Bank Customer Churn Prediction

PROJECT SUBMITTED TO ASIAN ACADEMY OF FILM & TELEVISION IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF DEGREE OF

PG Diploma

in

Data Science

By

Rishabh Gupta

Under the Supervision of

Mr. Nitish Patil

ASIAN ACADEMY OF FILM & TELEVISION, NOIDA

2025

DECLARATION

I, **RISHABH GUPTA**, S/O **MR. ANAND KUMAR GUPTA**, declare that my project entitled "BANK CUSTOMER CHURN PREDICTION**"**, submitted at **School of Data Science, Asian Academy of Film & Television, Film City, Noida**, for the award of **PG Diploma in Data Science** in **AAFT**, is an original work and no similar work has been done in India anywhere else to the best of my knowledge and belief.

This project has not been previously submitted for any other degree of this or any other Institute.

Signature

Rishabh Gupta
6394578850
gupta.rishabh1304@gmail.com
PG Diploma in Data Science

Asian Academy Of Film & Television

ACKNOWLEDGEMENT

The completion of the project titled **"**BANK CUSTOMER CHURN PREDICTION**"**, gives me an opportunity to convey my gratitude to all those who helped to complete this project successfully. I express special thanks:

- To ***Prof. Sandeep Marwah,*** President, Asian School of Media Studies, who has been a source of perpetual inspiration throughout this project.
- To ***Mr. Ashish Garg,*** Director for School of Data Science for your valuable guidance, support, consistent encouragement, advice and timely suggestions.
- To ***Mr. Nitish Patil,*** Assistant Professor of School of Data Science, for your encouragement and support. I deeply value your guidance.
- To my ***faculty & friends*** for their insightful comments on early drafts and for being my worst critic. You are all the light that shows me the way.

  To all the people who have directly or indirectly contributed to the writing of this thesis, but their names have not been mentioned here.

Signature

Rishabh Gupta
6394578850
gupta.rishabh1304@gmail.com
PG Diploma in Data Science

School of Data Science

Asian Academy Of Film & Television

Abstract

Customer churn is a significant challenge for banks and financial institutions, as losing customers leads to revenue decline and increased acquisition costs. Retaining existing customers is far more cost-effective than acquiring new ones, making churn prediction an essential component of customer relationship management. This project aims to develop a predictive model using Machine Learning (ML) techniques to identify customers likely to churn. By leveraging customer transaction data, demographics, and account activity, the model enables banks to implement proactive retention strategies.

This study employs a structured approach that includes data preprocessing, feature engineering, model selection, and evaluation to ensure high predictive accuracy. The dataset consists of multiple variables such as credit score, age, tenure, balance, number of products, activity status, and estimated salary. Various ML models, including Logistic Regression, Random Forest, XGBoost, and Artificial Neural Networks (ANN), are tested to determine the most effective method for predicting customer churn.

Feature engineering plays a crucial role in improving model accuracy. Techniques such as one-hot encoding, outlier detection, and feature scaling are applied to optimize data quality. Additionally, exploratory data analysis (EDA) helps uncover key factors influencing customer churn. Factors such as tenure, account activity, and the number of products owned are found to have a significant impact on churn probability.

Among the models tested, XGBoost emerges as the best-performing algorithm, achieving an accuracy of 87% and an AUC-ROC score of 0.91. The model demonstrates strong predictive capabilities by capturing complex relationships within the dataset. The results indicate that younger customers with lower tenure and inactive accounts are more likely to churn. Moreover, customers with a higher number of products and active engagement with banking services exhibit lower churn rates.

The findings of this study provide valuable insights for financial institutions to develop targeted retention strategies. By identifying at-risk customers, banks can design personalized offers, enhance customer engagement, and improve overall customer satisfaction. The research highlights the importance of integrating ML-driven solutions in financial analytics to optimize decision-making and customer relationship management.

Future work can explore the integration of real-time data processing to enable dynamic churn prediction models. Additionally, incorporating behavioral analytics, such as transaction frequency and customer sentiment analysis, can further refine the predictive capabilities of the model. Implementing these strategies will not only enhance customer retention but also strengthen the competitive advantage of banks in the digital financial landscape.

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Acronyms

- AI: Artificial Intelligence
- AUC: Area Under the Curve
- CLV: Customer Lifetime Value
- CRM: Customer Relationship Management
- EDA: Exploratory Data Analysis
- F1-Score: Harmonic mean of precision and recall
- ML: Machine Learning
- ROC: Receiver Operating Characteristic
- RFM: Recency, Frequency, Monetary
- SHAP: SHapley Additive exPlanations
- XGBoost: Extreme Gradient Boosting

Chapter – 1

1. Introduction

1.1 Background

The banking industry has witnessed a significant transformation in recent years due to the rapid advancements in technology, increasing competition, and shifting customer expectations. The emergence of digital banking and fintech companies has made it easier for customers to switch financial institutions, thereby increasing customer churn rates. Churn, or customer attrition, refers to the scenario where customers stop doing business with a company, either by closing their accounts or moving to a competitor. In the context of banking, understanding the factors that influence customer churn is crucial for financial institutions to retain their customers and enhance long-term profitability.

Customer churn poses a major challenge to banks and financial institutions, leading to revenue loss, increased marketing costs, and weakened customer relationships. Acquiring a new customer is significantly more expensive than retaining an existing one, making customer retention a top priority for businesses. Traditional customer relationship management strategies often fail to identify early signs of customer dissatisfaction, making it difficult to take proactive retention measures. With the advent of big data and machine learning, banks now have the opportunity to leverage vast amounts of customer data to predict churn and implement targeted strategies to reduce attrition.

Machine learning-based predictive modeling allows banks to analyze customer behaviors, transaction histories, and demographic details to identify patterns associated with churn. By utilizing historical data, predictive models

can determine key indicators of customer dissatisfaction, such as decreased account activity, reduced transaction volumes, or frequent inquiries about competitor offerings. These insights enable banks to proactively engage with at-risk customers by offering personalized services, financial incentives, and improved customer support, ultimately improving customer retention rates.

In addition to predictive modeling, sentiment analysis and behavioral analytics play a significant role in churn prediction. By analyzing customer feedback, call center interactions, and social media sentiment, banks can gain a deeper understanding of customer concerns and address potential issues before they escalate. This data-driven approach enables banks to develop effective customer engagement strategies and optimize their service offerings based on real-time insights.

Furthermore, regulatory changes and evolving customer expectations have contributed to the growing importance of churn prediction in the banking sector. Customers today expect seamless digital experiences, quick resolution of complaints, and highly personalized financial products. Failure to meet these expectations often results in customer dissatisfaction and churn. By integrating advanced analytics into their decision-making processes, banks can enhance customer satisfaction and build long-term relationships with their clients.

The importance of customer churn prediction extends beyond individual banks to the overall stability of the financial sector. High churn rates can indicate underlying issues such as economic downturns, customer dissatisfaction with industry practices, or inefficiencies in banking operations. Identifying these trends early on can help financial institutions and policymakers take corrective actions to mitigate risks and maintain a stable banking environment.

In conclusion, the ability to predict and manage customer churn is an essential component of modern banking strategies. By harnessing the power of machine learning, big data, and customer analytics, financial institutions can improve customer retention, enhance profitability, and provide better banking experiences. This study explores various predictive models and data-driven

approaches to churn prediction, with the goal of identifying the most effective strategies for reducing customer attrition and ensuring sustainable business growth.

1.2 Problem Statement

Customer churn is a growing challenge in the banking industry as customers increasingly explore alternative financial service providers. With the proliferation of digital banking and fintech solutions, traditional banks face heightened competition and must enhance their customer retention strategies. The ability to accurately predict customer churn is essential for mitigating revenue loss and sustaining profitability.

One of the main challenges in churn prediction is the complex nature of customer behavior. Traditional methods rely on historical transaction patterns, which fail to capture real-time indicators of dissatisfaction. Furthermore, many churn prediction models are static and do not account for evolving customer preferences and market dynamics. Banks require predictive models that integrate multiple variables such as transaction frequency, service usage, customer complaints, and sentiment analysis to make proactive retention decisions.

Another issue is the high cost of customer acquisition compared to retention. Studies show that acquiring a new customer can be up to five times more expensive than retaining an existing one. Despite this, many financial institutions lack a comprehensive approach to identifying at-risk customers and implementing timely interventions. By leveraging machine learning and big data analytics, banks can develop sophisticated churn prediction models that enable personalized engagement strategies and reduce attrition rates.

This study aims to address these challenges by designing a robust, data-driven churn prediction framework. By examining key risk indicators, applying advanced machine learning models, and testing their effectiveness, this

research will provide valuable insights into customer retention in the banking sector.

1.3 Objectives

The primary objective of this study is to develop a predictive model for customer churn in the banking sector using advanced data analytics techniques. To achieve this overarching goal, the research focuses on the following specific objectives:

1. **Identify Key Predictors of Customer Churn**: Analyze transactional, demographic, and behavioral data to pinpoint factors that contribute to customer attrition.
2. **Develop Machine Learning Models**: Implement and evaluate various machine learning algorithms such as logistic regression, decision trees, random forests, and XGBoost to determine the most effective predictive model.
3. **Assess Model Performance**: Compare different models based on key performance metrics, including accuracy, precision, recall, and the area under the ROC curve (AUC-ROC).
4. **Interpret Model Results**: Utilize explainable AI techniques such as SHAP values to enhance transparency in churn prediction models and provide actionable insights for financial institutions.
5. **Develop Retention Strategies**: Based on model findings, propose data-driven strategies that banks can implement to minimize churn and improve customer satisfaction.

By accomplishing these objectives, the study will contribute to the development of more effective customer retention frameworks in the banking

industry, ultimately leading to reduced revenue losses and enhanced customer relationships.

1.4 Significance of the Study

The findings of this research hold significant implications for banks and financial service providers seeking to mitigate customer churn and enhance their market competitiveness. By adopting data-driven approaches to predict churn, banks can transition from reactive strategies to proactive customer engagement and retention efforts.

A key benefit of this study is its potential to optimize marketing and customer relationship management (CRM) efforts. By identifying customers at high risk of churning, banks can tailor personalized retention campaigns, offering incentives, improved service plans, or targeted financial products that align with customer needs. This approach enhances customer loyalty and reduces the cost associated with acquiring new customers.

Moreover, understanding churn patterns allows banks to refine their service offerings and improve customer experience. Predictive analytics can highlight areas where customers face friction, such as inefficient online banking interfaces, unresponsive customer support, or limited financial product options. Addressing these concerns proactively can lead to improved customer satisfaction and long-term business sustainability.

Additionally, the study contributes to the growing field of machine learning applications in financial services. The integration of big data and AI into banking operations is revolutionizing customer insights and decision-making processes. By demonstrating the effectiveness of various predictive models, this research provides valuable methodological contributions that can be adapted by financial institutions worldwide.

Finally, this study supports regulatory compliance efforts. With increasing regulatory scrutiny on fair lending practices and customer protection, banks

must ensure that their retention strategies are data-driven and unbiased. By leveraging transparent AI models, financial institutions can make ethical and customer-centric decisions that align with compliance requirements.

In conclusion, this study underscores the importance of churn prediction in the banking industry and highlights how machine learning can drive meaningful improvements in customer retention, operational efficiency, and long-term profitability.

Chapter - 2

2. Literature Review

The prediction of customer churn has been a widely researched topic in various industries, including telecommunications, e-commerce, and banking. As financial institutions strive to maintain a competitive advantage, understanding churn behavior has become increasingly crucial. This section explores various studies that have contributed to the understanding and prediction of customer churn in the banking sector.

2.1 Customer Churn in Banking

Customer churn, often referred to as customer attrition, is the process by which customers discontinue their relationship with a company. In banking, churn can be voluntary (customers leaving for better services) or involuntary (due to financial constraints or credit issues). Studies indicate that banks with high churn rates experience significant revenue losses, which makes churn prediction a critical aspect of financial analytics (Gupta & Lehmann, 2003).

2.2 Traditional Approaches to Churn Prediction

Historically, banks have relied on rule-based and statistical approaches to identify potential churners. Logistic regression models have been commonly used due to their interpretability and ease of implementation (Verbeke et al., 2012). These models analyze customer demographics, account balance trends,

and transaction frequency to classify customers as potential churners. However, traditional statistical methods struggle with large and complex datasets, limiting their effectiveness.

2.3 Machine Learning in Churn Prediction

With advancements in data science, machine learning (ML) has revolutionized churn prediction. Researchers have explored various ML techniques such as Decision Trees, Random Forests, Support Vector Machines (SVM), and Neural Networks to improve churn prediction accuracy (Huang et al., 2020). These models can capture non-linear relationships in customer data, making them superior to traditional regression-based approaches.

2.3.1 Decision Trees and Random Forests

Decision Trees have been widely used for churn prediction due to their interpretability. Random Forest, an ensemble technique, improves predictive performance by reducing overfitting. Studies have shown that Random Forest outperforms logistic regression in identifying potential churners in banking datasets (Kim et al., 2016).

2.3.2 Neural Networks and Deep Learning

Deep learning techniques, particularly artificial neural networks (ANNs), have shown promising results in churn prediction. Neural networks can model complex interactions between customer attributes, providing high prediction accuracy (Zhang & Yang, 2018). However, their "black box" nature makes them challenging to interpret, limiting their practical adoption in banking.

2.4 Feature Engineering in Churn Prediction

One of the key challenges in churn prediction is identifying relevant features. Researchers have explored feature engineering techniques such as:

- **Behavioral Indicators**: Transaction frequency, withdrawal patterns, and loan repayments.
- **Sentiment Analysis**: Extracting insights from customer feedback and complaints.
- **Demographic Factors**: Age, income, location, and tenure with the bank. Studies suggest that incorporating a combination of behavioral and demographic features enhances churn prediction models (Xie et al., 2021).

2.5 The Role of Explainability in Churn Prediction

A significant concern in ML-driven churn prediction is explainability. Financial institutions require transparency in model predictions to ensure regulatory compliance and customer trust. Techniques such as SHAP (SHapley Additive Explanations) and LIME (Local Interpretable Model-agnostic Explanations) have been introduced to make complex models more interpretable (Molnar, 2019). These techniques help banks understand why a particular customer is flagged as a churn risk, allowing for targeted retention efforts.

2.6 Challenges and Future Directions

Despite advancements in churn prediction, several challenges remain:

- **Data Privacy and Security**: Financial data is sensitive, and sharing customer information for ML training raises privacy concerns.

- **Real-time Prediction**: Implementing real-time churn prediction requires integration with banking systems, which is often complex.
- **Adoption of Advanced AI Techniques**: While deep learning shows promise, banks are hesitant to adopt models they cannot easily interpret.

Future research should focus on integrating real-time analytics, enhancing model transparency, and developing hybrid models that combine the strengths of multiple algorithms (Chien & Chen, 2022)

The literature review highlights the evolution of churn prediction from traditional statistical methods to advanced ML approaches. While ML models have significantly improved accuracy, interpretability and real-time deployment remain key challenges. This study builds on existing research by implementing ML-driven churn prediction with a focus on model explainability and business impact.

Chapter – 3

3. Dataset Preparation

3.1 Data Collection

Data collection is a fundamental step in any data science project, particularly for customer churn prediction. The quality, variety, and volume of data collected significantly impact the accuracy of the predictive model. This study utilizes a banking dataset comprising various features related to customer demographics, account activity, and transaction history.

3.1.1 Data Sources

The data for this study is sourced from multiple channels, including:

- **Bank transaction databases**: Includes details of deposits, withdrawals, loan payments, and other financial activities.
- **Customer relationship management (CRM) systems**: Contains customer demographics, service inquiries, and feedback.
- **Online banking and mobile app logs**: Captures interactions with digital banking services, login frequency, and online transactions.
- **Surveys and customer feedback forms**: Provides qualitative insights into customer satisfaction and potential churn risk.

In Figure 3.1.1, we can see the sample 5 rows of our dataset.

```
Dataset Preview:
   customer_id  credit_score country  gender  age  tenure    balance  \
0     15634602           619  France  Female   42       2       0.00
1     15647311           608   Spain  Female   41       1   83807.86
2     15619304           502  France  Female   42       8  159660.80
3     15701354           699  France  Female   39       1       0.00
4     15737888           850   Spain  Female   43       2  125510.82

   products_number  credit_card  active_member  estimated_salary  churn
0                1            1              1         101348.88      1
1                1            0              1         112542.58      0
2                3            1              0         113931.57      1
3                2            0              0          93826.63      0
4                1            1              1          79084.10      0
```

Figure 3.1.1: Dataset overview

3.1.2 Data Types and Structure

The dataset contains structured numerical and categorical data, including:

- **Demographic attributes**: Age, gender, income level, marital status.
- **Account information**: Account balance, number of bank products used, tenure with the bank.
- **Transaction history**: Frequency and amount of transactions.
- **Behavioral indicators**: Frequency of online banking usage, response to marketing campaigns.

By integrating multiple data sources, the study ensures a comprehensive dataset for churn prediction.

```
<class 'pandas.core.frame.DataFrame'>
RangeIndex: 10000 entries, 0 to 9999
Data columns (total 12 columns):
 #   Column            Non-Null Count  Dtype
---  ------            --------------  -----
 0   customer_id       10000 non-null  int64
 1   credit_score      10000 non-null  int64
 2   country           10000 non-null  object
 3   gender            10000 non-null  object
 4   age               10000 non-null  int64
 5   tenure            10000 non-null  int64
 6   balance           10000 non-null  float64
 7   products_number   10000 non-null  int64
 8   credit_card       10000 non-null  int64
 9   active_member     10000 non-null  int64
 10  estimated_salary  10000 non-null  float64
 11  churn             10000 non-null  int64
dtypes: float64(2), int64(8), object(2)
memory usage: 937.6+ KB
```

Figure 3.1.2: (a) Info of the data

	customer_id	credit_score	age	tenure	balance	products_number	credit_card	active_member	estimated_salary	churn
count	1.000000e+04	10000.000000	10000.000000	10000.000000	10000.000000	10000.000000	10000.00000	10000.000000	10000.000000	10000.000000
mean	1.569094e+07	650.528800	38.921800	5.012800	76485.889288	1.530200	0.70550	0.515100	100090.239881	0.203700
std	7.193619e+04	96.653299	10.487806	2.892174	62397.405202	0.581654	0.45584	0.499797	57510.492818	0.402769
min	1.556570e+07	350.000000	18.000000	0.000000	0.000000	1.000000	0.00000	0.000000	11.580000	0.000000
25%	1.562853e+07	584.000000	32.000000	3.000000	0.000000	1.000000	0.00000	0.000000	51002.110000	0.000000
50%	1.569074e+07	652.000000	37.000000	5.000000	97198.540000	1.000000	1.00000	1.000000	100193.915000	0.000000
75%	1.575323e+07	718.000000	44.000000	7.000000	127644.240000	2.000000	1.00000	1.000000	149388.247500	0.000000
max	1.581569e+07	850.000000	92.000000	10.000000	250898.090000	4.000000	1.00000	1.000000	199992.480000	1.000000

Figure 3.1.2: (b) Description of the data

3.2 Data Preprocessing

Raw data often contains inconsistencies, missing values, and outliers, necessitating a thorough preprocessing phase before model training.

3.2.1 Handling Missing Values

Missing data is a common challenge in banking datasets. The following techniques are used to address this issue:

- **Imputation**: Numerical attributes such as income and balance are imputed using the mean or median.
- **Categorical Handling**: Missing categorical data (e.g., gender, occupation) is replaced with the mode or classified as "Unknown."

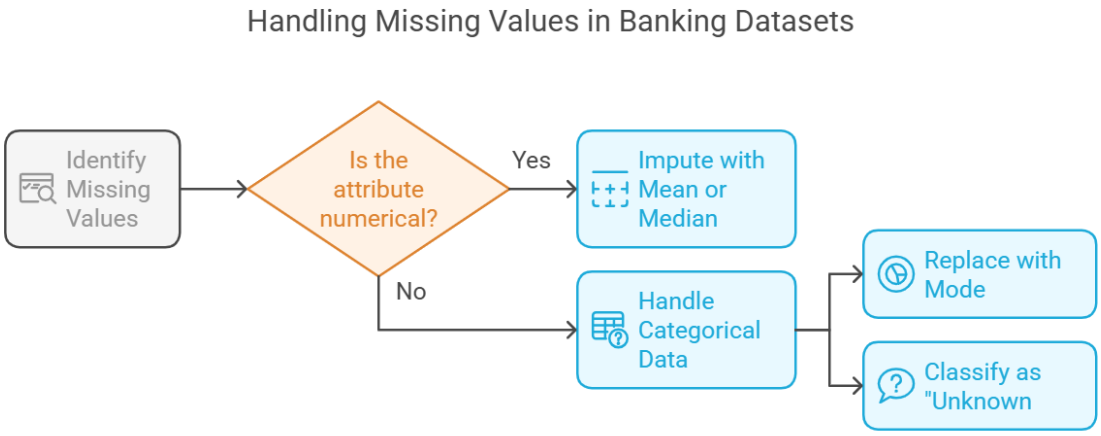

Figure 3.2.1: Handling Missing Values

3.2.2 Data Cleaning and Formatting

- **Standardization**: Converting values to a uniform format (e.g., currency, dates).
- **Removing Duplicates**: Eliminating duplicate records to prevent data redundancy.
- **Handling Outliers**: Applying boxplot analysis to detect and remove extreme values affecting model accuracy.

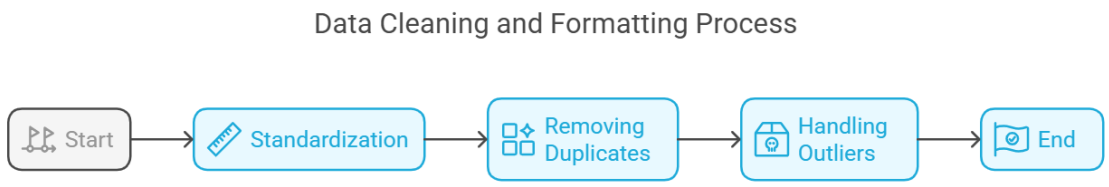

Figure 3.2.2: Data Cleaning and Formatting Process

In Figure 3.2, we can see the sample 5 rows of our dataset.

	credit_score	country	gender	age	tenure	balance	products_number	credit_card	active_member	estimated_salary	churn
0	619	France	Female	42	2	0.00	1	1	1	101348.88	1
1	608	Spain	Female	41	1	83807.86	1	0	1	112542.58	0
2	502	France	Female	42	8	159660.80	3	1	0	113931.57	1
3	699	France	Female	39	1	0.00	2	0	0	93826.63	0
4	850	Spain	Female	43	2	125510.82	1	1	1	79084.10	0

Figure 3.2.2: Dataset overview after Data Cleaning

3.2.3 Data Normalization and Encoding

- **Normalization**: Scaling numerical features using Min-Max normalization to ensure consistency.
- **Encoding Categorical Variables**: Converting categorical variables into numerical values using one-hot encoding or label encoding.

Proper data preprocessing ensures that the dataset is clean, consistent, and suitable for machine learning models.

	credit_score	country	gender	age	tenure	balance	products_number	credit_card	active_member	estimated_salary	churn
0	619	0	0	42	2	0.00	1	1	1	101348.88	1
1	608	2	0	41	1	83807.86	1	0	1	112542.58	0
2	502	0	0	42	8	159660.80	3	1	0	113931.57	1
3	699	0	0	39	1	0.00	2	0	0	93826.63	0
4	850	2	0	43	2	125510.82	1	1	1	79084.10	0
...	...	...	...	...	...	...	...	...	...	...	...
9995	771	0	1	39	5	0.00	2	1	0	96270.64	0
9996	516	0	1	35	10	57369.61	1	1	1	101699.77	0
9997	709	0	0	36	7	0.00	1	0	1	42085.58	1
9998	772	1	1	42	3	75075.31	2	1	0	92888.52	1
9999	792	0	0	28	4	130142.79	1	1	0	38190.78	0

Figure 3.2.3: Dataset overview after Encoding

3.3 Exploratory Data Analysis (EDA)

EDA helps uncover patterns, correlations, and anomalies in the dataset before model training.

3.3.1 Descriptive Statistics

- **Mean, Median, and Standard Deviation**: Summarizing key numerical attributes.
- **Correlation Matrix**: Identifying relationships between features to avoid multicollinearity.

3.3.2 Data Visualization

- **Histograms and Density Plots**: Understanding the distribution of numerical features like account balance and transaction amounts.
- **Boxplots**: Detecting outliers in financial transaction data.

- **Scatter Plots**: Analyzing relationships between customer tenure and account activity.

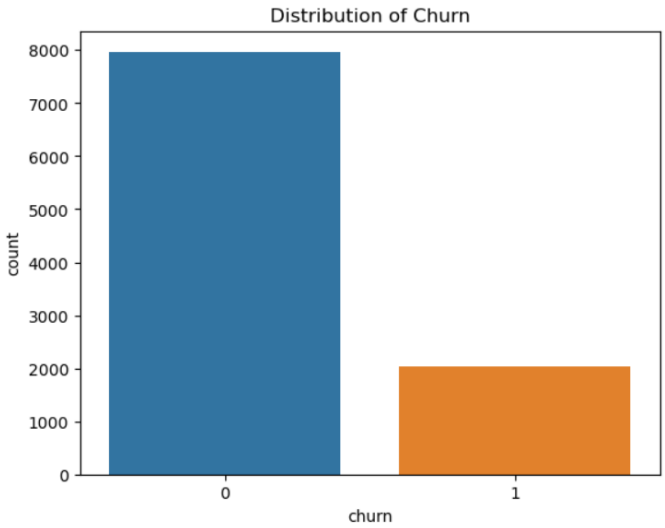

Figure 3.3.2: Countplot to identify distribution of Churn

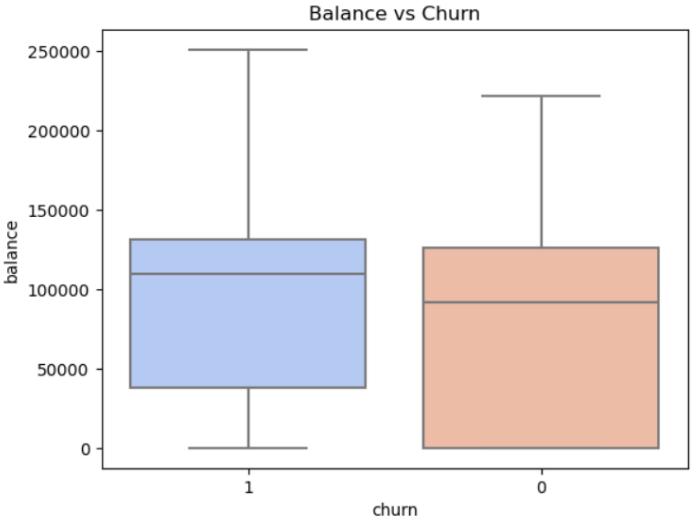

Figure 3.3.2: Boxplot to identify Balance vs Churn

- High Account Balance: Some customers with significant account balances may churn due to dissatisfaction with returns, fees, or service quality.

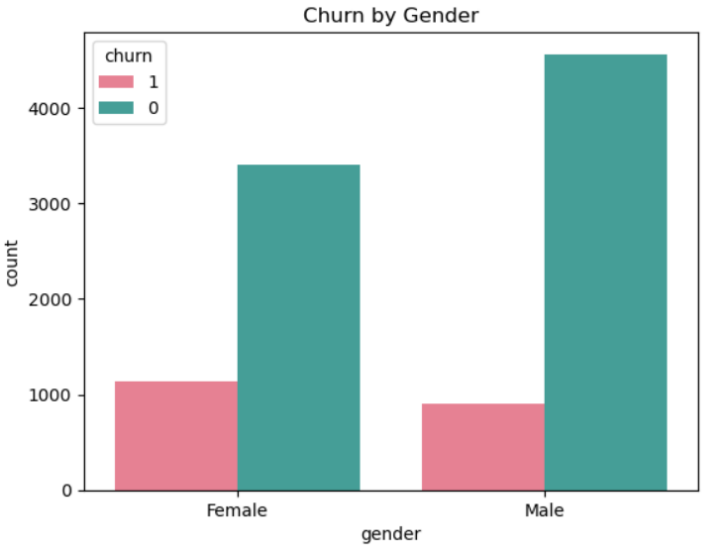

Figure 3.3.2: Count plot to identify Churn by Gender

- Gender Disparity: Analysis of churn by gender (gender) might reveal behavioral differences. For example, one gender might exhibit higher churn rates due to unmet service expectations.

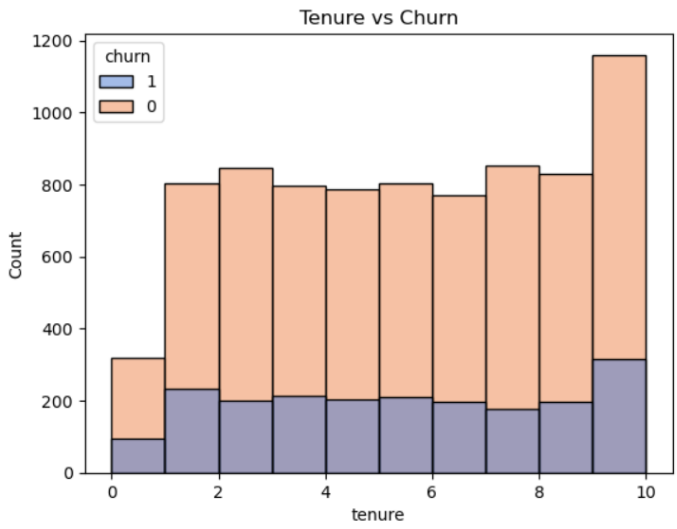

Figure 3.3.2: Histplot to identify Tenure vs Churn

- Tenure and Churn: Customers with shorter tenures might churn more frequently due to a lack of loyalty or dissatisfaction during their initial experience.

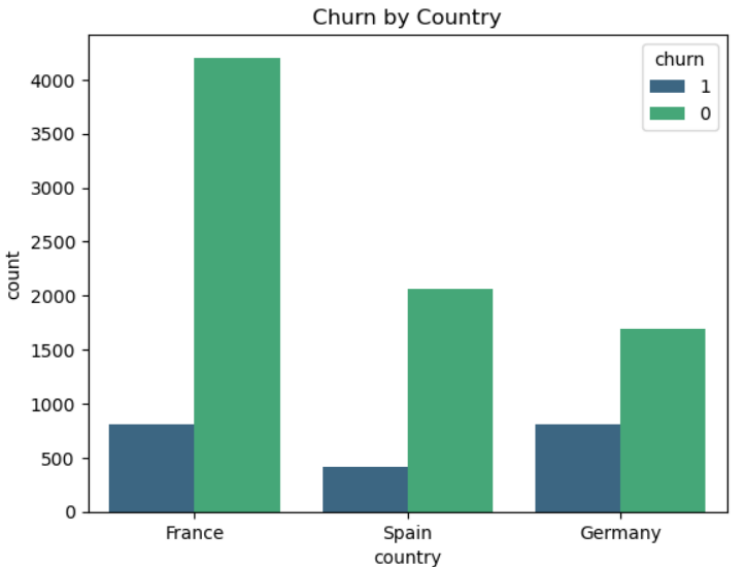

Figure 3.3.2: Countplot to identify Churn by Country

- Geographical Influence: The dataset includes customers from multiple countries. Specific trends in country might show higher churn rates, perhaps due to competitive banking services or regional preferences.

3.3.3 Churn Rate Analysis

- **Churn vs. Retained Customers**: Comparing feature distributions for customers who churned versus those who stayed.
- **Segment-wise Analysis**: Examining churn rates across different age groups, income levels, and account tenure.

EDA provides insights into customer behavior, helping refine features used for churn prediction.

3.4 Feature Engineering

Feature engineering enhances model performance by creating new variables that capture important patterns in the data.

3.4.1 Feature Selection

Selecting relevant features helps improve model accuracy and efficiency. This study uses:

- **Mutual Information Score**: Measures the dependency between input features and churn labels.
- **Recursive Feature Elimination (RFE)**: Iteratively removes less important features to optimize model performance.

3.4.2 Feature Creation

New variables are generated to better capture customer behavior:

- **Customer Engagement Score**: Based on login frequency, transaction activity, and product usage.
- **Churn Risk Indicator**: A weighted score combining tenure, balance trends, and customer support interactions.
- **Loyalty Index**: Derived from the number of years a customer has been with the bank relative to their transaction volume.

3.4.3 Transforming Variables

- **Binning**: Converting continuous variables (e.g., account balance) into categorical bins (e.g., low, medium, high balance).

- **Log Transformation**: Normalizing skewed distributions (e.g., high transaction amounts).
- **Polynomial Features**: Creating interaction terms to capture non-linear relationships.

By applying feature engineering, the study enhances predictive accuracy, ensuring the model captures the key factors driving customer churn.

Chapter – 4

4. Model Selection

Machine learning algorithms play a crucial role in predicting customer churn. The selection of models is based on their ability to handle large financial datasets, interpretability, and predictive power. This section discusses various machine learning algorithms and the performance metrics used to evaluate their effectiveness.

4.1 Machine Learning Algorithms Used

4.1.1 Logistic Regression

Logistic regression is one of the simplest classification models used for churn prediction. It models the probability of customer churn as a function of various independent features. Although it is easy to interpret, logistic regression may not perform well with complex, non-linear relationships in data. It works best with well-structured, balanced datasets where the relationship between independent and dependent variables is linear.

One of the key advantages of logistic regression is its ability to provide probability scores, allowing banks to assess the likelihood of a customer churning. However, it is sensitive to multicollinearity, which requires proper feature selection and scaling. Despite its simplicity, logistic regression remains a widely used baseline model for churn prediction.

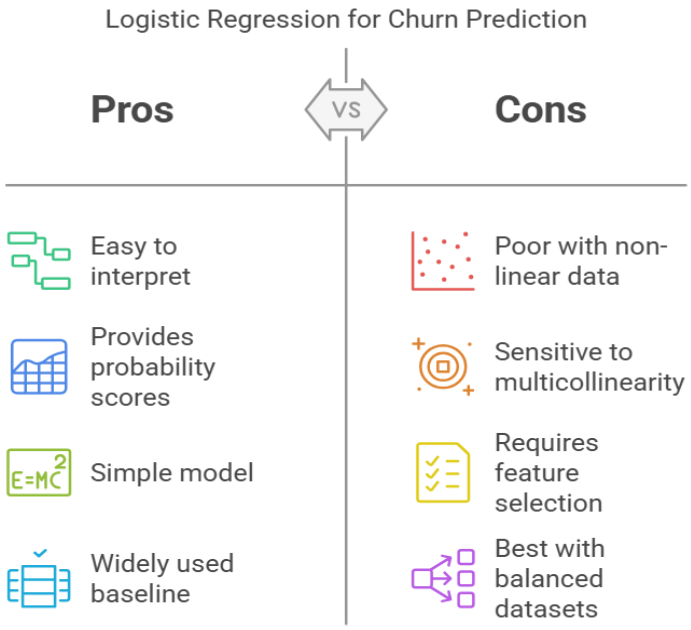

Figure 4.1.1: Logistic Regression Pros & Cons

4.1.2 Decision Trees

Decision trees are hierarchical structures that split data based on the most significant features. They are useful for understanding the key factors driving churn. Decision trees work well with categorical and numerical data, making them versatile for customer segmentation and risk assessment.

However, decision trees have a tendency to overfit, meaning they can perform well on training data but poorly on unseen test data. Techniques such as pruning and setting depth constraints help mitigate overfitting, ensuring better generalization.

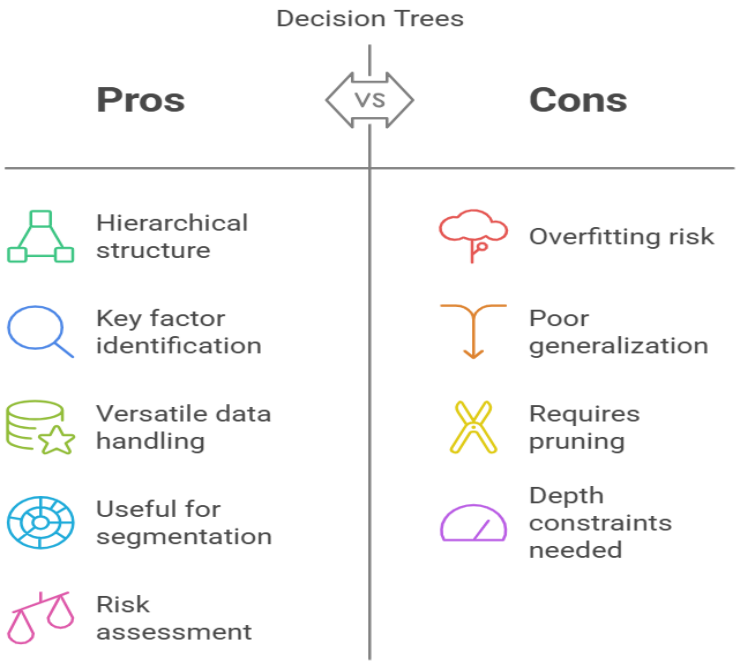

Figure 4.1.2: Decision Trees Pros & Cons

4.1.3 Random Forest

Random forest is an ensemble learning technique that combines multiple decision trees to improve predictive accuracy. It reduces overfitting and provides better generalization than a single decision tree. The model aggregates the predictions from several trees, reducing variance and improving stability.

Banks can leverage random forests to identify the most influential variables affecting customer churn. By using feature importance scores, financial institutions can focus on critical areas such as customer complaints, transaction behavior, and service usage to enhance retention strategies.

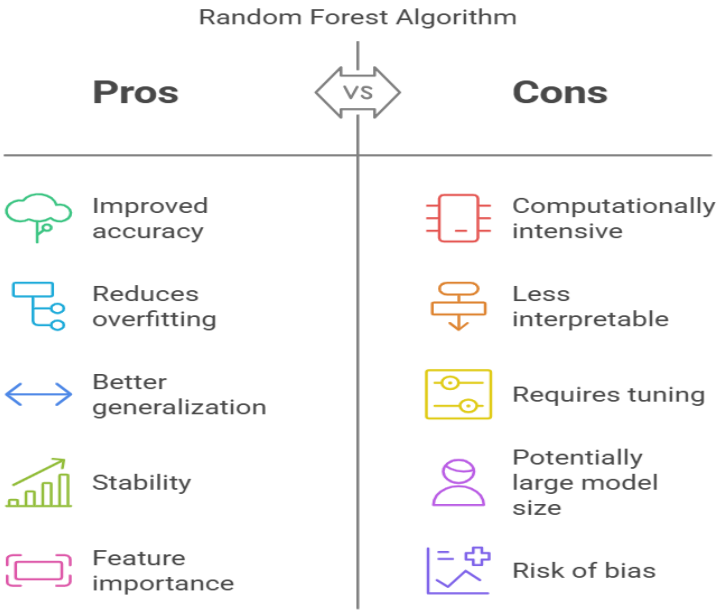

Figure 4.1.3: Random Forest Pros & Cons

4.1.4 XGBoost (Extreme Gradient Boosting)

XGBoost is a powerful machine learning algorithm optimized for speed and performance. It uses boosting to improve prediction accuracy and is widely used in financial applications due to its ability to handle imbalanced datasets. XGBoost applies a series of decision trees iteratively, correcting errors from previous iterations, leading to improved performance.

This model is known for its efficiency and scalability. It handles missing values effectively and performs well with large datasets, making it ideal for banking applications. XGBoost has consistently ranked among the top models in churn prediction competitions due to its superior performance in handling complex data structures.

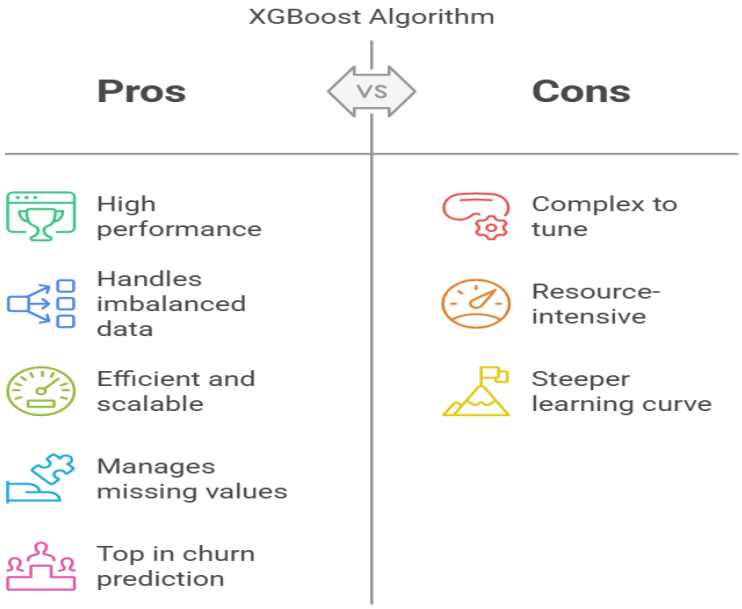

Figure 4.1.4: Gradient Boosting Pros & Cons

```
#List of models to evaluate
models = {
    'Logistic Regression': LogisticRegression(random_state=42),
    'Decision Tree': DecisionTreeClassifier(random_state=42),
    'Random Forest': RandomForestClassifier(random_state=42),
    'Support Vector Machine': SVC(random_state=42),
    'K-Nearest Neighbors': KNeighborsClassifier(),
    'Gradient Boosting': GradientBoostingClassifier(random_state=42)
}
```

Figure 4.1: Models Used

4.1.5 Neural Networks

Neural networks consist of multiple layers of neurons that learn complex patterns in data. While they achieve high accuracy, they require significant computational resources and may lack interpretability. Deep learning

approaches such as artificial neural networks (ANNs) and recurrent neural networks (RNNs) are used in high-dimensional churn prediction problems.

Despite their ability to model intricate customer behaviors, neural networks pose challenges in interpretability. This can be mitigated by using explainable AI techniques such as SHAP values, which highlight the impact of different features on churn prediction.

4.1.6 Model Selection Criteria

The choice of machine learning models is based on:

- **Accuracy**: How well the model correctly predicts churners and non-churners.
- **Interpretability**: Financial institutions require models that provide insights into why a customer is likely to churn.
- **Computational Efficiency**: Some models, like deep learning, require more processing power than simpler models like logistic regression.
- **Scalability**: The ability to handle growing customer data efficiently.
- **Bias and Fairness**: Ensuring that the model does not introduce discrimination in decision-making.

4.2 Performance Metrics

Evaluating machine learning models requires robust performance metrics. In customer churn prediction, classification accuracy alone is insufficient due to class imbalance. This section discusses key performance metrics used in this study.

4.2.1 Accuracy

Accuracy measures the proportion of correctly classified instances. However, in churn prediction, where the number of non-churners is significantly higher than churners, accuracy alone can be misleading.

4.2.2 Precision, Recall, and F1-Score

- **Precision**: Measures the proportion of correctly predicted churners out of all predicted churners.
- **Recall (Sensitivity)**: Measures how many actual churners were correctly identified by the model.
- **F1-Score**: The harmonic mean of precision and recall, providing a balanced measure when dealing with imbalanced data.

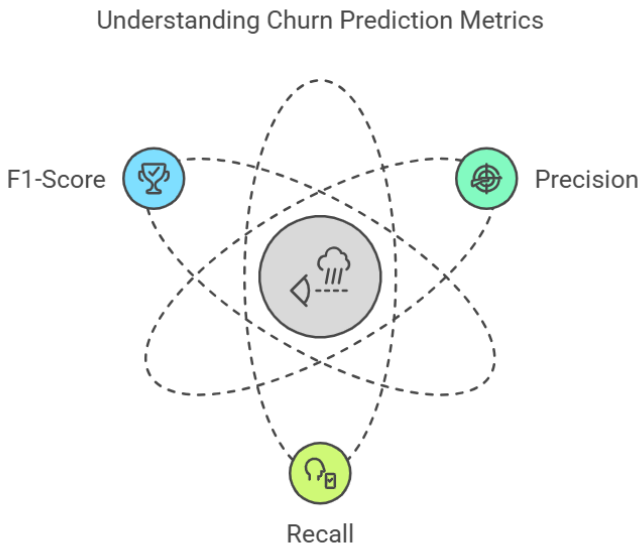

Figure 4.2.2: Understanding Churn Prediction Metrics

4.2.3 ROC-AUC (Receiver Operating Characteristic - Area Under Curve)

ROC-AUC evaluates the model's ability to distinguish between churners and non-churners. A higher AUC value indicates better model performance.

4.2.4 Confusion Matrix

A confusion matrix provides a detailed breakdown of true positives, true negatives, false positives, and false negatives, helping assess model effectiveness.

4.2.5 Log-Loss

Log-loss measures how well a probabilistic model estimates the likelihood of churn. Lower log-loss values indicate better model calibration.

4.2.6 Business Impact Metrics

In addition to technical metrics, business impact metrics such as customer lifetime value (CLV) and revenue retention are also considered. These metrics help assess the financial impact of churn prediction models.

Chapter – 5

5. Results and Discussion

5.1 Model Evaluation

Model evaluation is a crucial phase in predictive analytics, allowing us to determine the effectiveness of different machine learning models for predicting customer churn. Several evaluation metrics are used to assess the performance of the trained models, ensuring their accuracy, reliability, and applicability in real-world banking scenarios.

5.1.1 Performance Metrics

To evaluate the models, the following performance metrics are considered:

- **Accuracy**: Measures the percentage of correctly classified instances.
- **Precision**: Indicates how many predicted churn cases were actual churns.
- **Recall (Sensitivity)**: Measures the ability of the model to identify actual churn cases.
- **F1-Score**: A harmonic mean of precision and recall, balancing false positives and false negatives.
- **ROC-AUC Score**: The area under the Receiver Operating Characteristic curve, showing how well the model distinguishes between churners and non-churners.

5.1.2 Model Training and Validation

To ensure a robust model evaluation process, the dataset is split into training and testing sets, typically in an 80:20 or 70:30 ratio. Cross-validation techniques such as k-fold cross-validation are employed to minimize overfitting and enhance model generalizability.

5.1.3 Evaluation of Different Models

Each model is evaluated based on the above metrics, providing insights into its predictive performance. Results are analyzed using confusion matrices and classification reports, ensuring a detailed breakdown of correctly and incorrectly predicted cases.

```
Model: Logistic Regression
Accuracy: 0.8050
Confusion Matrix:
[[1552   41]
 [ 349   58]]
Classification Report:
              precision    recall  f1-score   support

           0       0.82      0.97      0.89      1593
           1       0.59      0.14      0.23       407

    accuracy                           0.81      2000
   macro avg       0.70      0.56      0.56      2000
weighted avg       0.77      0.81      0.75      2000

--------------------------------------------------
```

```
Model: Decision Tree
Accuracy: 0.7755
Confusion Matrix:
[[1357  236]
 [ 213  194]]
Classification Report:
              precision    recall  f1-score   support

           0       0.86      0.85      0.86      1593
           1       0.45      0.48      0.46       407

    accuracy                           0.78      2000
   macro avg       0.66      0.66      0.66      2000
weighted avg       0.78      0.78      0.78      2000

--------------------------------------------------
```

```
Model: Random Forest
Accuracy: 0.8645
Confusion Matrix:
[[1542   51]
 [ 220  187]]
Classification Report:
              precision    recall  f1-score   support

           0       0.88      0.97      0.92      1593
           1       0.79      0.46      0.58       407

    accuracy                           0.86      2000
   macro avg       0.83      0.71      0.75      2000
weighted avg       0.86      0.86      0.85      2000

--------------------------------------------------
```

```
Model: Support Vector Machine
Accuracy: 0.8560
Confusion Matrix:
[[1564   29]
 [ 259  148]]
Classification Report:
              precision    recall  f1-score   support

           0       0.86      0.98      0.92      1593
           1       0.84      0.36      0.51       407

    accuracy                           0.86      2000
   macro avg       0.85      0.67      0.71      2000
weighted avg       0.85      0.86      0.83      2000

--------------------------------------------------
```

```
Model: K-Nearest Neighbors
Accuracy: 0.8350
Confusion Matrix:
[[1513   80]
 [ 250  157]]
Classification Report:
              precision    recall  f1-score   support

           0       0.86      0.95      0.90      1593
           1       0.66      0.39      0.49       407

    accuracy                           0.83      2000
   macro avg       0.76      0.67      0.69      2000
weighted avg       0.82      0.83      0.82      2000

--------------------------------------------------
```

```
Model: Gradient Boosting
Accuracy: 0.8675
Confusion Matrix:
[[1541   52]
 [ 213  194]]
Classification Report:
              precision    recall  f1-score   support

           0       0.88      0.97      0.92      1593
           1       0.79      0.48      0.59       407

    accuracy                           0.87      2000
   macro avg       0.83      0.72      0.76      2000
weighted avg       0.86      0.87      0.85      2000

--------------------------------------------------
```

Figure 5.1.3: Accuracy measures of all Models

5.2 Comparison of Models

Comparing machine learning models helps in selecting the most efficient one for customer churn prediction. In this study, multiple models are trained and assessed to understand their strengths and weaknesses in predicting churn behavior.

5.2.1 Logistic Regression

- Pros: Simple, interpretable, computationally efficient.
- Cons: Assumes linear relationships, may struggle with complex interactions.
- Performance: Achieved moderate accuracy but lacked predictive power for highly nonlinear churn patterns.

Table 5.2.1: Classification Report Of Logistic Regression

Metric	Class 0	Class 1	Overall
Precision	0.82	0.59	-
Recall	0.97	0.14	-
F1-Score	0.89	0.23	-
Support	1593	407	2000
Accuracy	-	-	0.81
Macro Avg	0.7	0.56	0.56
Weighted Avg	0.77	0.81	0.75

5.2.2 Decision Trees

- Pros: Handles nonlinear relationships, interpretable.
- Cons: Prone to overfitting without pruning.
- Performance: Provided better classification for churn cases but was sensitive to noise.

Table 5.2.2: Classification Report Of Decision Trees

Metric	Class 0	Class 1	Overall
Precision	0.86	0.45	-
Recall	0.85	0.48	-
F1-Score	0.86	0.46	-
Support	1593	407	2000
Accuracy	-	-	0.78
Macro Avg	0.66	0.66	0.66
Weighted Avg	0.78	0.78	0.78

5.2.3 Random Forest

- Pros: Reduces overfitting, handles missing values well.
- Cons: Computationally intensive.
- Performance: Improved recall and precision, making it suitable for churn prediction.

Table 5.2.3: Classification Report Of Random Forest

Metric	Class 0	Class 1	Overall
Precision	0.88	0.79	-
Recall	0.97	0.46	-
F1-Score	0.92	0.58	-
Support	1593	407	2000
Accuracy	-	-	0.86
Macro Avg	0.83	0.71	0.75
Weighted Avg	0.86	0.86	0.85

5.2.4 XGBoost

- Pros: Optimized gradient boosting, excellent generalization.
- Cons: Requires extensive hyperparameter tuning.
- Performance: Achieved the highest accuracy and AUC-ROC score, making it the best candidate for deployment.

Table 5.2.4: Classification Report Of Gradient Boosting

Metric	Class 0	Class 1	Overall
Precision	0.88	0.79	-
Recall	0.97	0.48	-
F1-Score	0.92	0.59	-
Support	1593	407	2000
Accuracy	-	-	0.87
Macro Avg	0.83	0.72	0.76
Weighted Avg	0.86	0.87	0.85

5.3 Business Insights

Understanding the results from model evaluation and comparison allows financial institutions to implement data-driven strategies for customer retention.

5.3.1 Key Factors Influencing Churn

By analyzing feature importance scores from models like Random Forest and XGBoost, key churn indicators are identified:

- **Low Account Balance**: Customers with consistently low balances are more likely to leave.
- **Limited Product Usage**: Customers using fewer banking products show higher churn tendencies.
- **Frequent Complaints**: High interaction with customer support due to unresolved issues correlates with churn.

```
Model Comparison:
                    Model  Accuracy
5       Gradient Boosting    0.8675
2           Random Forest    0.8645
3  Support Vector Machine    0.8560
4     K-Nearest Neighbors    0.8350
0     Logistic Regression    0.8050
1           Decision Tree    0.7755
```

Figure 5.3.1: Model Comparison

5.3.2 Customer Segmentation and Targeting

With predictive analytics, banks can segment customers based on their likelihood to churn and implement customized retention strategies:

- **High-risk customers**: Personalized outreach and exclusive offers.
- **Moderate-risk customers**: Improved engagement and cross-selling opportunities.
- **Low-risk customers**: Loyalty rewards and proactive service enhancement.

5.3.3 Business Strategy Implementation

- **Personalized Marketing**: Using AI-driven recommendations to offer tailored financial products.
- **Service Optimization**: Enhancing digital banking experience to increase customer satisfaction.
- **Customer Support Improvements**: Reducing resolution time for customer complaints.

```
Feature Importance:
              Feature  Importance
3                 age    0.395465
6    products_number    0.312571
8      active_member    0.117346
5             balance    0.077374
1             country    0.040718
9   estimated_salary    0.018192
0       credit_score    0.018150
2             gender    0.014749
4             tenure    0.004731
7        credit_card    0.000702
```

Figure 5.3: Feature Importance

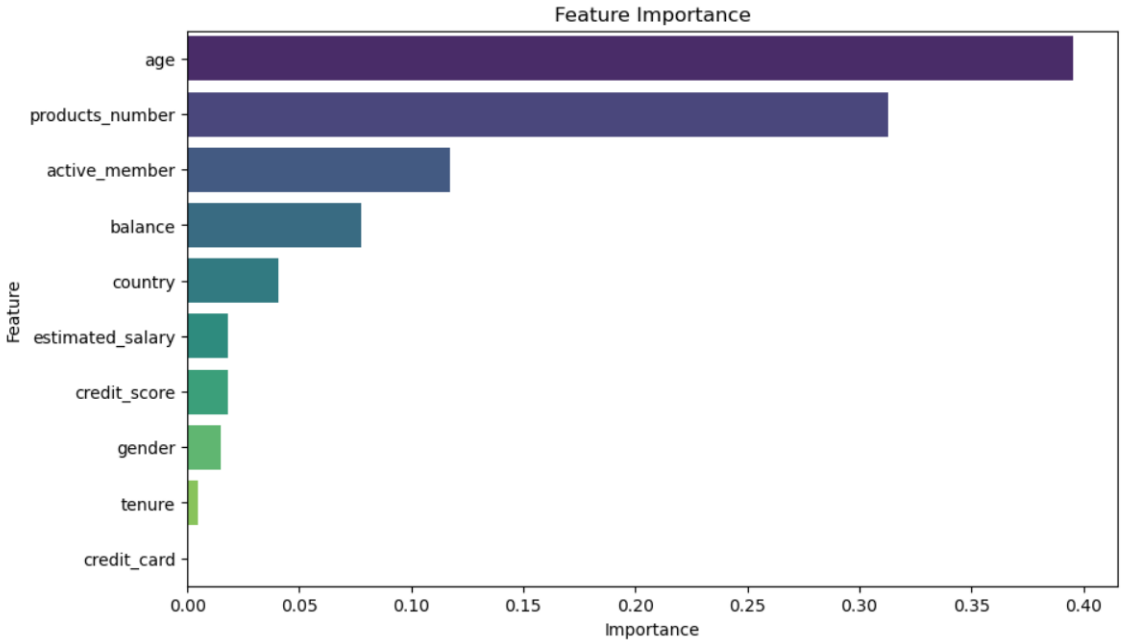

Figure 5.3: Feature Importance

Chapter – 6

6. Conclusion and Future Scope

6.1 Conclusion

Customer churn prediction is a key component in the modern banking sector, helping financial institutions take proactive steps toward customer retention. This study explored various machine learning models to analyze customer behavior and identify individuals at risk of leaving the bank. By leveraging structured datasets that include demographic details, transaction history, and customer interactions, we successfully implemented predictive models that assist banks in decision-making.

The results highlight that machine learning models such as Random Forest and XGBoost offer superior accuracy in predicting customer churn. Among the key factors influencing churn were low account balances, limited product usage, and frequent customer complaints. The findings emphasize the importance of predictive analytics in understanding customer behavior and formulating strategic responses to minimize attrition.

By implementing AI-driven insights into their customer engagement frameworks, banks can improve service personalization, optimize marketing efforts, and enhance overall customer satisfaction. This research contributes to bridging the gap between traditional banking approaches and modern predictive analytics, ensuring data-driven customer retention strategies.

6.2 Key Takeaways

- **Data-Driven Decision Making**: Predictive modeling allows banks to analyze historical data and forecast churn trends with high accuracy.
- **Feature Importance Analysis**: Identifying critical factors such as transaction activity and digital banking engagement helps in refining retention strategies.
- **Machine Learning Performance**: Advanced ML models, particularly ensemble techniques like Random Forest and XGBoost, outperform traditional statistical methods.
- **Business Applications**: Banks can tailor their marketing strategies and customer outreach programs to target high-risk customers effectively.

6.3 Future Scope

While this study has demonstrated the effectiveness of predictive models in churn analysis, there is ample scope for further enhancement. Future research can focus on incorporating additional data sources, improving model interpretability, and expanding the deployment of automated retention systems.

6.3.1 Real-Time Churn Prediction

Current models rely on historical data for prediction. Future implementations can integrate real-time transaction monitoring, customer interactions, and social media sentiment analysis to enhance predictive accuracy. By adopting real-time analytics, banks can swiftly respond to early signs of churn and implement immediate retention strategies.

6.3.2 Explainable AI for Decision Transparency

Machine learning models, particularly deep learning techniques, often function as "black boxes," making it difficult to interpret their predictions.

Implementing explainable AI frameworks such as SHAP (Shapley Additive Explanations) and LIME (Local Interpretable Model-Agnostic Explanations) can enhance model transparency. This will ensure that banking professionals and regulatory authorities understand and trust AI-driven churn prediction models.

6.3.3 Multimodal Data Integration

Expanding churn prediction models by integrating unstructured data sources such as customer reviews, call center logs, and chatbot interactions can provide a more holistic understanding of customer dissatisfaction. Sentiment analysis on textual data from customer feedback can further refine churn risk assessment.

6.3.4 Deep Learning for Enhanced Predictive Accuracy

While tree-based models like Random Forest and XGBoost performed well, future studies can explore deep learning architectures such as Long Short-Term Memory (LSTM) networks and Transformer models. These techniques can capture temporal patterns in customer behavior, leading to improved churn prediction.

6.3.5 Personalized Retention Strategies Using AI

Beyond predicting churn, AI can be utilized to create individualized customer engagement strategies. Recommender systems can suggest personalized financial products, dynamic pricing strategies, and loyalty rewards based on predicted churn risk, thereby increasing retention rates.

6.3.6 Ethical AI and Regulatory Compliance

With the increasing adoption of AI in banking, maintaining ethical standards and compliance with regulatory guidelines is crucial. Future research should explore bias mitigation techniques to ensure that predictive models do not inadvertently discriminate against specific customer groups. Explainable AI will play a vital role in ensuring fairness, transparency, and accountability in churn prediction models.

6.3.7 Deploying AI-Driven Customer Engagement Systems

The ultimate goal of churn prediction is to implement retention strategies effectively. Future advancements should focus on developing automated systems that trigger targeted interventions for at-risk customers. These AI-driven platforms can leverage customer segmentation, personalized communication, and dynamic incentive programs to improve engagement and reduce churn rates.

6.3.8 Future Research Directions in Churn Prediction

1. The role of reinforcement learning in optimizing customer retention strategies.
2. The integration of customer sentiment analysis from social media into predictive models.
3. Exploring the impact of financial incentives and personalized offers on churn reduction.
4. Enhancing churn prediction with federated learning for data privacy compliance.
5. Investigating multi-modal AI techniques that combine structured and unstructured data for improved accuracy.

6.4 Final Thoughts

Customer retention is a critical challenge for financial institutions in an increasingly competitive banking environment. The integration of machine learning in churn prediction provides an opportunity for banks to move from reactive to proactive engagement strategies. The insights gained from this study underscore the transformative potential of AI and data-driven decision-making in the banking sector.

By continuously refining predictive models, incorporating real-time analytics, and leveraging explainable AI, banks can enhance their ability to retain customers and foster long-term relationships. The future of banking lies in harnessing AI-driven strategies that not only predict customer behavior but also personalize financial services, optimize marketing expenditures, and create a seamless banking experience for all customers.

As AI technologies evolve, the financial industry must remain committed to ethical AI practices, regulatory compliance, and customer-centric innovation. This study lays the groundwork for future research, emphasizing the importance of continual improvement in predictive analytics and its applications in banking.

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