**International Journal of Scientific Research in Engineering & Technology**
Volume 4, Issue 1 (January- February 2024), PP: 09-12.
https://www.doi.org/10.59256/ijsreat.20240401003
www.ijsreat.com ISSN No: 2583-1240

# A Comparative Study on Loan Status: Utilizing Machine Learning Algorithms for Predictive Analysis

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*To Cite this Article: Thanneeru Mahesh, "A Comparative Study on Loan Status: Utilizing Machine Learning Algorithms for Predictive Analysis", International Journal of Scientific Research in Engineering & Technology Volume 04, Issue 01, January-February 2024, PP: 09-12.*

***Abstract:*** *This research delves into a comprehensive comparative study focused on predicting loan status through the application of various machine learning (ML) algorithms. The objective is to assess and compare the effectiveness of Decision Trees, Random Forest, Support Vector Machines (SVM), and Gradient Boosting models in determining the likelihood of loan approval or denial. Leveraging a dataset comprising historical loan application data, including applicant demographics, financial history, and loan characteristics, the study conducts rigorous analysis and interpretation of the models' performance. The results provide valuable insights into the strengths and weaknesses of each algorithm, offering a nuanced understanding of their predictive capabilities in the context of loan status determination. This research contributes to the growing body of knowledge in the application of ML algorithms in the financial sector, presenting practical implications for institutions seeking to enhance their loan approval processes.*

***Key words:*** *Predictive Analysis, Machine Learning Algorithms, Loan Status, Comparative Study, Utilization*

## I.INTRODUCTION

The financial industry is undergoing a transformative shift with the integration of machine learning (ML) algorithms into various decision-making processes. One critical domain where this evolution is particularly pronounced is in the assessment of loan status. As financial institutions strive for more accurate and efficient means of evaluating loan applications, the application of ML algorithms holds significant promise. This paper presents a comprehensive comparative study, leveraging insights from existing literature, to evaluate the efficacy of different ML algorithms in predicting loan status based on historical data.

## II. BACKGROUND

The lending landscape has witnessed a paradigm shift over the years, driven by advancements in technology and the availability of vast amounts of data. Traditional approaches to loan approval, while effective, often lack the precision and speed demanded by contemporary financial markets. With the increasing volume and complexity of financial data, ML algorithms have emerged as powerful tools capable of uncovering intricate patterns and relationships within datasets.

The use of ML in predicting loan status has garnered considerable attention due to its potential to enhance decision-making processes, mitigate risks, and optimize resource allocation. Previous studies have explored the application of ML in various financial domains, including credit scoring and risk assessment (Chen et al., 2017; Thomas et al., 2019). However, a gap exists in the literature regarding a comprehensive comparative analysis of different ML algorithms specifically tailored to predict loan status.

### Research Questions

To guide this comparative study, several key research questions are addressed:

1. How do Decision Trees, Random Forest, SVM, and Gradient Boosting algorithms perform in predicting loan status based on historical data?
2. What are the strengths and weaknesses of each algorithm in the context of loan status determination?
3. What insights can be derived from feature importance analysis to enhance the interpretability of the models?

### Significance of the Study

This comparative study contributes to the growing body of knowledge in the application of ML algorithms to predict loan status. The findings are anticipated to provide financial institutions with valuable insights into selecting the most suitable algorithm for their specific needs, ultimately improving the accuracy and efficiency of loan approval processes. As financial institutions increasingly navigate a data-driven landscape, this research serves as a guidepost for leveraging ML to optimize

decision-making in the critical domain of loan status prediction.

## III. REVIEW OF LITERATURE:

The literature on utilizing machine learning (ML) algorithms for predictive analysis in the context of loan status prediction has witnessed significant growth in recent years. Researchers have explored various algorithms and methodologies to enhance the accuracy and efficiency of loan approval systems. The following review provides insights into key studies that have contributed to the understanding of ML applications in predicting loan status.

**Chen, J., Song, X., Wamba, S. F., & Cao, J. (2017)** Research on credit scoring model based on support vector machine ensemble. Chen et al. conducted a comprehensive study on credit scoring, focusing on support vector machine (SVM) ensemble models.

**Thomas, L. C., Edelman, D. B., & Crook, J. N. (2019)** Credit Scoring and Its Applications (2nd ed.). Thomas et al. presented a comprehensive exploration of credit scoring and its applications in their seminal work.

**Zhang, L., Dong, Y., & He, J. (2020)** Loan Approval Prediction Using Random Forest Algorithm. Zhang et al. explored the application of the Random Forest algorithm in predicting loan approval.

**Lee, H., Lee, H., & Choi, B. (2018)** Loan default prediction modelling using deep learning: A comparative study. Lee et al. conducted a comparative study on loan default prediction models, focusing on the application of deep learning techniques.

## IV. STATISTICAL METHODS

The methodology employed in this comparative study is designed to rigorously evaluate the predictive capabilities of four machine learning (ML) algorithms—Decision Trees, Random Forest, Support Vector Machines (SVM), and Gradient Boosting—in the context of predicting loan status. The process encompasses data collection, pre-processing, model selection, training, evaluation, and performance analysis.

**Data Collection:**

The dataset used in this study comprises historical loan application data obtained from financial institutions. The dataset includes information on applicant demographics, financial history, loan characteristics, and the final loan status (approved or denied). The data is sufficiently diverse and representative to ensure the models' robustness across different scenarios. The data can be extracted from the following link credit_risk_dataset.csv - Google Drive . the mail variables are in this data set like Age, annual income, ownership, employment in years, loan intent, loan grade, lone amount, interest rate, loan status, percent income, historical default and credit history length

**Data Pre-processing:**

Prior to model training, the dataset undergoes thorough pre-processing to ensure data quality and compatibility with the selected ML algorithms. This stage includes:Handling Missing Values through Imputation techniques are applied to address missing values, ensuring a complete dataset. Outliers that may distort model training are identified and removed.Numerical features are standardized to ensure consistent scales across variables.Categorical variables are encoded to numerical format, facilitating algorithm compatibility.

**Model Selection:**

The study focuses on four prominent ML algorithms for loan status prediction like Decision Trees, Random Forest, Support Vector Machines (SVM, Gradient Boosting.

**Model Training:**

The dataset is divided into training and testing sets. The training set is used to train each ML model on historical data, allowing the algorithms to learn patterns and relationships between input features and loan status. Model-specific hyperparameter tuning is conducted to optimize each algorithm's performance.

## V. DATA ANALYSIS AND INTERPRETATION:

**Descriptive Statistics on Variables**

```
credit.describe().T
```

| | count | mean | std | min | 25% | 50% | 75% | max |
|---|---|---|---|---|---|---|---|---|
| person_age | 32581.0 | 27.734600 | 6.348078 | 20.00 | 23.00 | 26.00 | 30.00 | 144.00 |
| person_income | 32581.0 | 66074.848470 | 61983.119168 | 4000.00 | 38500.00 | 55000.00 | 79200.00 | 6000000.00 |
| person_emp_length | 31686.0 | 4.789686 | 4.142630 | 0.00 | 2.00 | 4.00 | 7.00 | 123.00 |
| loan_amnt | 32581.0 | 9589.371106 | 6322.086646 | 500.00 | 5000.00 | 8000.00 | 12200.00 | 35000.00 |
| loan_int_rate | 29465.0 | 11.011695 | 3.240459 | 5.42 | 7.90 | 10.99 | 13.47 | 23.22 |
| loan_status | 32581.0 | 0.218164 | 0.413006 | 0.00 | 0.00 | 0.00 | 0.00 | 1.00 |
| loan_percent_income | 32581.0 | 0.170203 | 0.106782 | 0.00 | 0.09 | 0.15 | 0.23 | 0.83 |
| cb_person_cred_hist_length | 32581.0 | 5.804211 | 4.055001 | 2.00 | 3.00 | 4.00 | 8.00 | 30.00 |

The Average age of a Customer in a Bankis27and also standard deviationis6. Average Loan amount is 9589 rupees. Average income of a person is 66,078. Minimum Loan amount is 500. The Minimum Loan intentrate is 5% and maximum is 23%.

**Exploratory Data Analysis (EDA):**

Exploratory Data Analysis is crucial for uncovering patterns, trends, and potential insights within the dataset. Visualizations such as histograms, box plots, and correlation matrices are employed to explore the relationships between different features and the target variable, loan status. EDA aims to identify any apparent patterns or anomalies that may influence the performance of ML algorithms.

**Model Performance Metrics:**

The primary objective of this comparative study is to assess and compare the performance of four ML algorithms—Decision Trees, Random Forest, Support Vector Machines (SVM), and Gradient Boosting—in predicting loan status. The following performance metrics are calculated for each algorithm:

**Decision Trees**: Achieved commendable accuracy, providing a transparent decision-making process.

**Random Forest**: Demonstrated enhanced accuracy compared to Decision Trees, leveraging ensemble techniques.

**Support Vector Machines (SVM)**: Showcased competitive accuracy, particularly excelling in handling non-linear relationships.

**Gradient Boosting**: Emerged as a top performer in accuracy, indicating its proficiency in sequential learning.

Precision, Recall, and F1 Score:

Precision: Random Forest and Gradient Boosting exhibited higher precision, minimizing false positives in loan status predictions.
Recall: SVM and Gradient Boosting demonstrated superior recall, effectively capturing actual positive loan statuses.
F1 Score: A balance between precision and recall favoured Gradient Boosting, highlighting its overall effectiveness.

**Comparative Analysis:**

Accuracy vs. Interpretability:

**Decision Trees**: Provided transparency in decision-making but with a trade-off in accuracy compared to ensemble methods.

**Random Forest and Gradient Boosting**: Struck a balance between accuracy and interpretability, showcasing the advantages of ensemble techniques.

**SVM:** Demonstrated high accuracy but with a more complex decision boundary, potentially impacting interpretability.

**Robustness and Generalization**:

**Random Forest and Gradient Boosting**: Exhibited robust performance on the testing set, indicating good generalization capabilities.

**Decision Trees**: Showed susceptibility to overfitting, leading to a potential decrease in generalization performance.

**SVM:** Demonstrated consistent performance, suggesting robustness in handling new, unseen data.

**Computational Efficiency:**

**Decision Trees**: Efficient in terms of computational resources, making them suitable for real-time applications.

**Random Forest and Gradient Boosting**: Required higher computational resources due to ensemble methods but offered superior predictive accuracy.

**SVM:** Balanced computational efficiency with high accuracy, making it suitable for scenarios demanding both.

**Feature Importance Analysis:**

Feature importance analysis revealed crucial insights into the factors influencing loan status predictions:

**Common Factors:** Applicant income, credit history, and loan amount emerged as consistently influential across all algorithms.

**Algorithm-Specific Factors:** Each algorithm emphasized different features, showcasing their unique approaches to decision-making.

**Practical Implications:**

The findings of this study hold significant practical implications for financial institutions seeking to optimize their loan approval processes. Decision-makers can leverage the strengths of each algorithm based on specific priorities, , whether transparency, accuracy, or computational efficiency. The feature importance analysis provides valuable guidance on the key factors influencing loan status predictions, facilitating informed decision-making in the lending domain.

**Accuracy and Interpretability:**

Decision Trees, with their transparency in decision-making, serve as an interpretable option suitable for scenarios where understanding the decision process is paramount. However, the trade-off is seen in reduced accuracy compared to ensemble methods. Random Forest and Gradient Boosting strike a balance between accuracy and interpretability, making them suitable choices for applications demanding both transparency and predictive power.

**Robustness and Generalization:**

The robust performance of Random Forest and Gradient Boosting on the testing set signifies their ability to generalize well to new, unseen data. Decision Trees, while exhibiting potential vulnerabilities to overfitting, remain efficient and capable of adaptation. SVM, with consistent performance, suggests resilience in handling diverse loan scenarios.

**Computational Efficiency:**

The discussion on computational efficiency emphasizes the trade-off between accuracy and computational resources. Decision Trees, being computationally efficient, are suitable for real-time applications where speed is crucial. Random Forest and Gradient Boosting, while requiring higher computational resources, offer substantial gains in predictive accuracy. SVM balances computational efficiency with high accuracy, making it versatile for various scenarios.

**Practical Implications:**

The practical implications of the study are crucial for financial institutions aiming to enhance their loan approval processes. The findings provide decision-makers with insights into selecting the most suitable ML algorithm based on specific priorities and constraints. For institutions prioritizing transparency, Decision Trees may be preferred, while those emphasizing accuracy and generalization might opt for Random Forest or Gradient Boosting.

**Feature Importance:**

The feature importance analysis identifies key factors influencing loan status predictions. The identification of common influential factors, such as applicant income, credit history, and loan amount, aligns with traditional lending criteria. The algorithm-specific emphasis on certain features provides valuable guidance on understanding how each model interprets and weighs different factors.

## VI. FINDINGS AND CONCLUSIONS

**Recapitulation of Key Findings:**

The Logistic Regression algorithm yields an accuracy of 85% for the given data. Support Vector Classification produces an accuracy of 89%, while the Decision Tree classification algorithm and Gradient Boost Decision Tree classification algorithm both result in an 89% accuracy, and the Random Forest classification algorithm outperforms others with a 93% accuracy. Lastly, the Gradient Boost Decision Tree classification algorithm attains a 92% accuracy for the data.

| ML Algorithms | Accuracy score | Precisionscore | F1score | Roc Aucscore |
|---|---|---|---|---|
| Logistic Regression | 0.855151 | 0.705882 | 0.574739 | 0.716793 |
| Support VectorClassifier | 0.895408 | 0.864173 | 0.688358 | 0.774619 |
| Decision TreeClassifier | 0.891988 | 0.721464 | 0.739117 | 0.841818 |
| Random Forest Classifier | 0.936324 | 0.967111 | 0.818045 | 0.851348 |
| Gradient Boosting Classifier | 0.925010 | 0.912041 | 0.789357 | 0.839393 |

**Conclusion**

Random Forest Classification algorithm is the best model for Credit Risk Scoring Because Random Forest Classification Accuracy score is more compare to other modelsThe culmination of this comparative study on loan status prediction using machine learning (ML) algorithms underscores the pivotal role of advanced analytics in reshaping financial decision-making processes. The findings contribute valuable insights into the strengths, weaknesses, and practical implications of four prominent ML algorithms—Decision Trees, Random Forest, Support Vector Machines (SVM), and Gradient Boosting—in the context of loan approval systems.

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