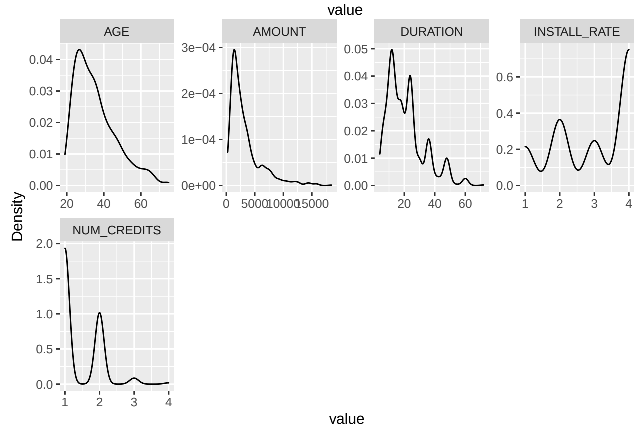


The plot helps us to see the percentage of continuous variable, the percentage of discrete variables and whether or not some observations are missing.

Visualization of the data

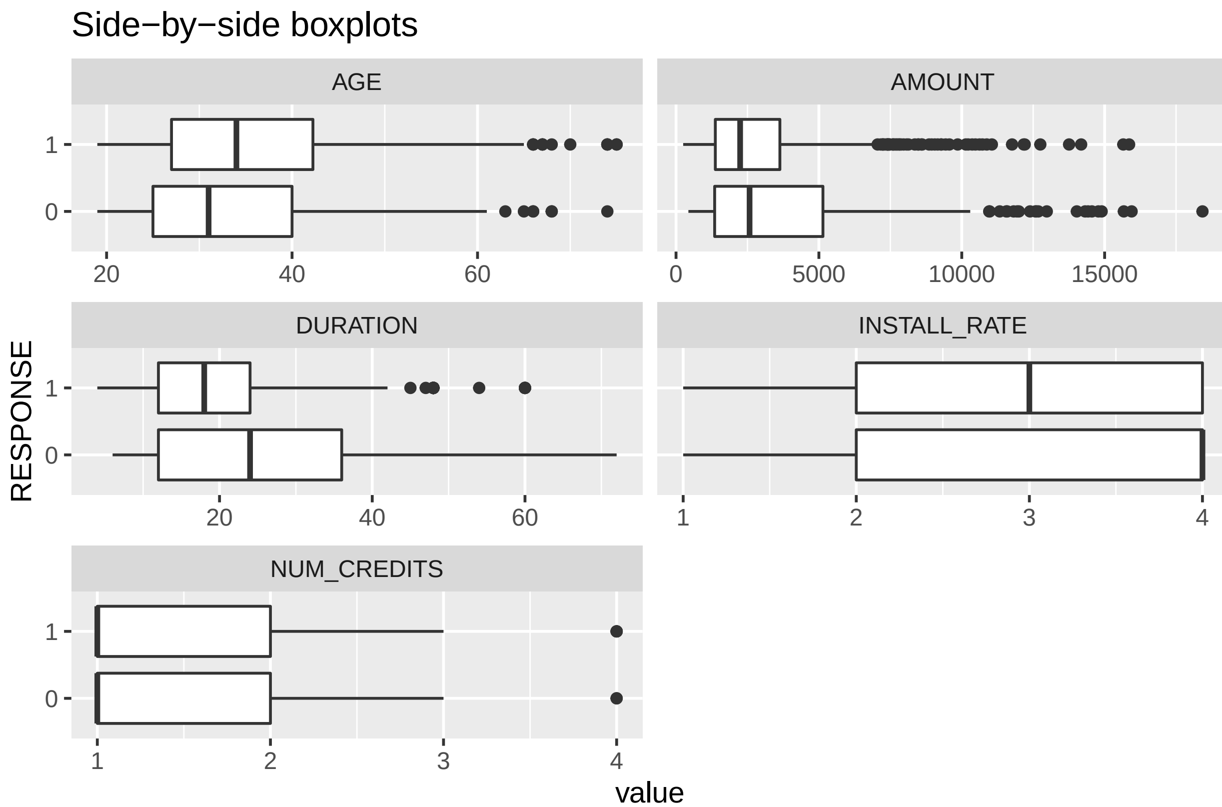
First, we plot all the continuous variables into histograms and their corresponding density plots.





Our first notice is that the data are not really normally distributed. Some of them are right-tailed.

We can look at the tails and outliers more carefully through boxplots.



This seems not to be disturbing. It makes sense that only a few people has a big credit amount. However it seems that the ‘bad’ clients tends to ask for bigger credit amount than ‘good’ clients.

Then, we made some barplots of the categorical variables (appendix A).

From these barplots we saw:

- The majority of people do not check their account status. (CHK_ACCT)
- Most people have an average balance of less than < 100 DM in their saving account. (SAV_ACCT)
- Most of the applicants has its own residence. (OWN_RES)
- Almost none of the applicants is a foreign worker. (FOREIGN)
- We have more information on people that are ‘good’ applicants and less information on ‘bad’ applicants. It would be better to have more information on ‘bad’ applicants as well in order to make good predictions with models. We will have to take this into account later. (RESPONSE)

A general summary can be done.

```
## Data Frame Summary
## Dimensions: 1000 x 32
## Duplicates: 0
##
## +----+------------------+----------------------------+--------------------+-----------------------
## | No | Variable         | Stats / Values             | Freqs (% of Valid) | Graph
## +====+==================+============================+====================+=======================
## | 1  | OBS.             | 1. 1                       |   1 ( 0.1%)        |
## |    | [factor]         | 2. 2                       |   1 ( 0.1%)        |
## |    |                  | 3. 3                       |   1 ( 0.1%)        |
## |    |                  | 4. 4                       |   1 ( 0.1%)        |
## |    |                  | 5. 5                       |   1 ( 0.1%)        |
## |    |                  | 6. 6                       |   1 ( 0.1%)        |
## |    |                  | 7. 7                       |   1 ( 0.1%)        |
```

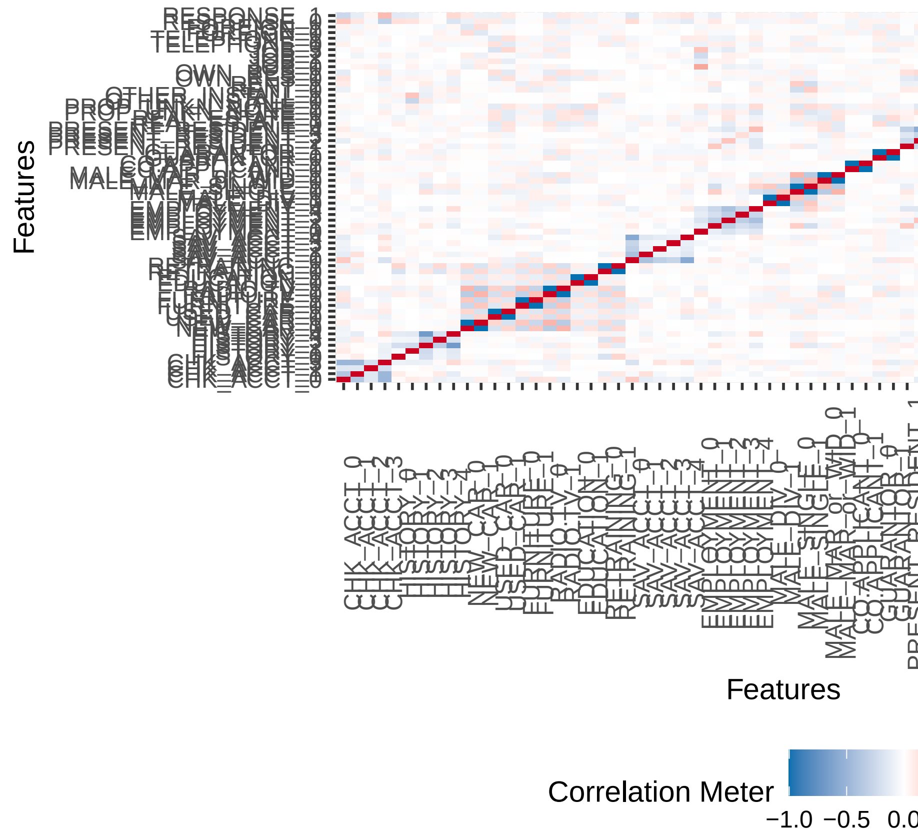
```
## |    |                   | 8. 8                        |   1 ( 0.1%)         |
## |    |                   | 9. 9                        |   1 ( 0.1%)         |
## |    |                   | 10. 10                      |   1 ( 0.1%)         |
## |    |                   | [ 990 others ]              | 990 (99.0%)         | IIIIIIIIIIIIIIIIIII
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 2  | CHK_ACCT          | 1. 0                        | 274 (27.4%)         | IIIII
## |    | [factor]          | 2. 1                        | 269 (26.9%)         | IIIII
## |    |                   | 3. 2                        |  63 ( 6.3%)         | I
## |    |                   | 4. 3                        | 394 (39.4%)         | IIIIIII
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 3  | DURATION          | Mean (sd) : 20.9 (12.1)     | 33 distinct values  |     :
## |    | [numeric]         | min < med < max:            |                     |   : :
## |    |                   | 4 < 18 < 72                 |                     | . : :
## |    |                   | IQR (CV) : 12 (0.6)         |                     | : : :   .
## |    |                   |                             |                     | : : : : : . :
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 4  | HISTORY           | 1. 0                        |  40 ( 4.0%)         |
## |    | [factor]          | 2. 1                        |  49 ( 4.9%)         |
## |    |                   | 3. 2                        | 530 (53.0%)         | IIIIIIIIII
## |    |                   | 4. 3                        |  88 ( 8.8%)         | I
## |    |                   | 5. 4                        | 293 (29.3%)         | IIIII
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 5  | NEW_CAR           | 1. 0                        | 766 (76.6%)         | IIIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        | 234 (23.4%)         | IIII
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 6  | USED_CAR          | 1. 0                        | 897 (89.7%)         | IIIIIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        | 103 (10.3%)         | II
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 7  | FURNITURE         | 1. 0                        | 819 (81.9%)         | IIIIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        | 181 (18.1%)         | III
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 8  | RADIO.TV          | 1. 0                        | 720 (72.0%)         | IIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        | 280 (28.0%)         | IIIII
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 9  | EDUCATION         | 1. 0                        | 950 (95.0%)         | IIIIIIIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        |  50 ( 5.0%)         | I
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 10 | RETRAINING        | 1. 0                        | 903 (90.3%)         | IIIIIIIIIIIIIIIIII
## |    | [factor]          | 2. 1                        |  97 ( 9.7%)         | I
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 11 | AMOUNT            | Mean (sd) : 3271.3 (2822.7) | 921 distinct values | :
## |    | [numeric]         | min < med < max:            |                     | : .
## |    |                   | 250 < 2319.5 < 18424        |                     | : :
## |    |                   | IQR (CV) : 2606.8 (0.9)     |                     | : :
## |    |                   |                             |                     | : : : : .
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 12 | SAV_ACCT          | 1. 0                        | 603 (60.3%)         | IIIIIIIIIIII
## |    | [factor]          | 2. 1                        | 103 (10.3%)         | II
## |    |                   | 3. 2                        |  63 ( 6.3%)         | I
## |    |                   | 4. 3                        |  48 ( 4.8%)         |
## |    |                   | 5. 4                        | 183 (18.3%)         | III
## +----+-------------------+-----------------------------+---------------------+----------------------
## | 13 | EMPLOYMENT        | 1. 0                        |  62 ( 6.2%)         | I
## |    | [factor]          | 2. 1                        | 172 (17.2%)         | III
```

```
## |    |                  | 3. 2                         | 339 (33.9%)         | IIIIII
## |    |                  | 4. 3                         | 174 (17.4%)         | III
## |    |                  | 5. 4                         | 253 (25.3%)         | IIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 14 | INSTALL_RATE     | Mean (sd) : 3 (1.1)          | 1 : 136 (13.6%)     | II
## |    | [numeric]        | min < med < max:             | 2 : 231 (23.1%)     | IIII
## |    |                  | 1 < 3 < 4                    | 3 : 157 (15.7%)     | III
## |    |                  | IQR (CV) : 2 (0.4)           | 4 : 476 (47.6%)     | IIIIIIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 15 | MALE_DIV         | 1. 0                         | 950 (95.0%)         | IIIIIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         |  50 ( 5.0%)         | I
## +----+------------------+------------------------------+---------------------+----------------------
## | 16 | MALE_SINGLE      | 1. 0                         | 452 (45.2%)         | IIIIIIIII
## |    | [factor]         | 2. 1                         | 548 (54.8%)         | IIIIIIIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 17 | MALE_MAR_or_WID  | 1. 0                         | 908 (90.8%)         | IIIIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         |  92 ( 9.2%)         | I
## +----+------------------+------------------------------+---------------------+----------------------
## | 18 | CO.APPLICANT     | 1. 0                         | 959 (95.9%)         | IIIIIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         |  41 ( 4.1%)         |
## +----+------------------+------------------------------+---------------------+----------------------
## | 19 | GUARANTOR        | 1. 0                         | 948 (94.8%)         | IIIIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         |  52 ( 5.2%)         | I
## +----+------------------+------------------------------+---------------------+----------------------
## | 20 | PRESENT_RESIDENT | 1. 1                         | 130 (13.0%)         | II
## |    | [factor]         | 2. 2                         | 308 (30.8%)         | IIIIII
## |    |                  | 3. 3                         | 149 (14.9%)         | II
## |    |                  | 4. 4                         | 413 (41.3%)         | IIIIIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 21 | REAL_ESTATE      | 1. 0                         | 718 (71.8%)         | IIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         | 282 (28.2%)         | IIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 22 | PROP_UNKN_NONE   | 1. 0                         | 846 (84.6%)         | IIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         | 154 (15.4%)         | III
## +----+------------------+------------------------------+---------------------+----------------------
## | 23 | AGE              | Mean (sd) : 35.5 (11.4)      | 53 distinct values  |   :
## |    | [numeric]        | min < med < max:             |                     |   : .
## |    |                  | 19 < 33 < 75                 |                     | : : : :
## |    |                  | IQR (CV) : 15 (0.3)          |                     | : : : : :
## |    |                  |                              |                     | : : : : : : : . .
## +----+------------------+------------------------------+---------------------+----------------------
## | 24 | OTHER_INSTALL    | 1. 0                         | 814 (81.4%)         | IIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         | 186 (18.6%)         | III
## +----+------------------+------------------------------+---------------------+----------------------
## | 25 | RENT             | 1. 0                         | 821 (82.1%)         | IIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                         | 179 (17.9%)         | III
## +----+------------------+------------------------------+---------------------+----------------------
## | 26 | OWN_RES          | 1. 0                         | 287 (28.7%)         | IIIII
## |    | [factor]         | 2. 1                         | 713 (71.3%)         | IIIIIIIIIIIIII
## +----+------------------+------------------------------+---------------------+----------------------
## | 27 | NUM_CREDITS      | Mean (sd) : 1.4 (0.6)        | 1 : 633 (63.3%)     | IIIIIIIIIIII
## |    | [numeric]        | min < med < max:             | 2 : 333 (33.3%)     | IIIIII
## |    |                  | 1 < 1 < 4                    | 3 :  28 ( 2.8%)     |
## |    |                  | IQR (CV) : 1 (0.4)           | 4 :   6 ( 0.6%)     |
```

```
## +----+------------------+-----------------------------+----------------------+------------------------
## | 28 | JOB              | 1. 0                        |  22 ( 2.2%)          |
## |    | [factor]         | 2. 1                        | 200 (20.0%)          | IIII
## |    |                  | 3. 2                        | 630 (63.0%)          | IIIIIIIIIIII
## |    |                  | 4. 3                        | 148 (14.8%)          | II
## +----+------------------+-----------------------------+----------------------+------------------------
## | 29 | NUM_DEPENDENTS   | Min  : 1                    | 1 : 845 (84.5%)      | IIIIIIIIIIIIIIII
## |    | [numeric]        | Mean : 1.2                  | 2 : 155 (15.5%)      | III
## |    |                  | Max  : 2                    |                      |
## +----+------------------+-----------------------------+----------------------+------------------------
## | 30 | TELEPHONE        | 1. 0                        | 596 (59.6%)          | IIIIIIIIIII
## |    | [factor]         | 2. 1                        | 404 (40.4%)          | IIIIIIII
## +----+------------------+-----------------------------+----------------------+------------------------
## | 31 | FOREIGN          | 1. 0                        | 963 (96.3%)          | IIIIIIIIIIIIIIIIIII
## |    | [factor]         | 2. 1                        |  37 ( 3.7%)          |
## +----+------------------+-----------------------------+----------------------+------------------------
## | 32 | RESPONSE         | 1. 0                        | 300 (30.0%)          | IIIIII
## |    | [factor]         | 2. 1                        | 700 (70.0%)          | IIIIIIIIIIIIII
## +----+------------------+-----------------------------+----------------------+------------------------
```

Correlation Analysis : Correlation plot between continuous variables :

There are little correlation between the continuous variables. We can notice that there is a correlation of 62% between the variable **DURATION** and **AMOOUNT**. This makes sense and is known by the bankers that the bigger the amount of credit, the longer the duration of the credit in months will last.



Correlation plot between categorical variables :

It is difficult to look at the correlation since there are a lot of variables on the graph. We can still see higher correlation between **RESPONSE 1**:

- and people that do not check their account (CHK_ACCT_3)
- and people that have a critical historical account (HISTORY_4)
- and the variable *REAL_ESTATE* (REAL_ESTATE)
- and applicant that does not have their own property (PROP_UNKN_NONE_0)
- and applicant that have their own residence (OWN_RES_1)

We can also see some correlation between **RESPONSE 0**:

- and people that have a checking account status < 0 DM (CHK_ACCT_0)
- and people that have an average balance in savings account < 100 DM (SAV_ACCT_0)
- and the variable *REAL_ESTATE* (REAL_ESTATE)

Principal Component Analysis Exploration: It is good to perform a PCA Exploration in order to reduce the dimensions or/and see which variables to select.

We start by selecting the numerical values because the PCA only works on numerical variables.

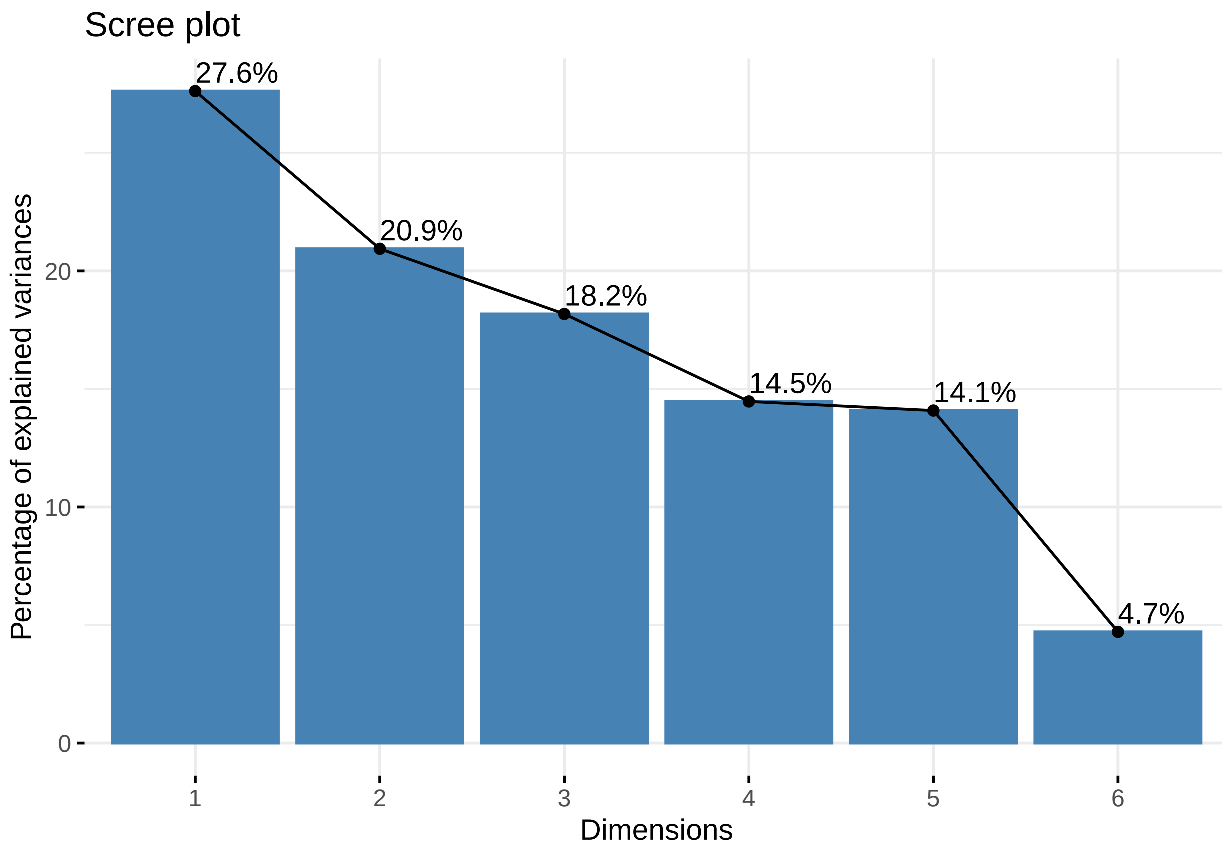
```
## Importance of components:
##                           PC1    PC2    PC3    PC4    PC5     PC6
## Standard deviation     1.2873 1.1208 1.0443 0.9318 0.9193 0.53164
## Proportion of Variance 0.2762 0.2094 0.1818 0.1447 0.1409 0.04711
## Cumulative Proportion  0.2762 0.4856 0.6673 0.8120 0.9529 1.00000
```

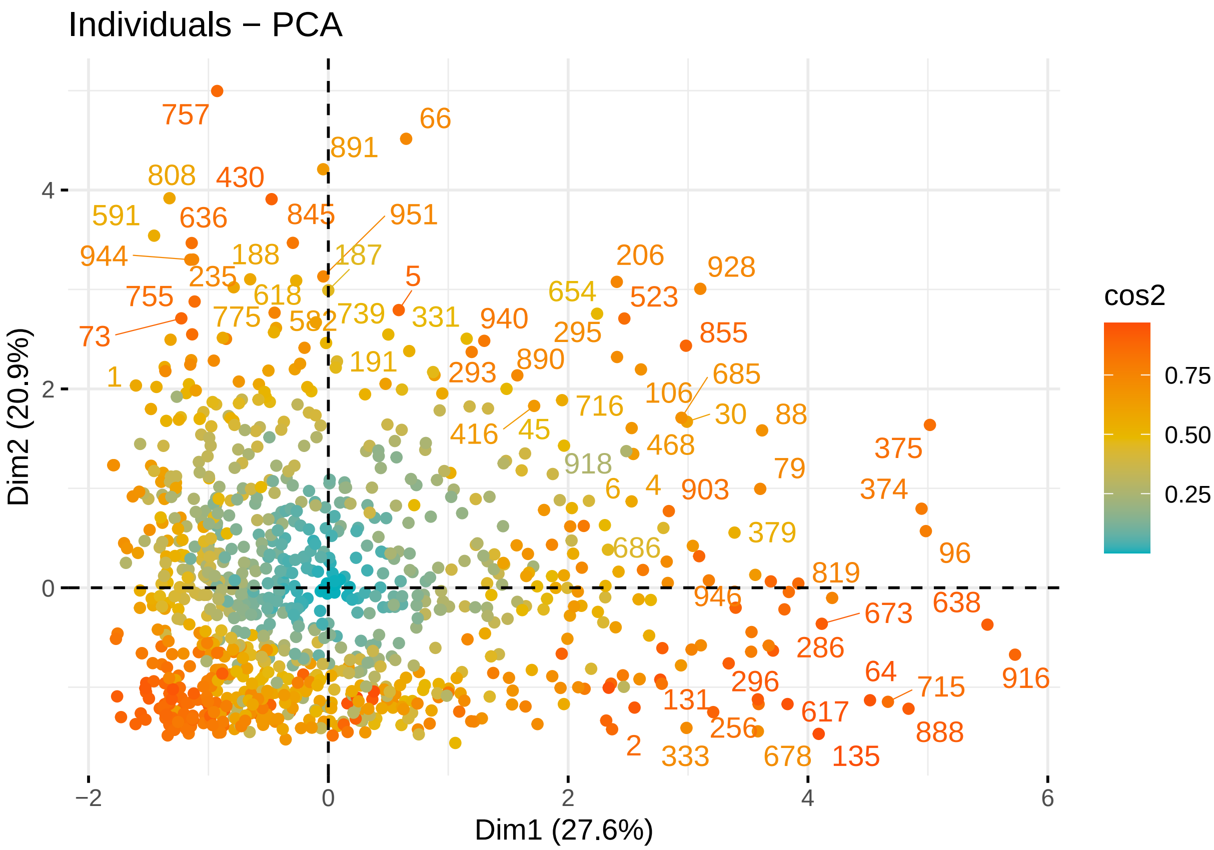
From the PCA summary we can see 4 principal components should be taken into account in order to explain approximately 81% of the variation of the data.

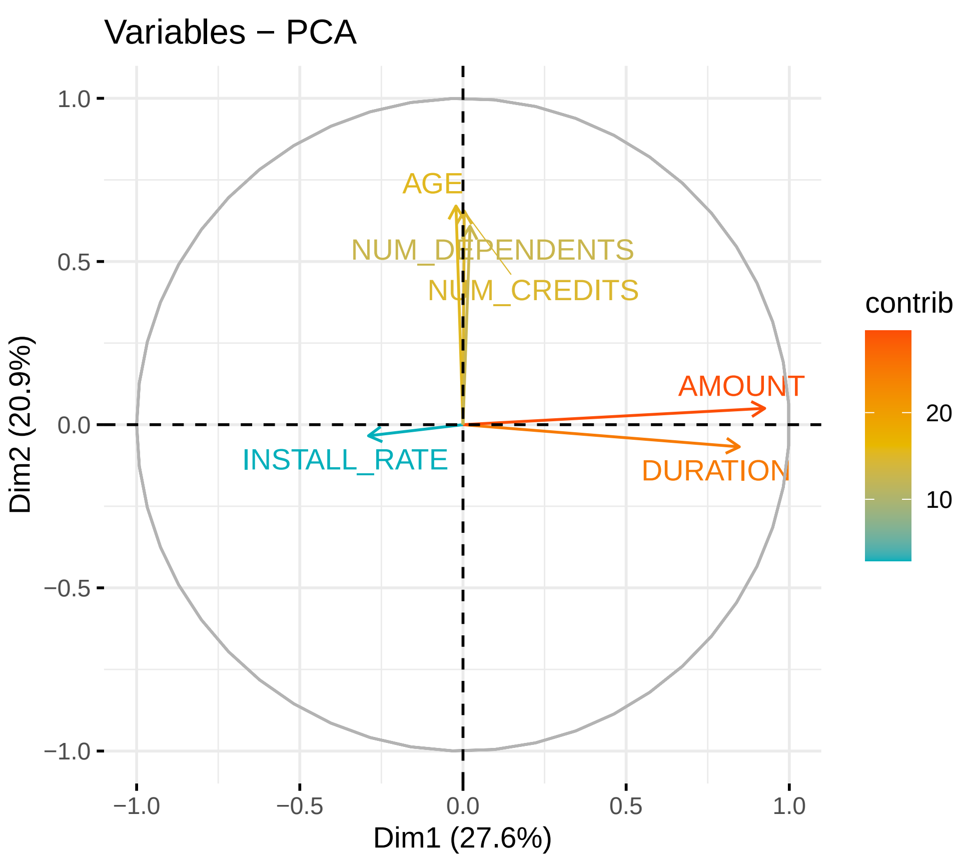
Eigenvalue analysis:

```
##        eigenvalue variance.percent cumulative.variance.percent
## Dim.1  1.6570953        27.618256                    27.61826
## Dim.2  1.2562810        20.938016                    48.55627
## Dim.3  1.0906419        18.177365                    66.73364
## Dim.4  0.8682109        14.470181                    81.20382
## Dim.5  0.8451277        14.085462                    95.28928
## Dim.6  0.2826431         4.710719                   100.00000
```

Then from this eigenvalues table, we know that we need to choose 3 dimensions because the first 3 dimensions are higher than the value 1.




Individuals − PCA
Dim1 (27.6%)
Dim2 (20.9%)
cos2
0.75
0.50
0.25

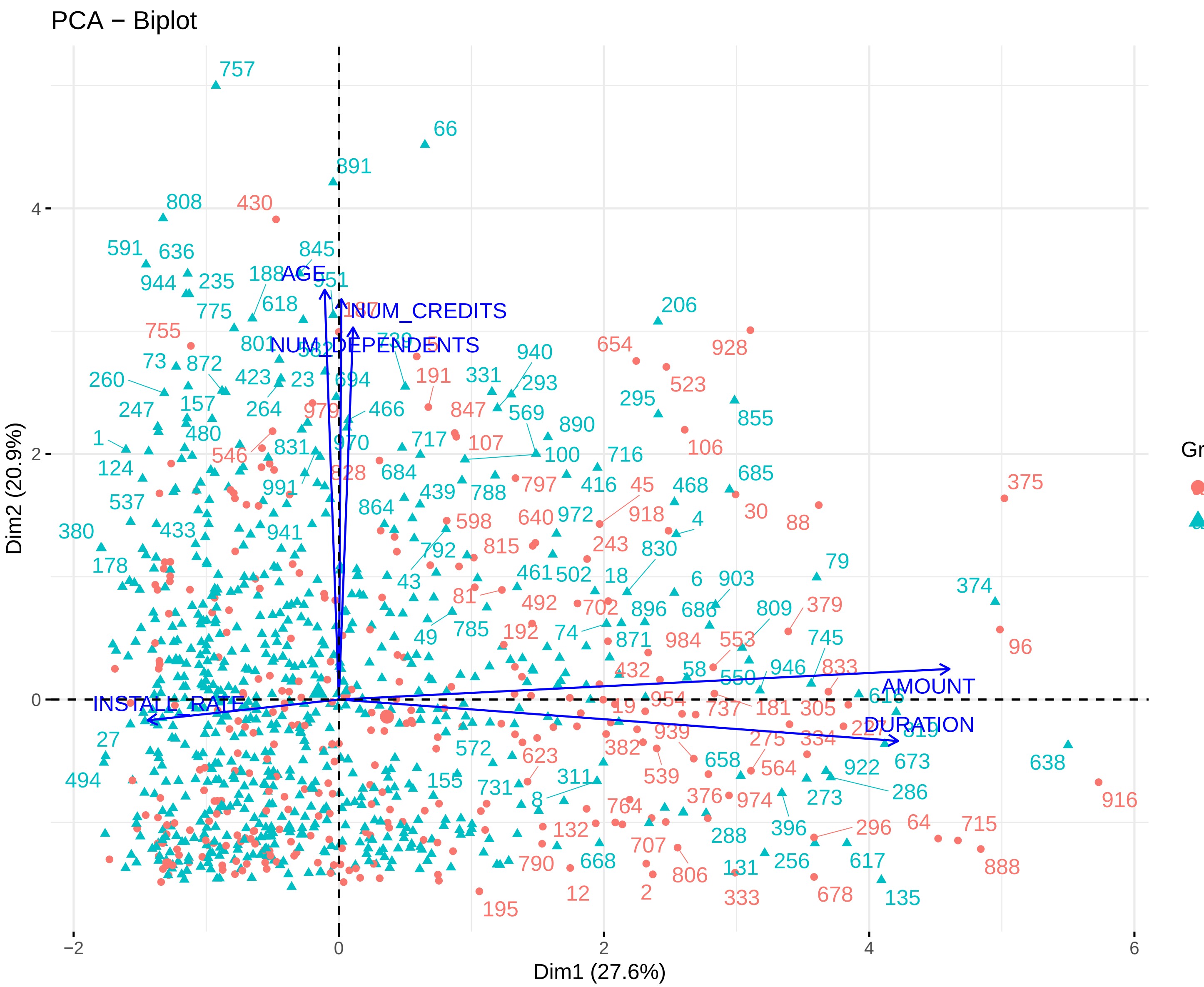

Variables − PCA
AGE
NUM_DEPENDENTS
NUM_CREDITS
AMOUNT
DURATION
INSTALL_RATE
Dim1 (27.6%)
Dim2 (20.9%)
contrib
20
10

From this circle of correlations, we see that :

- The first principal component PC1 is strongly positively correlated with the variables **AMOUNT** and **DURATION**. So the larger PC1, the larger these features. It is also a little bit negatively correlated with **INSTALL_RATE**.

- The second principal component PC2 is strongly positively correlated with **AGE**, **NUM_DEPENDENTS** and **NUM_CREDITS**.

From this biplot, we can see some characteristics of the observations.



Here, we can see the distribution of the response variables (0-1) according to the reduced dimension. What we can observe, is that the Bad credits: 0, look a little bit more positively correlated ot dimension 1. Therefore, more correlated to Amount and Duration. Compared to Good Credits, it looks positively correlated to dimesion 2; **AGE**, **NUM_CREDITS**, **NUM_DEPENDENTS**.

After having cleaned the dataset and looked at all the different features, we created a new dataset that contains our modifications in order to use it for our analysis.

Methodology

In this section we will talk about the methodology that has been used and the different models analysis that has been conducted.

Traning set and Test set

First of all we started by splitting our dataset into 2 sets: **training set** (`German_credit.tr`) and **test set** (`German_credit.te`). We do not forget to take the first variable **OBS.** out as it represents the index number for each observation. These two sets will allow us to train some models on the **training set** and then test the accuracy of the model fit on the **test set**.

Balancing the dataset

Then, we applied the balancing data technique in order to improve the predictions of **Good Credit** and **Bad Credit**, since we have more observations on the **Good Credit**.

The table below reveals the unbalanced problem.

Indeed, we observe that the "Good Credit" (1) response appears **527** times in the training set and "Bad Credit" (0) **223**, two times less. Since there are many more "Good Credit" than "Bad Credit", any model favors the prediction of the "Good Credit". It results a good accuracy but the specificity is low, as well as the balanced accuracy.

Sub-sampling Balancing using sub-sampling consists of taking all the cases in the smallest class (here "Bad Credit") and extract at random the same amount of cases in the largest category (here "Good").

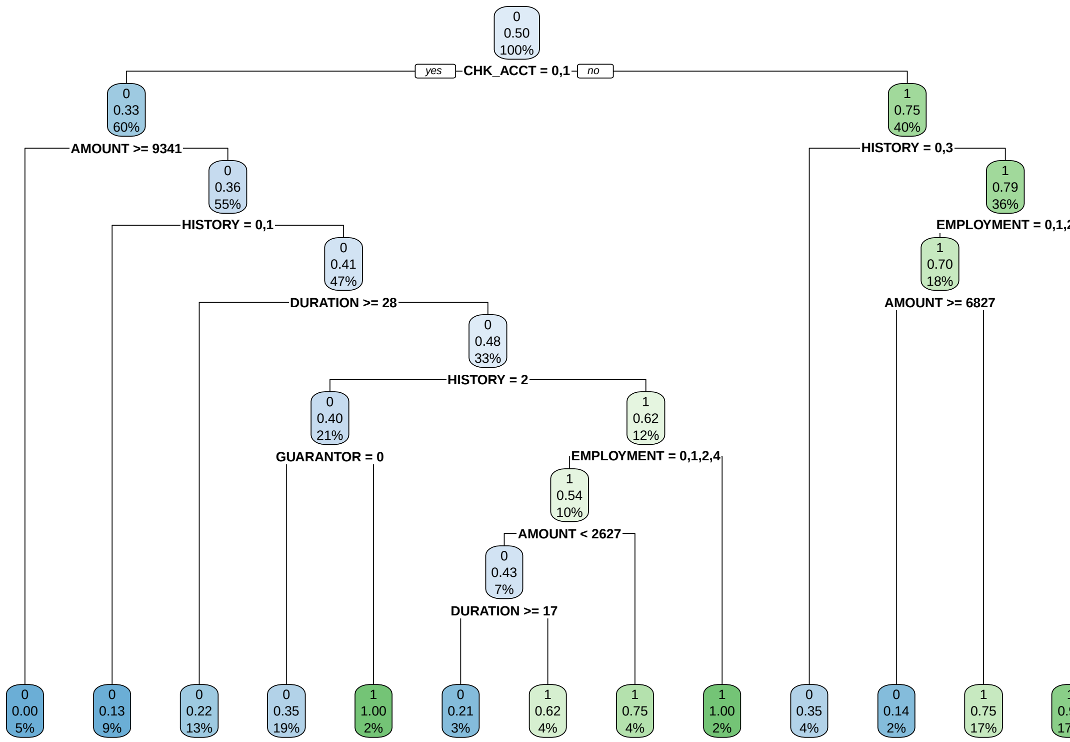
The **training set** is now balanced, we have 223 observations for both "Good Credit" (1) and "Bad Credit" (0). The new balanced training set is called `German_Credit.tr.subs`.

Models Fitting

Once we had our training set and test set, we could fit some models and compare them with together to choose the best model.

1. Classification Tree (Decision Tree) We first started with a decision tree and more specifically we chose the classification tree as we want to classify the applicants. The model was build on our previously balanced training set `German_Credit.tr.subs`. We used the R function `rpart`.

We obtained the following large tree.



We could see that among the 31 explanatory variables, this model uses 6 of them: **CHK_ACCT**, **AMOUNT**, **HISTORY**, **DURATION**, **GUARANTOR** and **EMPLOYMENT**.

Table 6: Confusion Matrix of the Big classification tree

	Bad credit risk	Good credit risk
Bad credit risk	58	70
Good credit risk	19	103

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.7532468            0.5953757            0.4531250
##       Neg Pred Value            Precision               Recall
##            0.8442623            0.4531250            0.7532468
##                   F1           Prevalence       Detection Rate
##            0.5658537            0.3080000            0.2320000
## Detection Prevalence    Balanced Accuracy
##            0.5120000            0.6743112
```

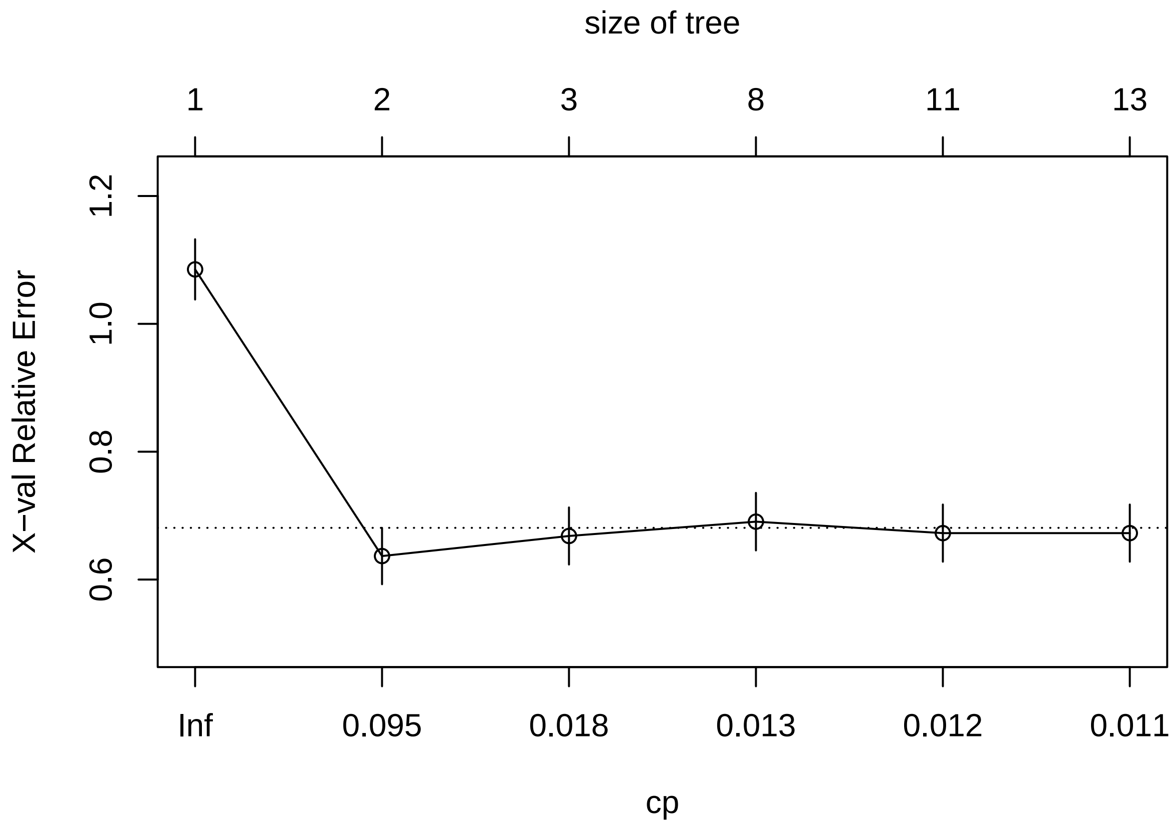
We first have an insight on how well it predict the test set (`German_credit.te`). We recall that 0 means a "Bad Credit" risk and 1 means a "Good Credit" risk. It seems that it has difficulty to predict the "Bad Credit" risk applicants.

As the tree is quite big and we want to know if we can prune it. To do so, we decided to use the `printcp` and `plotcp` commands and choose the best **cp** (complexity parameter) value to prune our tree.

Pruning the tree

```
##
## Classification tree:
## rpart(formula = RESPONSE ~ ., data = German_Credit.tr.subs, method = "class")
##
```

```
## Variables actually used in tree construction:
## [1] AMOUNT     CHK_ACCT   DURATION   EMPLOYMENT GUARANTOR  HISTORY
##
## Root node error: 223/446 = 0.5
##
## n= 446
##
##         CP nsplit rel error  xerror     xstd
## 1 0.399103      0   1.00000 1.08520 0.047179
## 2 0.022422      1   0.60090 0.63677 0.044117
## 3 0.014574      2   0.57848 0.66816 0.044668
## 4 0.011958      7   0.48430 0.69058 0.045028
## 5 0.011211     10   0.44843 0.67265 0.044742
## 6 0.010000     12   0.42601 0.67265 0.044742
```

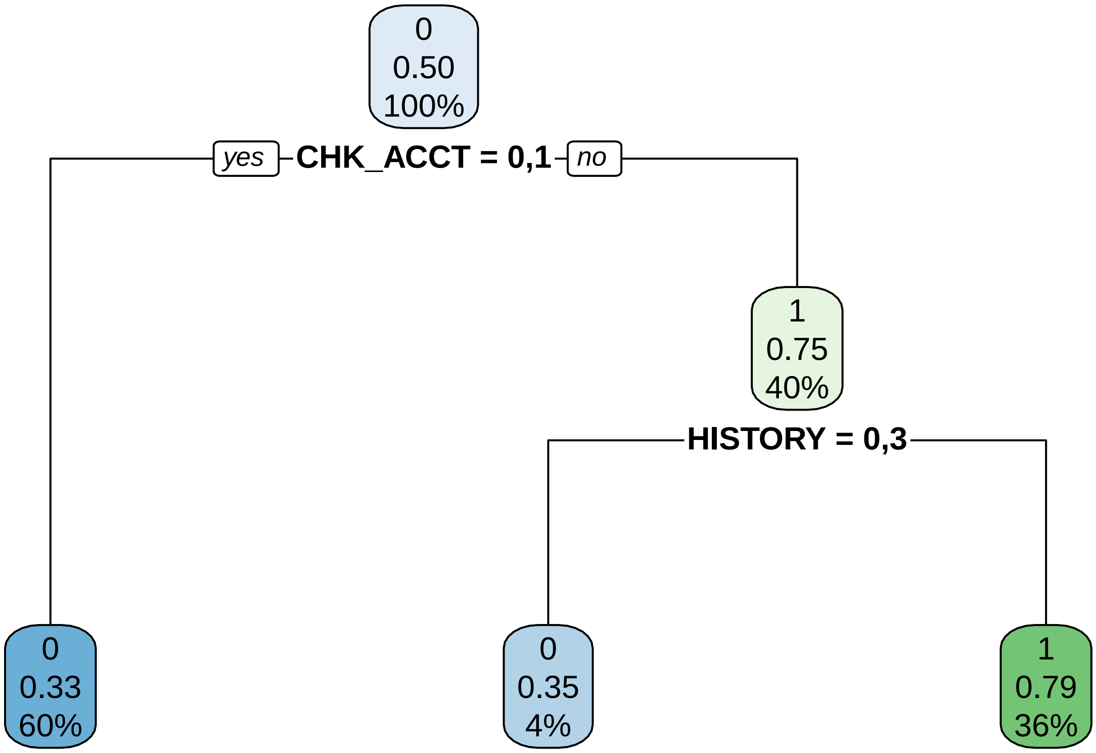


From the list of **cp** (complexity parameter), we would choose the line that has the lowest cross validation error. This can be seen on the column **xerror**. So the best cp would be 0.022422 with one split.

From the graph, we can identify that, according to the 1-SE rule, the tree with 2 and 3 are equivalent. The tree with 3 nodes should be preferred. It appears below the dotted-line.

The value of cp can be chosen arbitrarily between 0.018 and 0.095. So we decided to go with the suggested cp of 0.022 from the summary.

With these value, we obtain a very small tree.



This pruned decision tree with a cp of 0.022 uses the variables **CHK_ACCT** and **HISTORY**.

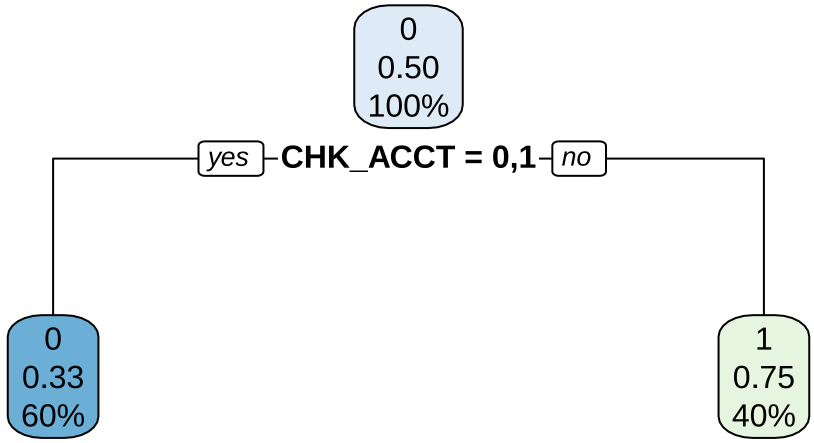
Using this pruned tree, we can computed the prediction and build a confusion matrix to see the performance of the model.

Table 7: Confusion Matrix of the Pruned classification tree

	Bad credit risk	Good credit risk
Bad credit risk	63	95
Good credit risk	14	78

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.8181818            0.4508671            0.3987342
##       Neg Pred Value            Precision               Recall
##            0.8478261            0.3987342            0.8181818
##                   F1           Prevalence       Detection Rate
##            0.5361702            0.3080000            0.2520000
## Detection Prevalence    Balanced Accuracy
##            0.6320000            0.6345244
```

We also decided to look at what would an automatically pruned using 1-SE rule would give us and whether or not it is better than the pruned tree we made by looking at the cp.



Here, only the variable **CHK__ACCT** is used. As we prune the tree more information are lost.

Table 8: Confusion Matrix of the Autoruned classification tree

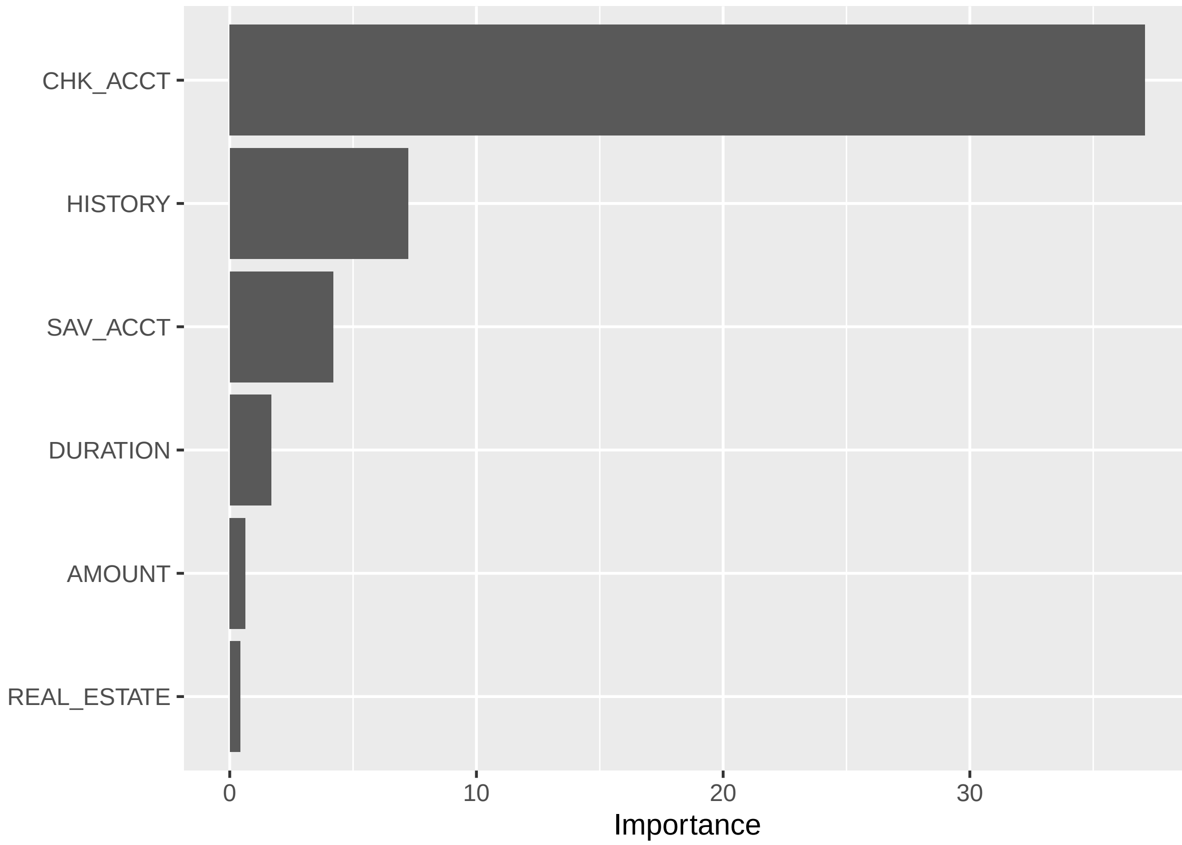
	Bad credit risk	Good credit risk
Bad credit risk	61	88
Good credit risk	16	85

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.7922078            0.4913295            0.4093960
##       Neg Pred Value            Precision               Recall
##            0.8415842            0.4093960            0.7922078
##                   F1           Prevalence       Detection Rate
##            0.5398230            0.3080000            0.2440000
## Detection Prevalence    Balanced Accuracy
##            0.5960000            0.6417686
```

Variable importance of the classification tree

```
##                      Overall
## AMOUNT             17.947179
## CHK_ACCT           37.098755
## DURATION           11.073258
## EMPLOYMENT          4.645266
## HISTORY            18.840050
## OTHER_INSTALL       3.216630
## RETRAINING          3.509915
## SAV_ACCT            9.538067
## NEW_CAR             0.000000
## USED_CAR            0.000000
## FURNITURE           0.000000
## RADIO.TV            0.000000
## EDUCATION           0.000000
## INSTALL_RATE        0.000000
## MALE_DIV            0.000000
## MALE_SINGLE         0.000000
## MALE_MAR_or_WID     0.000000
## CO.APPLICANT        0.000000
## GUARANTOR           0.000000
```

```
## PRESENT_RESIDENT  0.000000
## REAL_ESTATE       0.000000
## PROP_UNKN_NONE    0.000000
## AGE               0.000000
## RENT              0.000000
## OWN_RES           0.000000
## NUM_CREDITS       0.000000
## JOB               0.000000
## NUM_DEPENDENTS    0.000000
## TELEPHONE         0.000000
## FOREIGN           0.000000
```



From this plot, we see that the variables that influences the most are **CHK_ACCT**, **HISTORY**, **SAV_ACCT**, **DURATION**, **AMOUNT** and **REAL_ESTATE**. They are not exactly the same as the one we saw above.

The variable **CHK_ACCT** and **HISTORY** were noticed though.

2. Logistic Regression The next model we performed is a logistic regression.

```
##
## Call:
## glm(formula = RESPONSE ~ ., family = binomial, data = German_Credit.tr.subs)
##
## Deviance Residuals:
##      Min        1Q    Median        3Q       Max
## -2.34578  -0.68043   0.00049   0.65178   2.74937
##
```

```
## Coefficients:
##                     Estimate Std. Error z value Pr(>|z|)
## (Intercept)        1.1911402  1.7958756   0.663 0.507161
## CHK_ACCT1          0.5692882  0.3363406   1.693 0.090533 .
## CHK_ACCT2          0.8404451  0.5339512   1.574 0.115485
## CHK_ACCT3          2.4337691  0.3770606   6.455 1.09e-10 ***
## DURATION          -0.0123731  0.0142153  -0.870 0.384078
## HISTORY1          -1.0734853  0.8514386  -1.261 0.207384
## HISTORY2           0.0865599  0.6747882   0.128 0.897930
## HISTORY3          -0.0598560  0.7410028  -0.081 0.935619
## HISTORY4           1.1072483  0.6576414   1.684 0.092246 .
## NEW_CAR1          -0.4538649  0.5853211  -0.775 0.438096
## USED_CAR1          1.6322817  0.7540134   2.165 0.030404 *
## FURNITURE1         0.0509645  0.6182782   0.082 0.934305
## RADIO.TV1          0.5261147  0.5896893   0.892 0.372291
## EDUCATION1         0.5441469  0.7499724   0.726 0.468111
## RETRAINING1       -0.4293160  0.6787931  -0.632 0.527080
## AMOUNT            -0.0002155  0.0000739  -2.916 0.003550 **
## SAV_ACCT1          0.6181742  0.4475399   1.381 0.167195
## SAV_ACCT2         -0.2531524  0.5541205  -0.457 0.647776
## SAV_ACCT3          0.7292579  0.6813687   1.070 0.284492
## SAV_ACCT4          1.4221687  0.4243610   3.351 0.000804 ***
## EMPLOYMENT1        0.7574673  0.7956778   0.952 0.341108
## EMPLOYMENT2        1.4785839  0.7640267   1.935 0.052959 .
## EMPLOYMENT3        1.9691166  0.7947873   2.478 0.013229 *
## EMPLOYMENT4        1.8560330  0.7511387   2.471 0.013475 *
## INSTALL_RATE      -0.3367533  0.1411404  -2.386 0.017035 *
## MALE_DIV1         -0.5653453  0.5705857  -0.991 0.321775
## MALE_SINGLE1       0.1618525  0.3327207   0.486 0.626647
## MALE_MAR_or_WID1  -0.5551862  0.5312986  -1.045 0.296041
## CO.APPLICANT1     -0.6994379  0.6920599  -1.011 0.312179
## GUARANTOR1         1.7126786  0.6556150   2.612 0.008993 **
## PRESENT_RESIDENT2 -1.1195205  0.4773294  -2.345 0.019008 *
## PRESENT_RESIDENT3 -0.2590309  0.5313455  -0.487 0.625904
## PRESENT_RESIDENT4 -0.9082582  0.4793144  -1.895 0.058104 .
## REAL_ESTATE1      -0.0137202  0.3384983  -0.041 0.967669
## PROP_UNKN_NONE1   -1.4578770  0.6505748  -2.241 0.025032 *
## AGE                0.0167050  0.0141041   1.184 0.236255
## OTHER_INSTALL1    -0.6758552  0.3404321  -1.985 0.047113 *
## RENT1             -1.2066453  0.8244600  -1.464 0.143315
## OWN_RES1          -0.4707135  0.7665544  -0.614 0.539173
## NUM_CREDITS       -0.3634820  0.3011721  -1.207 0.227474
## JOB1              -0.7402802  1.1619781  -0.637 0.524069
## JOB2              -1.2142377  1.1317833  -1.073 0.283337
## JOB3              -1.4358446  1.1604352  -1.237 0.215964
## NUM_DEPENDENTS     0.1270172  0.3832474   0.331 0.740325
## TELEPHONE1         0.6259633  0.3143236   1.991 0.046430 *
## FOREIGN1           1.2496315  0.8543880   1.463 0.143576
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## (Dispersion parameter for binomial family taken to be 1)
##
##     Null deviance: 618.29  on 445  degrees of freedom
```

```
## Residual deviance: 390.97  on 400  degrees of freedom
## AIC: 482.97
##
## Number of Fisher Scoring iterations: 5
```

We see that a lot of variables are not statistically significant for the model so we can think of a model reduction.

Before doing a reduction of the model, we fitted the model and predicted on the test set.

Table 9: Confusion Matrix of the Logistic Regression

	Bad credit risk	Good credit risk
Bad credit risk	49	46
Good credit risk	28	127

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.6363636            0.7341040            0.5157895
##       Neg Pred Value            Precision               Recall
##            0.8193548            0.5157895            0.6363636
##                   F1           Prevalence       Detection Rate
##            0.5697674            0.3080000            0.1960000
## Detection Prevalence    Balanced Accuracy
##            0.3800000            0.6852338
```

Variable selection and interpretation with step method (AIC criteria) In order to reduce the logistic regression we used a stepwise variable selection. This has been done with the command `step`.

The final reduced model is as follow.

```
##
## Call:
## glm(formula = RESPONSE ~ CHK_ACCT + HISTORY + NEW_CAR + USED_CAR +
##     RETRAINING + AMOUNT + SAV_ACCT + EMPLOYMENT + INSTALL_RATE +
##     GUARANTOR + PRESENT_RESIDENT + PROP_UNKN_NONE + AGE + OTHER_INSTALL +
##     RENT + TELEPHONE + FOREIGN, family = binomial, data = German_Credit.tr.subs)
##
## Deviance Residuals:
##      Min        1Q    Median        3Q       Max
## -2.39343  -0.68768  -0.02628   0.71315   2.60726
##
## Coefficients:
##                    Estimate Std. Error z value Pr(>|z|)
## (Intercept)      -0.6339113  1.1570626  -0.548 0.583786
## CHK_ACCT1         0.5970566  0.3291383   1.814 0.069678 .
## CHK_ACCT2         1.1123874  0.5042812   2.206 0.027392 *
## CHK_ACCT3         2.4109175  0.3597629   6.701 2.06e-11 ***
## HISTORY1         -0.6393459  0.8007632  -0.798 0.424626
## HISTORY2          0.3153810  0.6295178   0.501 0.616379
## HISTORY3          0.0245812  0.7411154   0.033 0.973541
## HISTORY4          1.0638624  0.6476870   1.643 0.100475
## NEW_CAR1         -0.7159178  0.3141611  -2.279 0.022678 *
## USED_CAR1         1.3489217  0.5579072   2.418 0.015614 *
## RETRAINING1      -0.8489518  0.4619050  -1.838 0.066072 .
## AMOUNT           -0.0002631  0.0000595  -4.421 9.81e-06 ***
```

```
## SAV_ACCT1          0.5675624  0.4173990   1.360 0.173906
## SAV_ACCT2         -0.0693577  0.5399345  -0.128 0.897788
## SAV_ACCT3          0.5603771  0.6437202   0.871 0.384011
## SAV_ACCT4          1.3592948  0.4069584   3.340 0.000837 ***
## EMPLOYMENT1        0.5542570  0.6967423   0.795 0.426324
## EMPLOYMENT2        1.2338686  0.6524020   1.891 0.058588 .
## EMPLOYMENT3        1.7999683  0.6887566   2.613 0.008966 **
## EMPLOYMENT4        1.5521376  0.6518729   2.381 0.017264 *
## INSTALL_RATE      -0.3278020  0.1249721  -2.623 0.008716 **
## GUARANTOR1         1.6927223  0.6068573   2.789 0.005282 **
## PRESENT_RESIDENT2 -1.1117822  0.4641005  -2.396 0.016595 *
## PRESENT_RESIDENT3 -0.3408387  0.5041109  -0.676 0.498966
## PRESENT_RESIDENT4 -0.7613632  0.4531619  -1.680 0.092935 .
## PROP_UNKN_NONE1   -1.0532655  0.3848454  -2.737 0.006203 **
## AGE                0.0181856  0.0128738   1.413 0.157769
## OTHER_INSTALL1    -0.6281982  0.3256821  -1.929 0.053747 .
## RENT1             -0.8736712  0.3412119  -2.560 0.010452 *
## TELEPHONE1         0.5251823  0.2863172   1.834 0.066614 .
## FOREIGN1           1.2896516  0.8049248   1.602 0.109111
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## (Dispersion parameter for binomial family taken to be 1)
##
##     Null deviance: 618.29  on 445  degrees of freedom
## Residual deviance: 403.37  on 415  degrees of freedom
## AIC: 465.37
##
## Number of Fisher Scoring iterations: 5
```

The variables that have been removed are : **FURNITURE**, **RADIO.TV**, **EDUCATION**, **RETRAINING**, **MALE_DIV**, **MALE_SINGLE**, **MALE_MAR_or_WID**, **CO.APPLICANT**, **REAL_ESTATE**, **OWN_RES**, **NUM_CREDITS**, **JOB** and **NUM_DEPENDENTS**

In the end, we get the most significant model:

$$RESPONSE = -0.6339113 + 0.5970566 * CHK_{ACCT1} + 1.1123874 * CHK_{ACCT2} + 2.4109175 * CHK_{ACCT3} - 0.6393459 * HIST$$

$$p = (e^{RESPONSE})/(1 + e^{RESPONSE})$$

It means that :

- The predicted probability of being a good applicant for **CHCK_ACCT3** is higher than for **CHK_ACCT0** (and also higher than for **CHK_ACCT1** and **CHK_ACCT2**).
- The predicted probability of being a good applicant for **HISTORY1** is lower than for **HISTORY0**.
- The predicted probability of being a good applicant for **HISTORY4** is higher than for **HISTORY0** (and also higher than for **HISTORY2** and **HISTORY3**).
- The predicted probability of being a good applicant for **NEW_CAR1** is lower than for **NEW_CAR0**.
- The predicted probability of being a good applicant for **USED_CAR1** is higher than for **USED_CAR0**.
- The predicted probability of being a good applicant for **RETRAINING1** is lower than for **RETRAINING0**.
- **AMOUNT** is negatively associated with **RESPONSE**.

- The predicted probability of being a good applicant for **SAV__ACCT4** is higher than for **SAV__ACCT0** (and also higher than for **SAV__ACCT1** and **SAV__ACCT3**).
- The predicted probability of being a good applicant for **SAV__ACCT2** lower than for **SAV__ACCT0**.
- The predicted probability of being a good applicant for **EMPLOYMENT3** is higher than for **Employment0** (and also higher than for **EMPLOYMENT1**, **EMPLOYMENT2** and **EMPLOYMENT4**).
- **INSTALL__RATE** is negatively associated with **RESPONSE**.
- The predicted probability of being a good applicant for **GUARANTOR1** is higher than for **GUARANTOR0**.
- The predicted probability of being a good applicant for **PRESENT__RESIDENT2** is lower than for **PRESENT__RESIDENT0** (and also lower than **PRESENT__RESIDENT3** and **PRESENT__RESIDENT4**).
- The predicted probability of being a good applicant for **PROP__UNKN__NONE1** is lower than for **PROP__UNKN__NONE0**.
- **AGE** is positively associated with **RESPONSE**.
- The predicted probability of being a good applicant for **OTHER__INSTALL1** is lower than for **OTHER__INSTALL0**.
- The predicted probability of being a good applicant for **RENT1** is lower than for **RENT0**.
- The predicted probability of being a good applicant for **TELEPHONE1** is higher than for **TELEPHONE0**.
- The predicted probability of being a good applicant for **FOREIGN1** is higher than for **FOREIGN0**.

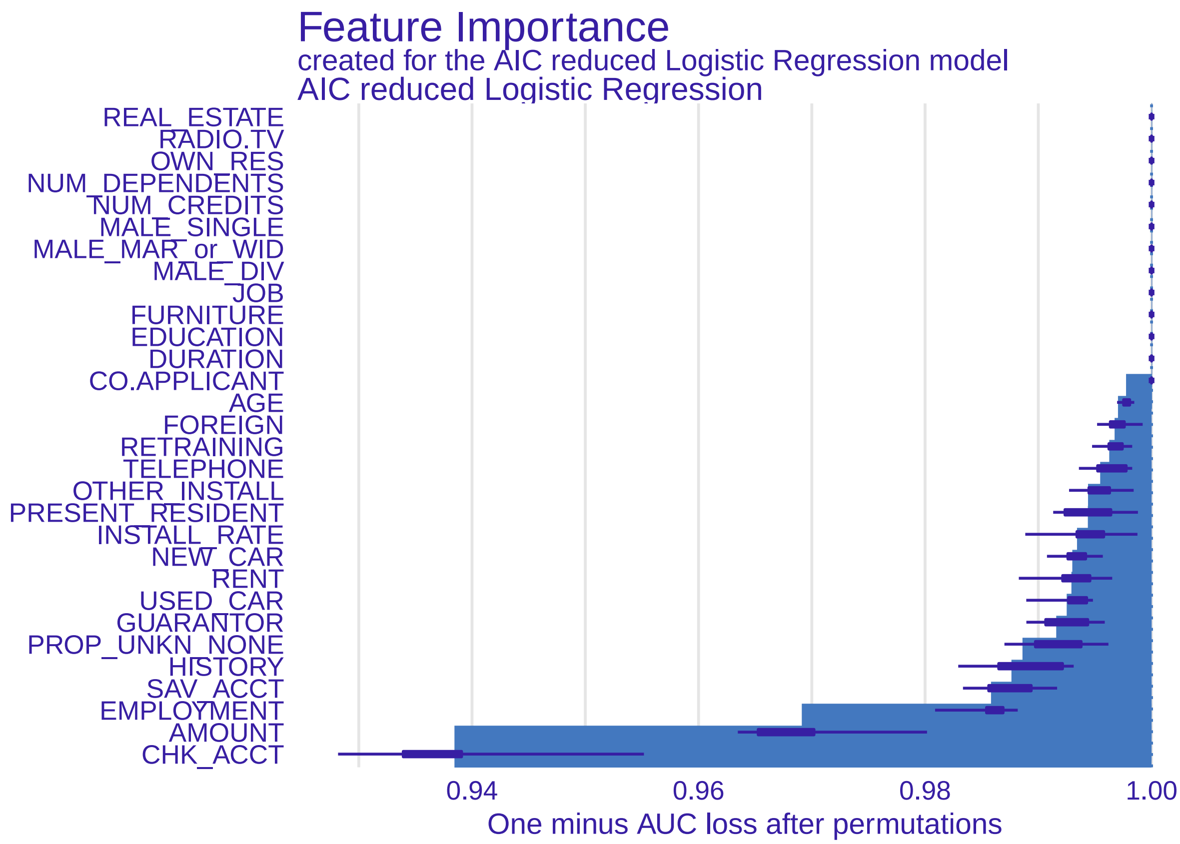
Table 10: Confusion Matrix of the AIC reduced Logistic regression

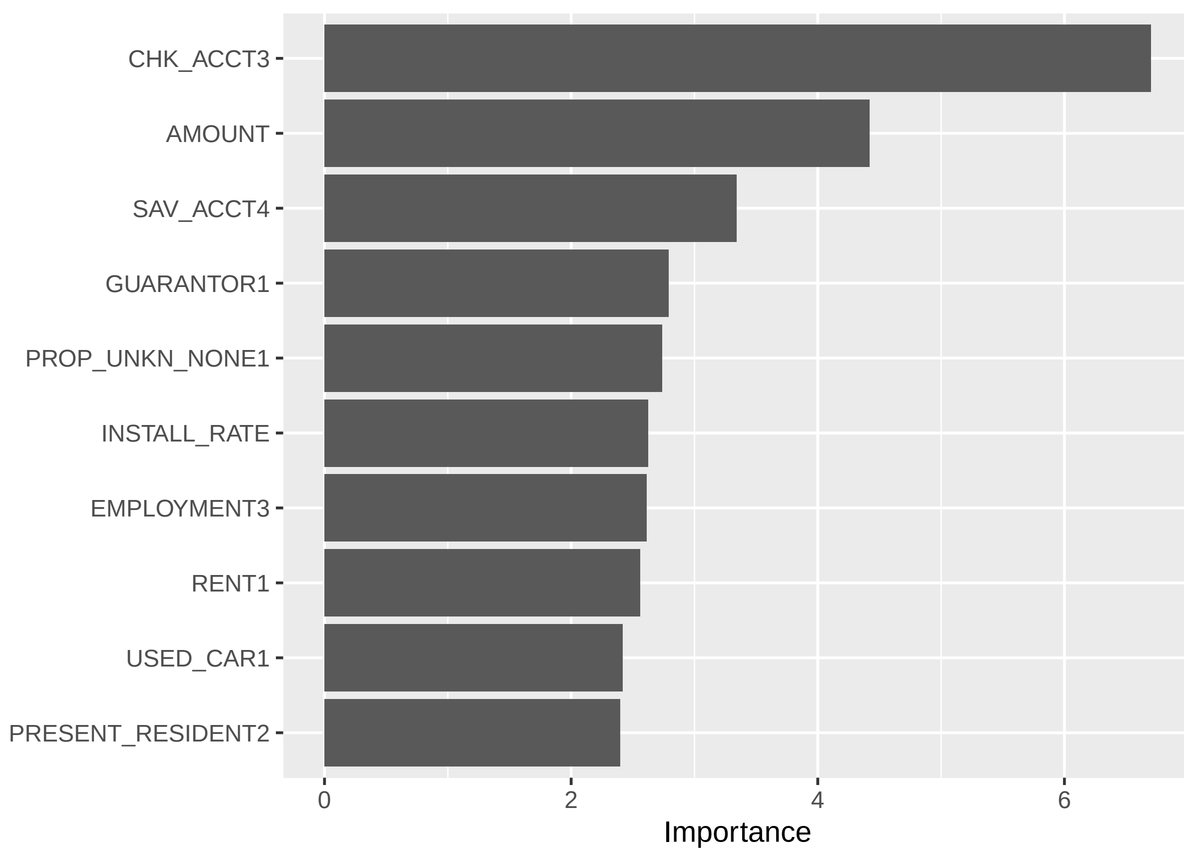
	Bad credit risk	Good credit risk
Bad credit risk	50	52
Good credit risk	27	121

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.6493506            0.6994220            0.4901961
##       Neg Pred Value            Precision               Recall
##            0.8175676            0.4901961            0.6493506
##                   F1           Prevalence       Detection Rate
##            0.5586592            0.3080000            0.2000000
## Detection Prevalence    Balanced Accuracy
##            0.4080000            0.6743863
```

Variable importance for logistic regression

```
## Preparation of a new explainer is initiated
##   -> model label       :  AIC reduced Logistic Regression
##   -> data              :  446  rows  30  cols
##   -> target variable   :  446  values
##   -> predict function  :  yhat.glm  will be used (  default  )
##   -> predicted values  :  No value for predict function target column. (  default  )
##   -> model_info        :  package stats , ver. 4.1.3 , task classification (  default  )
##   -> predicted values  :  numerical, min =  0.007541882 , mean =  0.5 , max =  0.9975191
##   -> residual function :  difference between y and yhat (  default  )
##   -> residuals         :  numerical, min =  0.05702613 , mean =  1 , max =  1.96659
##   A new explainer has been created!
```


Feature Importance
created for the AIC reduced Logistic Regression model
AIC reduced Logistic Regression
REAL_ESTATE
RADIO.TV
OWN_RES
NUM_DEPENDENTS
NUM_CREDITS
MALE_SINGLE
MALE_MAR_or_WID
MALE_DIV
JOB
FURNITURE
EDUCATION
DURATION
CO.APPLICANT
AGE
FOREIGN
RETRAINING
TELEPHONE
OTHER_INSTALL
PRESENT_RESIDENT
INSTALL_RATE
NEW_CAR
RENT
USED_CAR
GUARANTOR
PROP_UNKN_NONE
HISTORY
SAV_ACCT
EMPLOYMENT
AMOUNT
CHK_ACCT
0.94
0.96
0.98
1.00
One minus AUC loss after permutations


CHK_ACCT3
AMOUNT
SAV_ACCT4
GUARANTOR1
PROP_UNKN_NONE1
INSTALL_RATE
EMPLOYMENT3
RENT1
USED_CAR1
PRESENT_RESIDENT2
0
2
4
6
Importance

Listed above are the most important variables for the logarithmic regression we reduced. Here again, the CHK_ACCT variable differentiate itself from the others in term of importance in the model prediction.

3.a K-Nearest Neighbor (K=2) To perform a k-nearest neighbor method, we do not need to balance the data so we will use the unbalanced training set.

We first try to model it using a 2-NN (with Euclidean distance). Note that the model is fitting on the training set and the predictions are computed on the test set.

Table 11: Confusion Matrix of the 2-Nearest neighbor

	Bad credit risk	Good credit risk
Bad credit risk	21	45
Good credit risk	56	128

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.2727273            0.7398844            0.3181818
##       Neg Pred Value            Precision               Recall
##            0.6956522            0.3181818            0.2727273
##                   F1           Prevalence       Detection Rate
##            0.2937063            0.3080000            0.0840000
## Detection Prevalence    Balanced Accuracy
##            0.2640000            0.5063058
```

The table is read as follow :

- We predicted 21 Bad credits and there were indeed 21 observed Bad credits. But the prediction misjudges 45 good credits by predicting bad credits.
- We predicted 128 Good credits as it was in fact a Good credits but 56 where predicted as Good while it was in fact Bad.

The prediction is not perfect. We need to try to improve the prediction by changing K at that point. Therefore, we use K=3.

3.b K-Nearest Neighbor (K=3)

Table 12: Confusion Matrix of the 3-Nearest neighbor

	Bad credit risk	Good credit risk
Bad credit risk	58	70
Good credit risk	19	103

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.1818182            0.8381503            0.3333333
##       Neg Pred Value            Precision               Recall
##            0.6971154            0.3333333            0.1818182
##                   F1           Prevalence       Detection Rate
##            0.2352941            0.3080000            0.0560000
## Detection Prevalence    Balanced Accuracy
##            0.1680000            0.5099842
```

The table is read as follow :

- We predicted 14 Bad credits and they were indeed observed Bad credits. But the prediction misjudges 28 good credits by predicting bad credits.

- We predicted 145 Good credits as it was in fact a Good credits but 6 where predicted as Good while it was in fact Bad.

4. Linear Support Vector Machine The next model is the linear Support Vector Machine.

```
##
## Call:
## svm(formula = RESPONSE ~ ., data = German_Credit.tr.subs, kernel = "linear")
##
##
## Parameters:
##    SVM-Type:  C-classification
##  SVM-Kernel:  linear
##        cost:  1
##
## Number of Support Vectors:  246
```

Table 13: Confusion Matrix of the Linear support vector machine

	Bad credit risk	Good credit risk
Bad credit risk	50	50
Good credit risk	27	123

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.6493506            0.7109827            0.5000000
##       Neg Pred Value            Precision               Recall
##            0.8200000            0.5000000            0.6493506
##                   F1           Prevalence       Detection Rate
##            0.5649718            0.3080000            0.2000000
## Detection Prevalence    Balanced Accuracy
##            0.4000000            0.6801667
```

Tunning the hyperparameters of Linear SVM We want to select the good hyperparameters for our linear SVM.

```
## Support Vector Machines with Linear Kernel
##
## 446 samples
##  30 predictor
##   2 classes: '0', '1'
##
## No pre-processing
## Resampling: Cross-Validated (10 fold)
## Summary of sample sizes: 402, 400, 402, 401, 402, 402, ...
## Resampling results:
##
##   Accuracy   Kappa
##   0.7264361  0.4530209
##
## Tuning parameter 'C' was held constant at a value of 1
```

We see that we have a good accuracy (0.72).

```
## Support Vector Machines with Linear Kernel
##
```

```
## 446 samples
##  30 predictor
##   2 classes: '0', '1'
##
## No pre-processing
## Resampling: Cross-Validated (10 fold)
## Summary of sample sizes: 402, 400, 402, 401, 402, 402, ...
## Resampling results across tuning parameters:
##
##   C      Accuracy   Kappa
##   1e-02  0.7264339  0.4532044
##   1e-01  0.7286056  0.4575791
##   1e+00  0.7264361  0.4530209
##   1e+01  0.7108278  0.4216992
##   1e+02  0.7130501  0.4261940
##   1e+03  0.7197672  0.4397558
##
## Accuracy was used to select the optimal model using the largest value.
## The final value used for the model was C = 0.1.
```

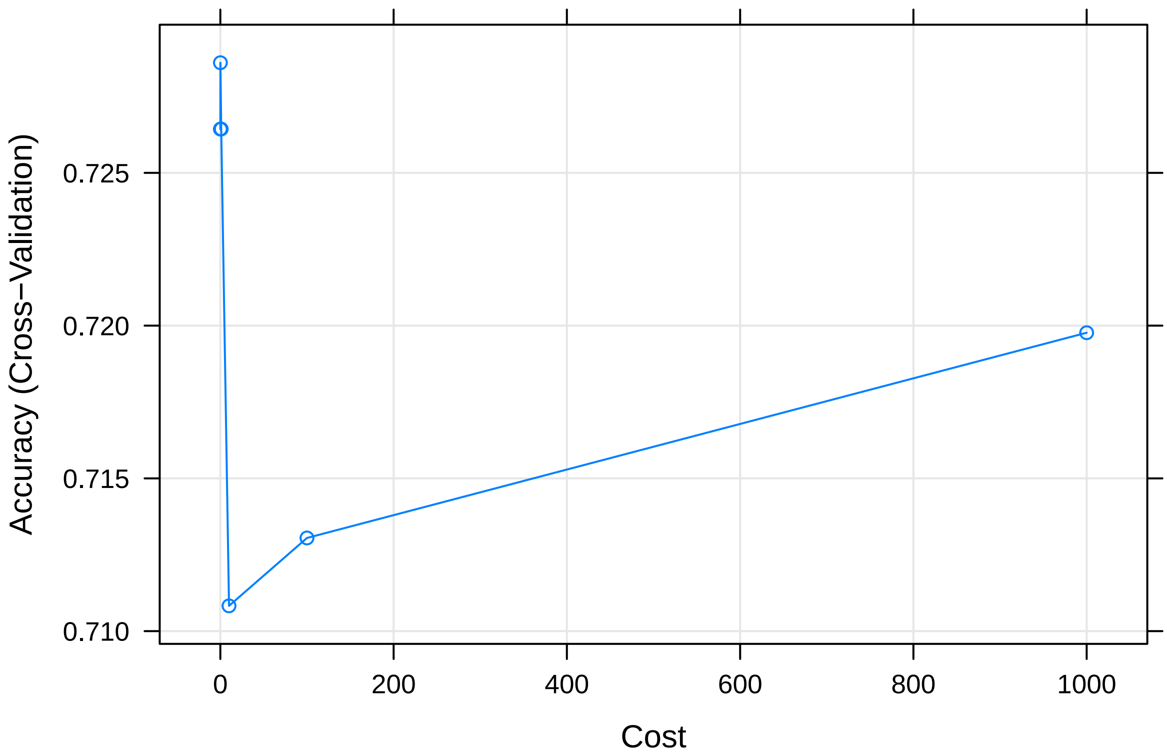


Table 14: Confusion Matrix of the Tuned linear support vector machine

	Bad credit risk	Good credit risk
Bad credit risk	49	49
Good credit risk	28	124

```
##          Sensitivity          Specificity        Pos Pred Value
##            0.6363636            0.7167630             0.5000000
##       Neg Pred Value            Precision                Recall
```

```
##           0.8157895            0.5000000            0.6363636
##                  F1           Prevalence       Detection Rate
##           0.5600000            0.3080000            0.1960000
## Detection Prevalence    Balanced Accuracy
##           0.3920000            0.6765633
```

5. Radial Basis Support Vector Machine We try now with a radial basis kernel (the default).

```
##
## Call:
## svm(formula = RESPONSE ~ ., data = German_Credit.tr.subs, kernel = "radial")
##
##
## Parameters:
##    SVM-Type:  C-classification
##  SVM-Kernel:  radial
##        cost:  1
##
## Number of Support Vectors:  334
```

Table 15: Confusion Matrix of the Radial base support vector machine

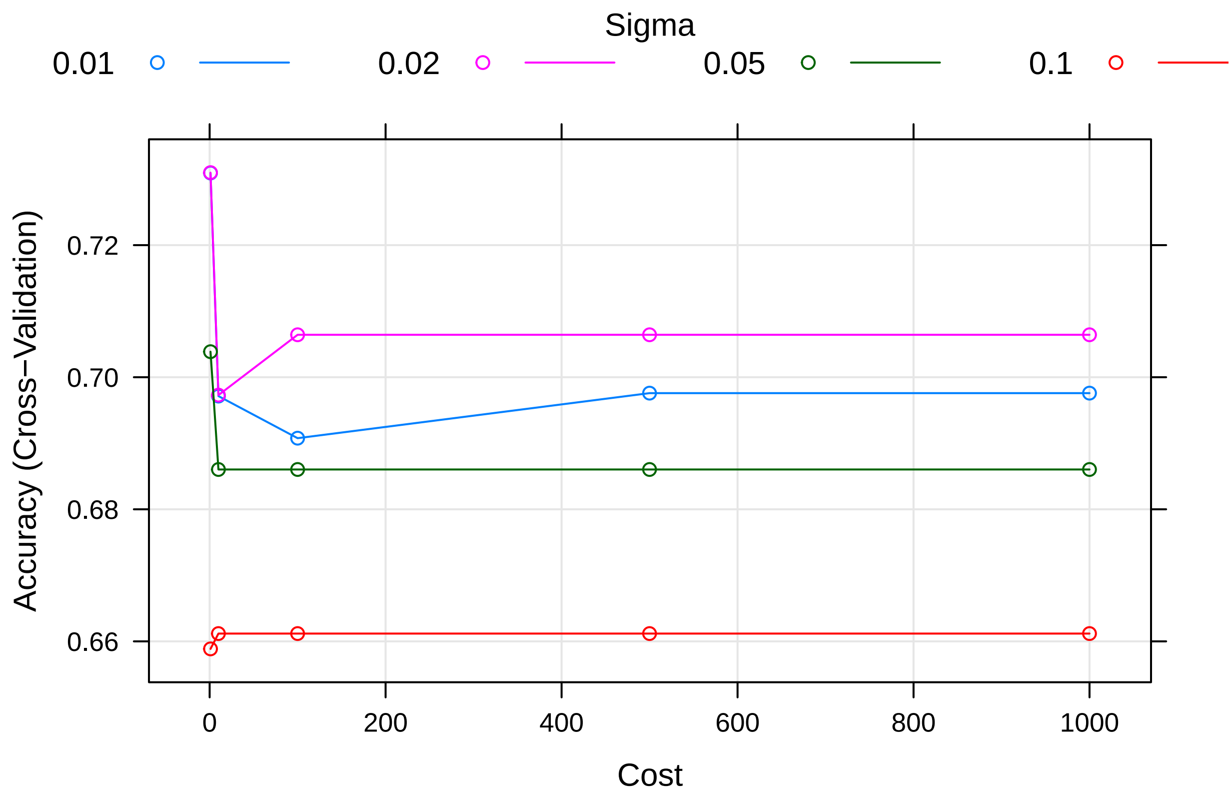
	Bad credit risk	Good credit risk
Bad credit risk	54	52
Good credit risk	23	121

```
##         Sensitivity          Specificity       Pos Pred Value
##           0.7012987            0.6994220            0.5094340
##      Neg Pred Value            Precision               Recall
##           0.8402778            0.5094340            0.7012987
##                  F1           Prevalence       Detection Rate
##           0.5901639            0.3080000            0.2160000
## Detection Prevalence    Balanced Accuracy
##           0.4240000            0.7003603
```

Tunning the hyperparameters of Radial basis SVM

```
## Support Vector Machines with Radial Basis Function Kernel
##
## 446 samples
##  30 predictor
##   2 classes: '0', '1'
##
## No pre-processing
## Resampling: Cross-Validated (10 fold)
## Summary of sample sizes: 402, 400, 402, 401, 402, 402, ...
## Resampling results across tuning parameters:
##
##   sigma  C     Accuracy   Kappa
##   0.01     1   0.7309289  0.4618150
##   0.01    10   0.6971476  0.3942416
##   0.01   100   0.6907708  0.3814209
##   0.01   500   0.6975889  0.3950572
```

```
##    0.01   1000  0.6975889  0.3950572
##    0.02      1  0.7309816  0.4620420
##    0.02     10  0.6972925  0.3946754
##    0.02    100  0.7064273  0.4127482
##    0.02    500  0.7064273  0.4127482
##    0.02   1000  0.7064273  0.4127482
##    0.05      1  0.7038647  0.4085756
##    0.05     10  0.6860299  0.3726705
##    0.05    100  0.6860299  0.3726705
##    0.05    500  0.6860299  0.3726705
##    0.05   1000  0.6860299  0.3726705
##    0.10      1  0.6588603  0.3190546
##    0.10     10  0.6611792  0.3234506
##    0.10    100  0.6611792  0.3234506
##    0.10    500  0.6611792  0.3234506
##    0.10   1000  0.6611792  0.3234506
##
## Accuracy was used to select the optimal model using the largest value.
## The final values used for the model were sigma = 0.02 and C = 1.
```



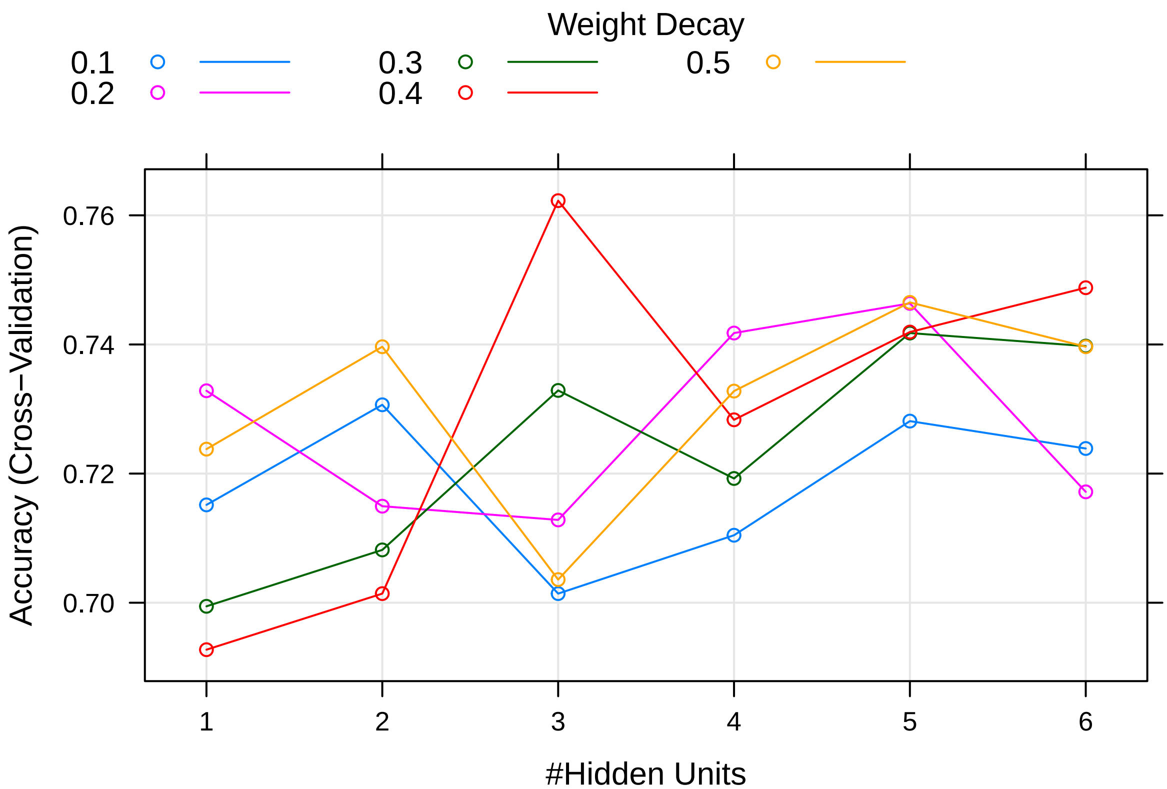

```
##   sigma C
## 6  0.02 1
```

Table 16: Confusion Matrix of the Tuned radial base support vector machine

	Bad credit risk	Good credit risk
Bad credit risk	54	53
Good credit risk	23	120

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.7012987            0.6936416            0.5046729
##       Neg Pred Value            Precision               Recall
##            0.8391608            0.5046729            0.7012987
##                   F1           Prevalence       Detection Rate
##            0.5869565            0.3080000            0.2160000
## Detection Prevalence    Balanced Accuracy
##            0.4280000            0.6974702
```

6. Neural Network - Simple hyperparameter tuning To select the good parameters, we build a search grid and fit the model with each possible value in the grid. This is brute force and time consuming. The best model is selected among all the possible choices.



The best Neural Networks parameters would be to choose 3 hidden layers, with a decay of 0.4.

Table 17: Confusion Matrix of the Hyperparameter tuned neural network 3 nodes

	Bad credit risk	Good credit risk
Bad credit risk	52	53
Good credit risk	25	120

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.6753247            0.6936416            0.4952381
##       Neg Pred Value            Precision               Recall
##            0.8275862            0.4952381            0.6753247
##                   F1           Prevalence       Detection Rate
##            0.5714286            0.3080000            0.2080000
## Detection Prevalence    Balanced Accuracy
```

```
##           0.4200000            0.6844831
```

7. Gradient Boosting The Gradient Boosting model accepts only numerical values so we have some transformation to do on our data in order to use it.

```
## ##### xgb.Booster
## raw: 31.2 Mb
## call:
##   xgb.train(params = xgb_params, data = xgb_train, nrounds = 5000,
##     verbose = 1)
## params (as set within xgb.train):
##   booster = "gbtree", eta = "0.01", max_depth = "8", gamma = "4", subsample = "0.75", colsample_bytre
## xgb.attributes:
##   niter
## callbacks:
##   cb.print.evaluation(period = print_every_n)
## # of features: 46
## niter: 5000
## nfeatures : 46
```

Here we have an accuracy of 68.4%. It is good but there is room for improvement.

Table 18: Confusion Matrix of the Gadient boosting

	Bad credit risk	Good credit risk
Bad credit risk	57	59
Good credit risk	20	114

```
##          Sensitivity          Specificity       Pos Pred Value
##            0.7402597            0.6589595            0.4913793
##       Neg Pred Value            Precision               Recall
##            0.8507463            0.4913793            0.7402597
##                   F1           Prevalence       Detection Rate
##            0.5906736            0.3080000            0.2280000
## Detection Prevalence    Balanced Accuracy
##            0.4640000            0.6996096
```

Review of statistics

Once all the models were modelized we compared them according to their scores and metrics. Below we summarized all their accuracy into one table.

Table 19: Scores of the models (continued below)

	Big classification tree	Pruned classification tree	Autoprune classification tree	Logistic regression	AIC reduced Logistic regression	Linear support vector machine
Accuracy	0.644	0.564	0.584	0.704	0.684	0.692
Kappa	0.2945	0.2083	0.2251	0.3479	0.32	0.3328

	Big classification tree	Pruned classification tree	Autoprune classification tree	Logistic regression	AIC reduced Logistic regression	Linear support vector machine
Accuracy lower bound	0.5812	0.5001	0.5202	0.6432	0.6224	0.6307
Accuracy upper bound	0.7033	0.6264	0.6458	0.7599	0.7411	0.7486
Accuracy null	0.692	0.692	0.692	0.692	0.692	0.692
Accuracy P-value	0.9552	1	0.9999	0.369	0.6369	0.5308
Mcnemar P-value	1.158e-07	1.822e-14	3.352e-12	0.04813	0.00693	0.01217

	Tuned linear support vector machine	Radial base support vector machine	Tuned radial base support vector machine	Hyperparameter tuned neural network 3 nodes	Gradient Boosting
Accuracy	0.692	0.7	0.696	0.688	0.684
Kappa	0.3283	0.3628	0.3564	0.3352	0.35
Accuracy lower bound	0.6307	0.6391	0.6349	0.6266	0.6224
Accuracy upper bound	0.7486	0.7561	0.7524	0.7449	0.7411
Accuracy null	0.692	0.692	0.692	0.692	0.692
Accuracy P-value	0.5308	0.4219	0.4762	0.5847	0.6369
Mcnemar P-value	0.02265	0.001224	0.0008794	0.002235	1.909e-05

According to these two first tables, the best model would be the “Radial base linear support vector machine” as it has the highest accuracy level of 0.7 and the best kappa value of 0.3628.

The accuracy means that out of total number of observations, the model predicted correctly 70% of them. The Cohen’s Kappa Coefficient means that there is 36% of agreement, indicating that the raters agree in their classification for 36% of the cases.

Another table is done to compare the KNN because they were not performed on the balanced dataset.

Table 21: Scores of the KNN models

	2-Nearest neighbor	3-Nearest neighbor
Accuracy	0.596	0.636
Kappa	0.01313	0.02285
AccuracyLower	0.5323	0.573
AccuracyUpper	0.6574	0.6957
AccuracyNull	0.692	0.692
AccuracyPValue	0.9995	0.9752
McnemarPValue	0.3197	0.000365

Overall, we see that the worst model is the 'Autoprune classification tree'. This is understandable because we pruned the model so much that we lost many observations on the way.

Conclusion

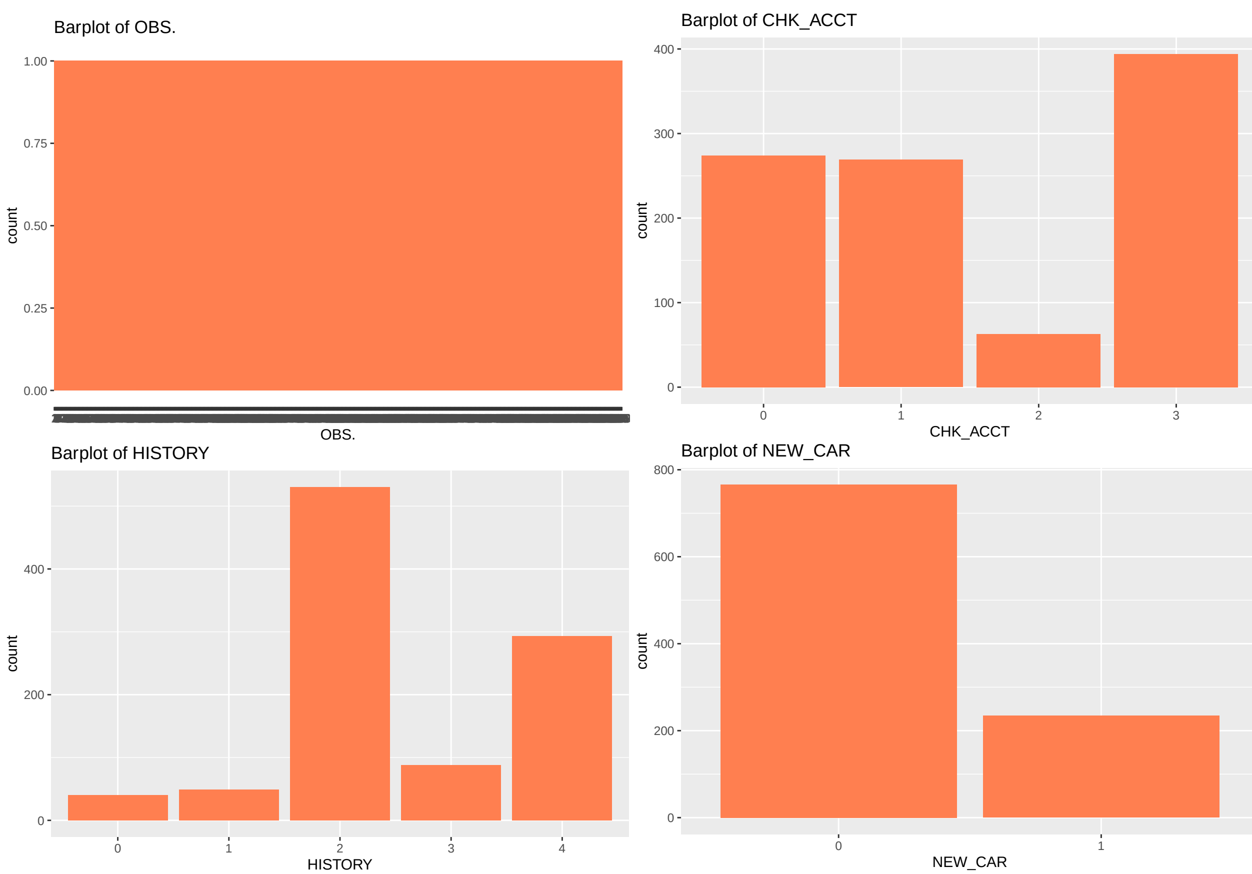
Our recommendations/Suggestions

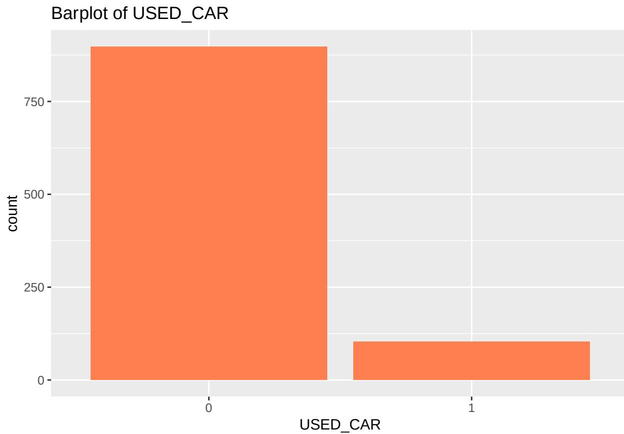
As we saw the models could be improved as the accuracies are not going over the 70%. We think that others variables describing better the 'Bad' credits could be added. For example, it would be interesting to know whether the applicant is under litigation for not paying back someone ('acte de poursuite' in French).

References

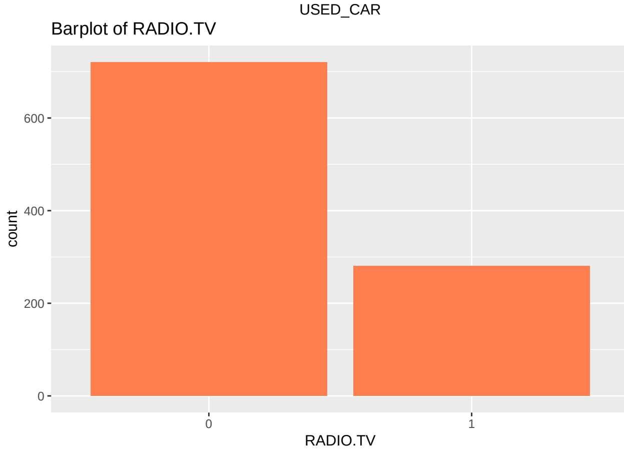
Annexes

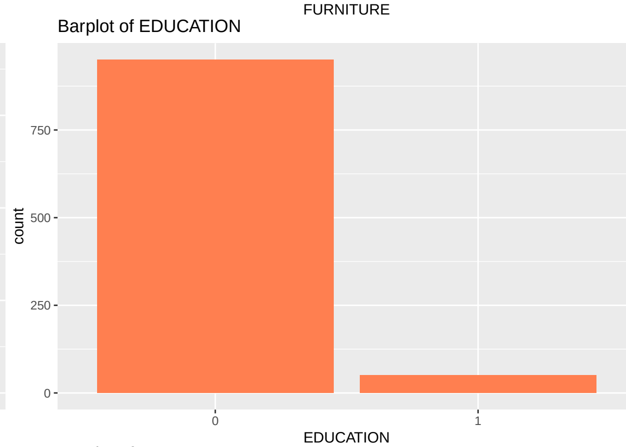
Appendix A : Barplots of the categorical variables from the EDA part.

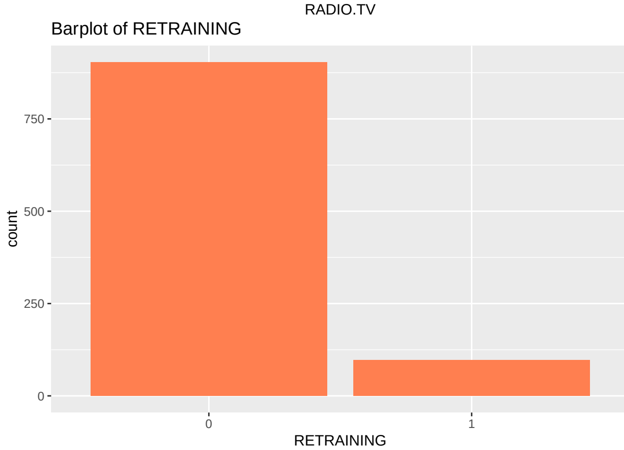


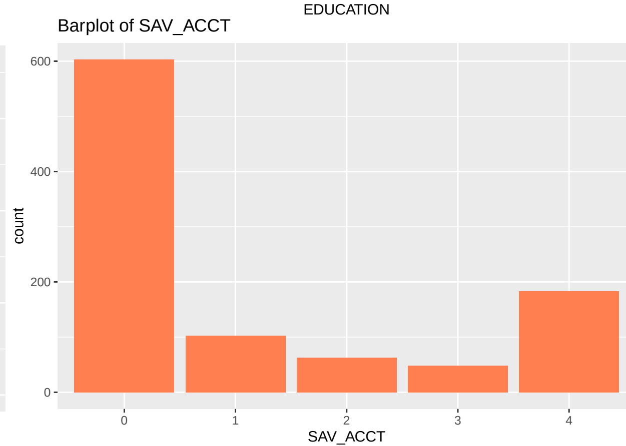

Barplot of USED_CAR
count
0
250
500
750
0
1
USED_CAR

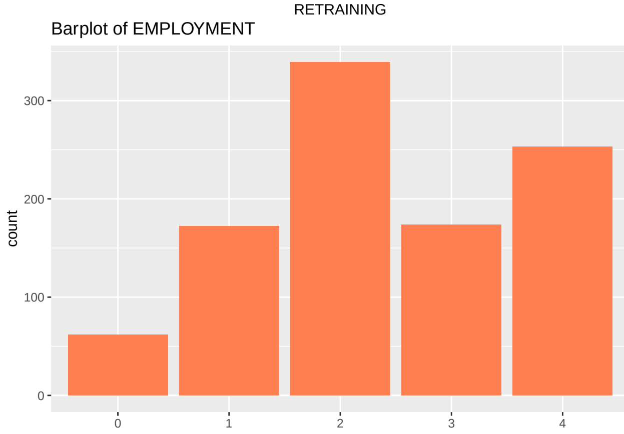

Barplot of FURNITURE
count
0
200
400
600
800
0
1
FURNITURE

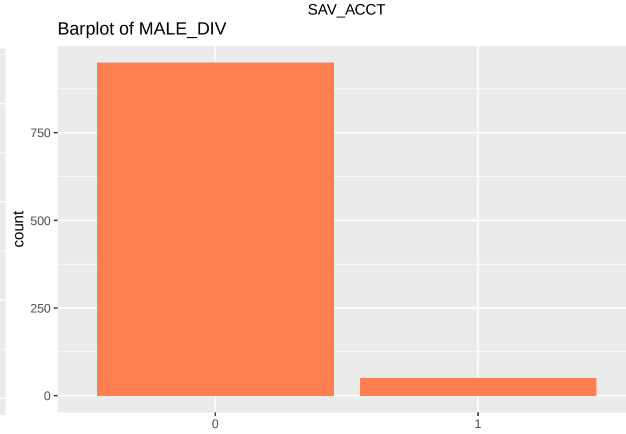

Barplot of RADIO.TV
count
0
200
400
600
0
1
RADIO.TV

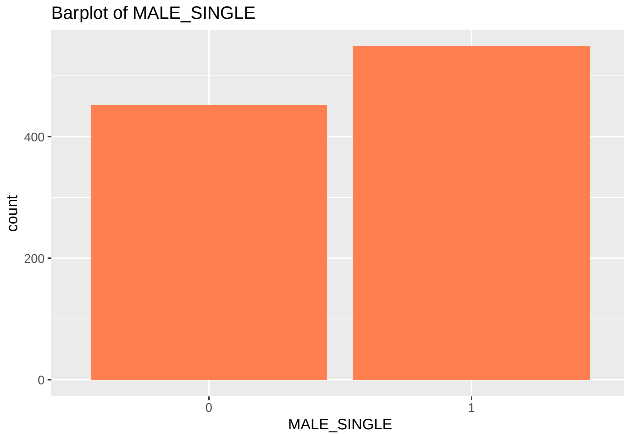

Barplot of EDUCATION
count
0
250
500
750
0
1
EDUCATION

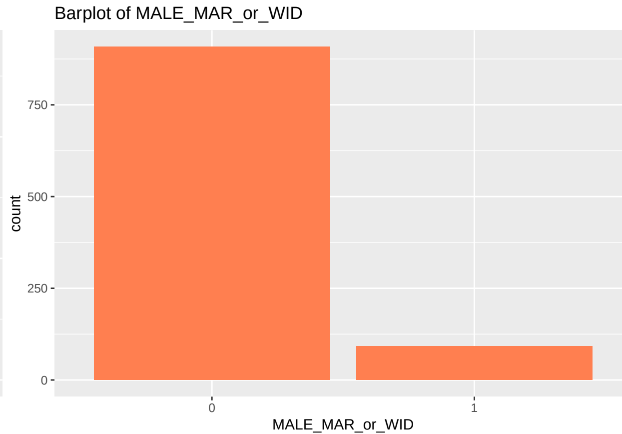

Barplot of RETRAINING
count
0
250
500
750
0
1
RETRAINING

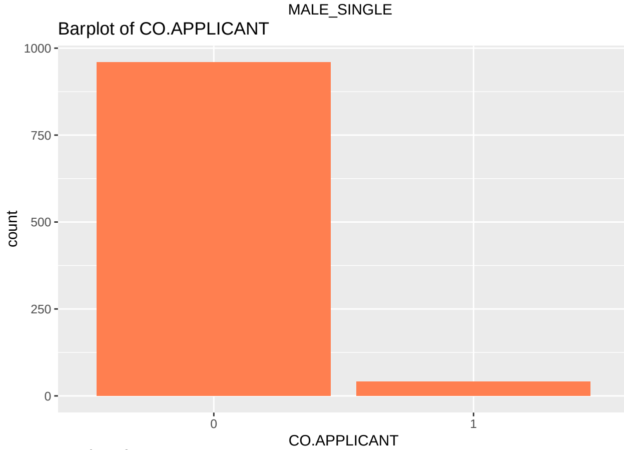

Barplot of SAV_ACCT
count
0
200
400
600
0
1
2
3
4
SAV_ACCT

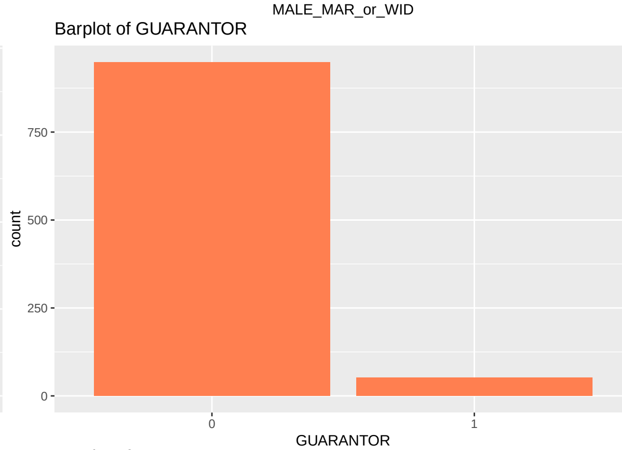

Barplot of EMPLOYMENT
count
0
100
200
300
0
1
2
3
4
EMPLOYMENT

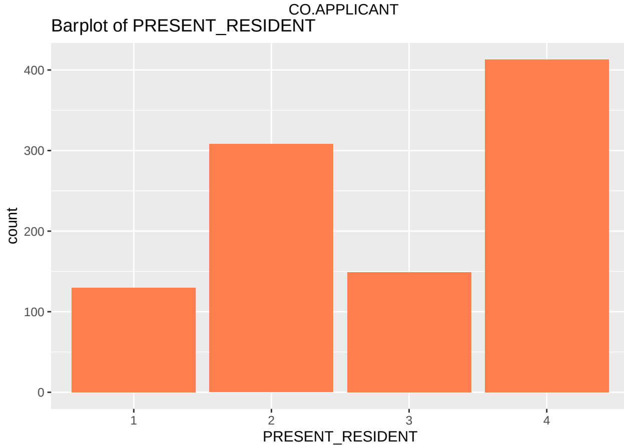

Barplot of MALE_DIV
count
0
250
500
750
0
1
MALE_DIV

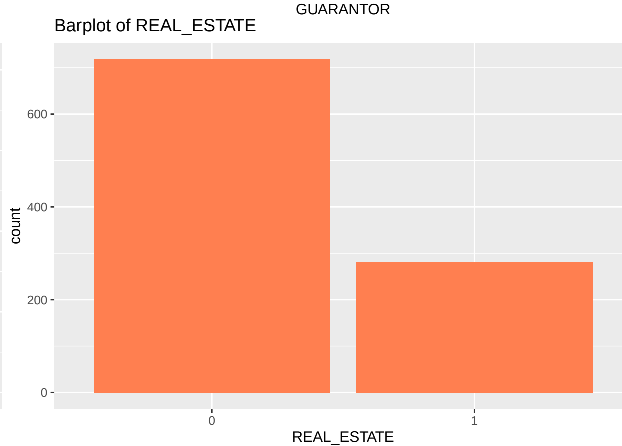

Barplot of MALE_SINGLE
count
0
200
400
0
1
MALE_SINGLE

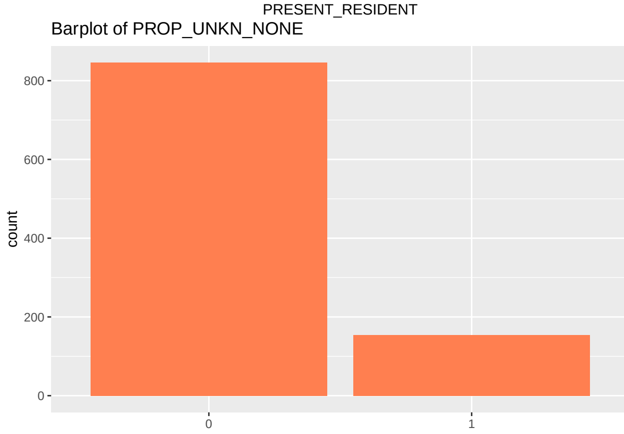

Barplot of MALE_MAR_or_WID
count
0
250
500
750
0
1
MALE_MAR_or_WID

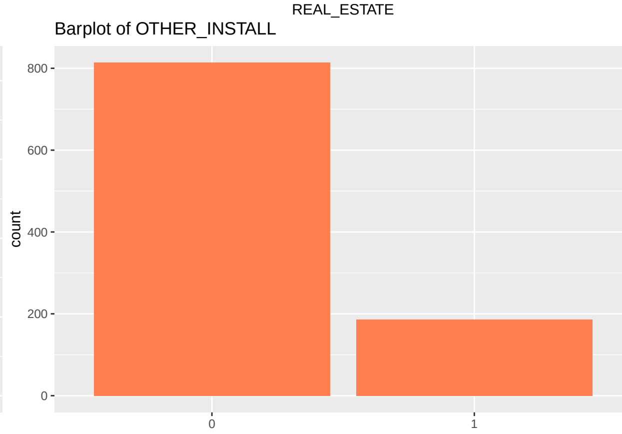

Barplot of CO.APPLICANT
count
0
250
500
750
1000
0
1
CO.APPLICANT


Barplot of GUARANTOR
count
0
250
500
750
0
1
GUARANTOR

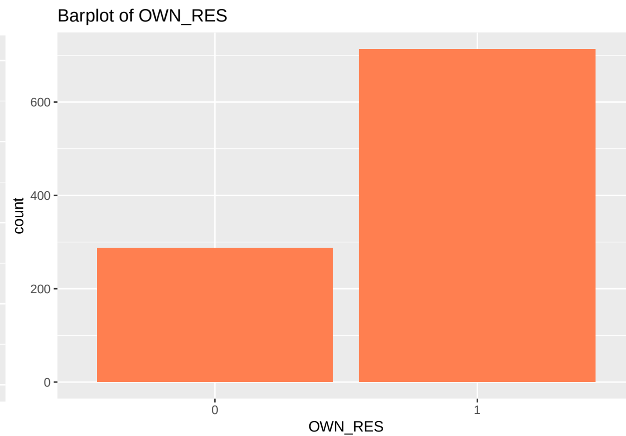

Barplot of PRESENT_RESIDENT
count
0
100
200
300
400
1
2
3
4
PRESENT_RESIDENT


Barplot of REAL_ESTATE
count
0
200
400
600
0
1
REAL_ESTATE

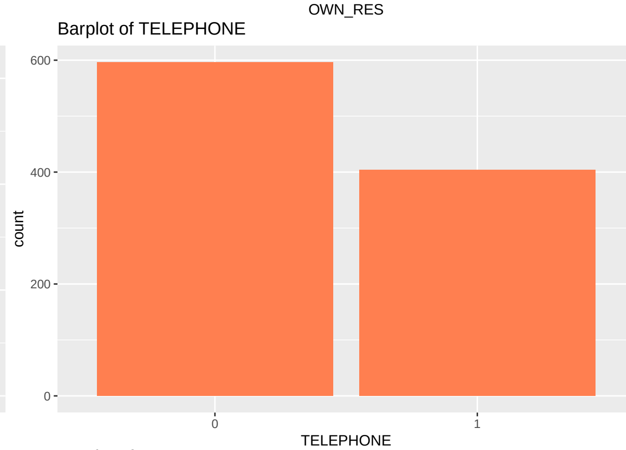

Barplot of PROP_UNKN_NONE
count
0
200
400
600
800
0
1
PROP_UNKN_NONE

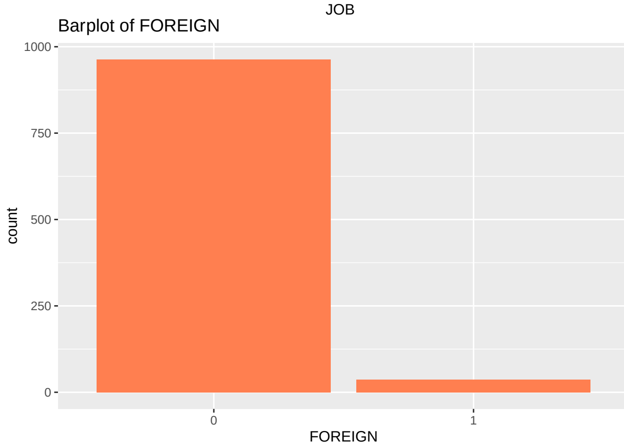

Barplot of OTHER_INSTALL
count
0
200
400
600
800
0
1
OTHER_INSTALL

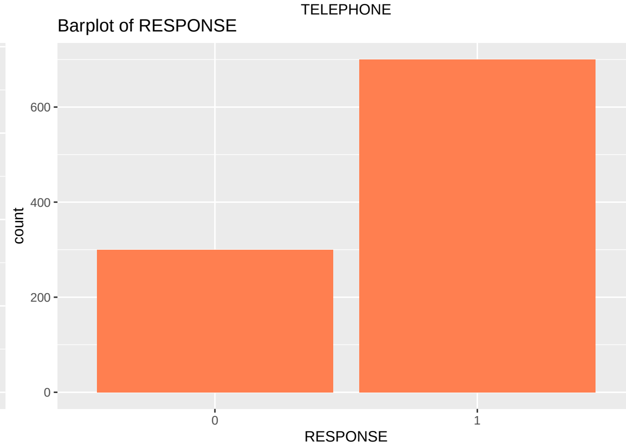

Barplot of RENT
count
800
600
400
200
0
0
1
RENT


Barplot of OWN_RES
count
600
400
200
0
0
1
OWN_RES


Barplot of JOB
count
600
400
200
0
0
1
2
3
JOB


Barplot of TELEPHONE
count
600
400
200
0
0
1
TELEPHONE


Barplot of FOREIGN
count
1000
750
500
250
0
0
1
FOREIGN


Barplot of RESPONSE
count
600
400
200
0
0
1
RESPONSE