



CREDIT RISK MANAGEMENT AMONG GEN Z

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ABSTRACT

As Gen Z increasingly engages with credit, traditional credit risk assessment models struggle to capture their unique financial behaviors. Unlike previous generations, Gen Z relies heavily on fintech-driven credit solutions like Buy Now, Pay Later (BNPL) and digital lending platforms. While these innovations enhance accessibility, they also introduce risks, particularly for borrowers with limited credit history and financial literacy.

Many Gen Z individuals lack awareness of credit management principles, leading to uninformed borrowing and higher default risks. Additionally, the influence of social media and digital financial advice often prioritizes convenience over long-term financial stability. Given these challenges, this study examines how fintech adoption, financial literacy, and evolving borrowing patterns impact credit risk among Gen Z. By analyzing default trends and risk factors, this research aims to help lenders, policymakers, and fintech platforms develop effective risk mitigation strategies for this emerging borrower segment.

INTRODUCTION

Credit risk management is a fundamental aspect of financial institutions and lending entities, ensuring that borrowers can meet their financial obligations. Credit risk refers to the possibility of a borrower defaulting on a loan or credit obligation, leading to financial losses for the lender. This risk is managed through various techniques, including credit scoring models, risk-based pricing, and regulatory frameworks that help assess the likelihood of repayment. Effective credit risk management not only protects financial institutions but also contributes to economic stability by minimizing systemic financial crises. With the rise of digital lending platforms and alternative credit sources,

the nature of credit risk has evolved. Traditionally, lenders relied on credit history, income stability, and repayment behavior to assess risk. However, with younger demographics such as Gen Z entering the credit market, conventional models may not fully capture the financial habits of this generation. Their borrowing preferences, digital-first approach, and evolving financial behaviors necessitate a reassessment of credit risk assessment strategies.

Gen Z, born between the mid-1990s and early 2010s, is the first generation to grow up entirely in the digital era. Their financial behavior is distinct from previous generations due to the widespread use of fintech platforms, digital wallets, and alternative lending solutions. Unlike Millennials, who were introduced to credit cards and traditional banking at a later stage, Gen Z has been exposed to digital-first credit models early in their financial journey. Services such as Buy Now, Pay Later (BNPL), peer-to-peer lending, and instant microloans have become integral to their spending patterns. However, while digital lending offers convenience and accessibility, it also introduces new risks. Many Gen Z individuals lack a thorough understanding of credit management, interest accumulation, and long-term financial planning. This raises concerns regarding financial literacy and responsible borrowing, as easy access to credit may lead to higher debt burdens and increased default rates. The reliance on alternative credit sources, often without adequate education on financial consequences, makes credit risk management crucial in evaluating the borrowing patterns of this generation.

Financial literacy is a key determinant of responsible credit usage and risk management. It encompasses an individual's ability to understand financial concepts, including budgeting, debt management, credit scores, and interest rates. Higher financial literacy levels

correlate with better credit decisions, timely repayments, and lower default rates. However, studies suggest that Gen Z may not be adequately equipped with essential financial knowledge, leading to uninformed borrowing choices. Despite their tech-savviness, many young borrowers struggle with concepts like credit scores, compounding interest, and debt repayment structures. This gap in financial education contributes to increased credit risk, as individuals may take on loans or credit lines without fully understanding repayment obligations. Additionally, the rise of influencer-driven financial advice on social media has led to mixed financial guidance, sometimes promoting risky credit habits rather than responsible financial planning. Addressing financial literacy among Gen Z is essential for mitigating credit risk and fostering long-term financial stability. Governments, educational institutions, and fintech companies play a critical role in promoting financial awareness through accessible resources, workshops, and in-app financial guidance tools. By strengthening financial literacy initiatives, lenders and policymakers can help reduce default rates and improve Gen Z's credit management skills.

The financial sector has witnessed a significant shift with the advent of fintech and digital lending platforms. These technologies leverage artificial intelligence, big data, and alternative credit scoring methods to assess borrower risk more dynamically. Unlike traditional banks, fintech lenders often rely on non-traditional data points such as spending patterns, social media behavior, and transaction history to determine creditworthiness. For Gen Z, fintech has made credit more accessible than ever before. With a few clicks, individuals can apply for loans, receive instant approvals, and manage finances through mobile applications. While this democratization of credit has benefits, it also raises concerns about risk management. The ease of access may lead to impulsive borrowing, increased debt accumulation, and higher default rates among young borrowers who may not fully comprehend the long-term impact of their financial choices. Moreover, fintech innovations such as BNPL services have altered traditional credit consumption. BNPL allows users to split purchases into interest-free installments, making it an attractive alternative to credit cards. However, many Gen Z borrowers fail to

track multiple BNPL payments, leading to unmanageable debt levels. The growing dependence on short-term credit solutions underscores the need for fintech companies to integrate responsible lending practices, including transparent interest structures, personalized financial education, and AI-driven risk monitoring to identify at-risk borrowers.

Understanding the credit risk factors specific to Gen Z is crucial for lenders, financial institutions, and regulators. Unlike older generations who relied on traditional banking structures, Gen Z exhibits different financial behaviors influenced by economic uncertainties, student debt burdens, and shifting employment trends. The gig economy, freelance work, and entrepreneurial pursuits have altered income stability for many young individuals, making traditional credit risk models less effective in predicting default probabilities. Key credit risk factors among Gen Z include limited credit history, making it difficult for traditional credit scoring models to assess their risk; high debt-to-income ratios due to rising living costs and student loans, impacting their repayment capacity; impulsive spending and reliance on BNPL services, increasing financial strain; and economic uncertainty, including inflation, job market instability, and economic downturns that can impact their ability to meet financial commitments. Analyzing default trends within this demographic can help lenders develop tailored risk mitigation strategies, such as flexible repayment structures, personalized financial coaching, and AI-powered risk monitoring tools. Additionally, the integration of behavioral analytics in credit risk assessment can provide a more holistic view of a borrower's financial habits beyond traditional credit scores.

As Gen Z becomes a dominant force in the credit market, understanding their financial literacy levels, borrowing behaviors, and risk factors is essential for effective credit risk management. The rise of fintech and digital lending has redefined how this generation accesses and manages credit, presenting both opportunities and challenges in mitigating default risks. While fintech innovations have made credit more inclusive, they also require responsible lending frameworks to ensure sustainable financial practices. This dissertation explores the interplay between financial literacy, fintech's influence, and credit risk

management among Gen Z. By examining borrowing trends, default risks, and the role of digital lending, this research aims to provide insights into how Gen Z can navigate credit responsibly while ensuring financial stability. The findings will contribute to understanding how financial education, policy interventions, and fintech innovations can collectively shape a more informed and resilient generation of borrowers.

OBJECTIVES:

Primary Objective: Credit Risk Management Among Gen Z:

Secondary Objective:

- Assessing Financial Literacy and Credit Awareness Among Gen Z
- Exploring the Role of Fintech and Digital Lending in Shaping Gen Z's Credit Habits
- Understanding Credit Risk Factors and Default Trends in Gen Z Borrowers

RESEARCH METHODOLOGY:

This study adopts a mixed-method approach, combining both qualitative and quantitative research methods to analyze credit risk management among Gen Z.

DATA COLLECTION:

Primary Data: Surveys and structured questionnaires will be conducted among Gen Z individuals to assess their financial literacy, borrowing habits, and credit awareness. Interviews with financial experts and fintech professionals will provide deeper insights into risk assessment strategies.

Secondary Data: Existing literature, industry reports, and financial data from banks, fintech platforms, and regulatory bodies will be analyzed to understand credit risk trends and default patterns among Gen Z borrowers.

REVIEW OF LITERATURE:

The Effects of Financial Literacy, Self-Efficacy, and Financial Stress on Risky Credit Behavior of Generation Z: Evidence from Pay Later Users - Brithania Constansje, Florentina Kurniasari, Arlyana Abubakar. (Universitas Multimedia Nusantara, Indonesia)

This study examines the impact of financial literacy, self-efficacy, and financial stress on risky credit behavior among Indonesian Gen Z pay-later users. With financial inclusion outpacing literacy, many users engage with

financial products without sufficient knowledge. Using Structural Equation Modeling (SEM) on survey data, findings reveal that financial literacy positively influences self-efficacy but negatively correlates with risky credit behavior. However, self-efficacy does not significantly impact risky credit behavior, nor does it mediate the literacy-risk relationship. Financial stress also does not moderate this relationship. The study highlights the need for financial institutions to educate Gen Z on responsible financial decision-making.

Credit Card and Compulsive Buying Behavior Among the Generation Z (Gen Z) in Malaysia - Nur Baiti Shafee, Zuraina Sal Salbila Mohamed, Shadia Suhaimi, Haniza Hashim & Siti Nurul Huda Mohd [Part of the book series: Lecture Notes in Networks and Systems ((LNNS, volume 923))]

This study examines compulsive buying behavior among Malaysian Gen Z credit card users, highlighting its impact on financial well-being and mental health. Analyzing data from 276 respondents, the research identifies key factors, including financial literacy, technological advancements, and social influences. The findings provide insights for policymakers, financial institutions, and educators to develop strategies that promote responsible financial behavior and reduce compulsive buying risks.

Machine learning analysis of financial behavior: A study of Gen Y and Gen Z preferences- Kanchan Tolani, Janmejy Vijaykumar Shukla, Rahul Mohare, Tejasvini Alok Paralkar.

This study analyzes Gen Y and Gen Z financial behavior using machine learning, highlighting globalization's impact on spending and saving habits. Comparing financial preferences, findings show Random Forest as the top predictor for Gen Y's spending behavior, while Support Vector Machine is preferred for Gen Z. Insights from this research help financial institutions tailor strategies to better serve these generations.

How does Generation Z handle their financial behavior? A multimethod study of a credit union's members in Rio Grande do

Sul (BR) Autores. - Fernando Carlini Guimarães, Cintia Paese Giacomello, Djeniffer De Bortoli, Cassiane Werner

This study provides valuable insights into Generation Z's financial behavior in Rio Grande do Sul, Brazil, using both qualitative and quantitative methods. The findings highlight Gen Z's strong financial awareness, emphasizing their saving habits, goal-setting, and responsible credit use. They learn financial practices from family, engage in bidirectional financial socialization, and leverage technology for better financial management. Quantitative analysis further supports their financial discipline, showing significant savings and lower credit commitments compared to the general population. Overall, Gen Z exhibits financial prudence, adaptability, and digital proficiency, reinforcing their role as financially responsible digital natives.

DATA ANALYSIS

1. ANOVA (Analysis of Variance)

Hypothesis:

- **H (Null):**

There is no significant difference in financial confidence among different academic backgrounds.

- **H (Alternative):**

There is a significant difference in financial confidence among different academic backgrounds.

- **Variables:**

- o Independent Variable (Categorical): *Academic Background*
- o Dependent Variable (Categorical converted to numeric scale): *Financial Confidence* (e.g., "Poor" = 1, "Good" = 2, "Very confident" = 3)

H. There is a significant difference between the academic background of the respondents and their financial confidence.

ANOVA

Financial Confidence	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	6.232	3	2.077	4.861	0.004
Within Groups	43.768	101	0.433		
Total	50.000	104			

ANOVA Effect Sizes

Financial Confidence		Point Estimate	95% Confidence Interval
	Eta-squared	0.125	0.018 – 0.252
	Epsilon-squared	0.095	-0.012 – 0.218
	Omega-squared Fixed	0.093	-0.014 – 0.215
	Omega-squared Random	0.045	-0.015 – 0.111

Findings:

- The significance value ($p = 0.004$) is less than 0.05, indicating that there is a statistically significant difference in financial confidence across different academic backgrounds.
- The effect size (Eta-squared = 0.125) suggests a moderate effect, meaning academic background moderately influences financial confidence.
- Since $p < 0.05$, we reject the null hypothesis (H_0).
- Therefore, we accept the alternative hypothesis (H_1):
There is a significant difference in financial confidence among respondents from different academic backgrounds

2. Simple Correlation

Hypothesis:

- **H (Null):**
There is no correlation between credit score knowledge and whether the respondent has checked their credit score.
- **H(Alternative):**
There is a correlation between credit score knowledge and checking credit score.
- **Variables:**
 - Variable 1: *Know Credit Score* (Yes = 1, No = 0)
 - Variable 2: *Checked Credit Score* (Yes = 1, No = 0)

H. There is a significant relationship between the age of the respondents and the frequency of programs.

Cross Tabulation Table

Age of the Respondents	Frequency of Programs						
	1.00	2.00	3.00	4.00	5.00	Total	
1.00	2	3	16	2	0	23	
2.00	3	16	16	2	0	37	
3.00	0	1	1	2	2	6	
4.00	0	0	1	0	1	2	
Total	5	18	25	6	3	56	

Symmetric Measures (Correlation Test Results)

Measure Type	Value	Asymptotic Standard Error	Approx. T	Approx. Sig.
Pearson's R	0.301	0.115	2.318	0.024
Spearman Correlation	0.320	0.121	2.486	0.016
No. of Valid Cases	56			

Findings:

- The Pearson correlation coefficient is 0.301, and the p-value is 0.024, which is less than 0.05, indicating a significant positive correlation between age and frequency of programs attended.
- Similarly, Spearman correlation is 0.320 with a p-value of 0.016, also confirming a significant correlation on the ordinal scale.
- Since $p < 0.05$, we reject the null hypothesis (H).
- Therefore, we accept the alternative hypothesis (H):
There is a statistically significant relationship between the age of the respondents and the frequency of upskilling/reskilling program

3. Chi-Square Test of Independence

Hypothesis:

- **H (Null):**
There is no association between gender and whether the respondent has taken a loan.
- **H (Alternative):**
There is an association between gender and loan taken.
- **Variables:**
 - *Gender* (Categorical)
 - *Loan Taken* (Categorical: Yes/No)

Cross Tabulation Table

Gender	Loan Taken: Yes	Loan Taken: No	Total
Male	22	31	53
Female	18	26	44
Other	2	6	8
Total	42	63	105

Chi-Square Tests

Test	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	4.756	2	0.093
Likelihood Ratio	4.921	2	0.085
Linear-by-Linear Association	2.987	1	0.084
N of Valid Cases	105		

Findings:

- The Pearson Chi-Square significance value is 0.093, which is greater than 0.05. Hence, we fail to reject the null hypothesis (H).
- There is no statistically significant association between gender and whether a loan was taken at the 5% significance level

CONCLUSION

In an era where digital transformation is rapidly reshaping financial services, understanding Gen Z's relationship with credit has become increasingly important. This study reveals that while Gen Z embraces the convenience of fintech solutions such as BNPL and digital lending platforms, their financial decisions often stem from limited awareness and a lack of traditional financial literacy. The research highlights that impulsive borrowing, misunderstanding of loan terms, and a tendency to default due to poor repayment planning are growing concerns among this demographic.

Despite their tech-savviness and confidence in handling personal finance, many Gen Z individuals face challenges related to credit management, especially when navigating new-age lending platforms without sufficient guidance. A significant number are open to using credit cautiously, automating payments, and even seeking personalized financial advice, showing a strong willingness to learn and grow financially.

To mitigate credit risk effectively, financial institutions, educators, and fintech platforms must work collaboratively to promote financial literacy, incorporate AI-driven risk assessments, and build credit solutions tailored to Gen Z's

unique habits. By fostering responsible borrowing behaviors and creating accessible financial education tools, stakeholders can ensure that this generation not only thrives in the digital credit ecosystem but also contributes to long-term financial stability and economic resilience.

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