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VIEWPOINT

INCREASED REGULATION AND RISING INTEREST RATES BUILD ON BNPL'S WOES

Challenges are growing for Buy Now, Pay Later providers, but demand is nonetheless rising. Banks need to rise to these challenges and build solutions that leverage their capabilities and offer tailored services that both support their customers and remain competitive with fintechs' offerings.

Headwinds are strengthening for the Buy Now Pay Later (BNPL) sector. From the previously frothy landscape[1], where global spending via BNPL rose by 300% between 2019 and 2021, and where the market was expected to top $1tn in annual gross merchandise by 2023, conditions now are looking much more challenging.

BNPL providers have been coming under increased scrutiny from regulators given concerns that people struggling with the fast-rising cost of living are using BNPL to pay essential bills rather than spread the cost of discretionary spending.

Regulatory pressure is mounting globally

In UK, the government in June announced plans to require BNPL lenders to be approved by the Financial Conduct Authority. Other proposals, aimed at protecting consumers, include requiring BNPL lenders to carry out affordability checks, allow consumers to take complaints to the ombudsman, and to make sure that adverts are not misleading. In the US, the federal Consumer Financial Protection Bureau opened an inquiry into BNLP credit, ordering five providers – Affirm, Afterpay, Klarna, PayPal, and Zip – to collect information on the risks and benefits of BNPL loans so that the Bureau can "report to the public about industry practices and risks".[2]

Inflationary environment is increasing the cost of debt

In addition to the regulatory scrutiny, growing defaults on loans and higher cost of debt due to rising interest rates are compressing margins and valuations for BNPL market leaders. Klarna reported operating losses of $748mn for 2021 and said in May that it would shed 10% of its workforce. Klarna's valuation has been slashed to $6.7bn in its latest funding round, sharply down from its peak valuation just a year previously of $46bn.[3] Other BNPL providers such as Affirm and Afterpay also reported ballooning losses.

Apple is creating a space for itself in the unsecured lending space

While the costs are rising fast, the demand for BNPL continues to rise. In this context the entry of the well-funded Apple with the launch of "Apple Pay Later" is likely to take a big bite out of the BNPL market share. This is consistent with Apple's ambition to grow into the unsecured lending after the launch of "Apple Card" and "Tap to Pay".

The increasingly difficult landscape and rise in scrutiny from regulators and commentators means we have moved into a new, tougher stage for the BNPL sector: BNPL 2.0.

BNPL 2.0 offers banks an opportunity to tap into the long-term growth

In the short term, higher interest rates, defaults and servicing costs will drive up the operating costs for established BNPL players. This presents an opportunity for incumbent banks to grow their unsecured lending portfolio be that "on-card" or "POS financing" products.

Banks will need to reimagine their products to meet consumer needs, introduce tailored solutions to reach younger consumers and drive engagement. In this process, banks must evaluate the pre-purchase, at-purchase and post-purchase points of consumers' buying journeys and design BNPL value propositions which can deliver sustainable profits while remaining competitive with fintechs.

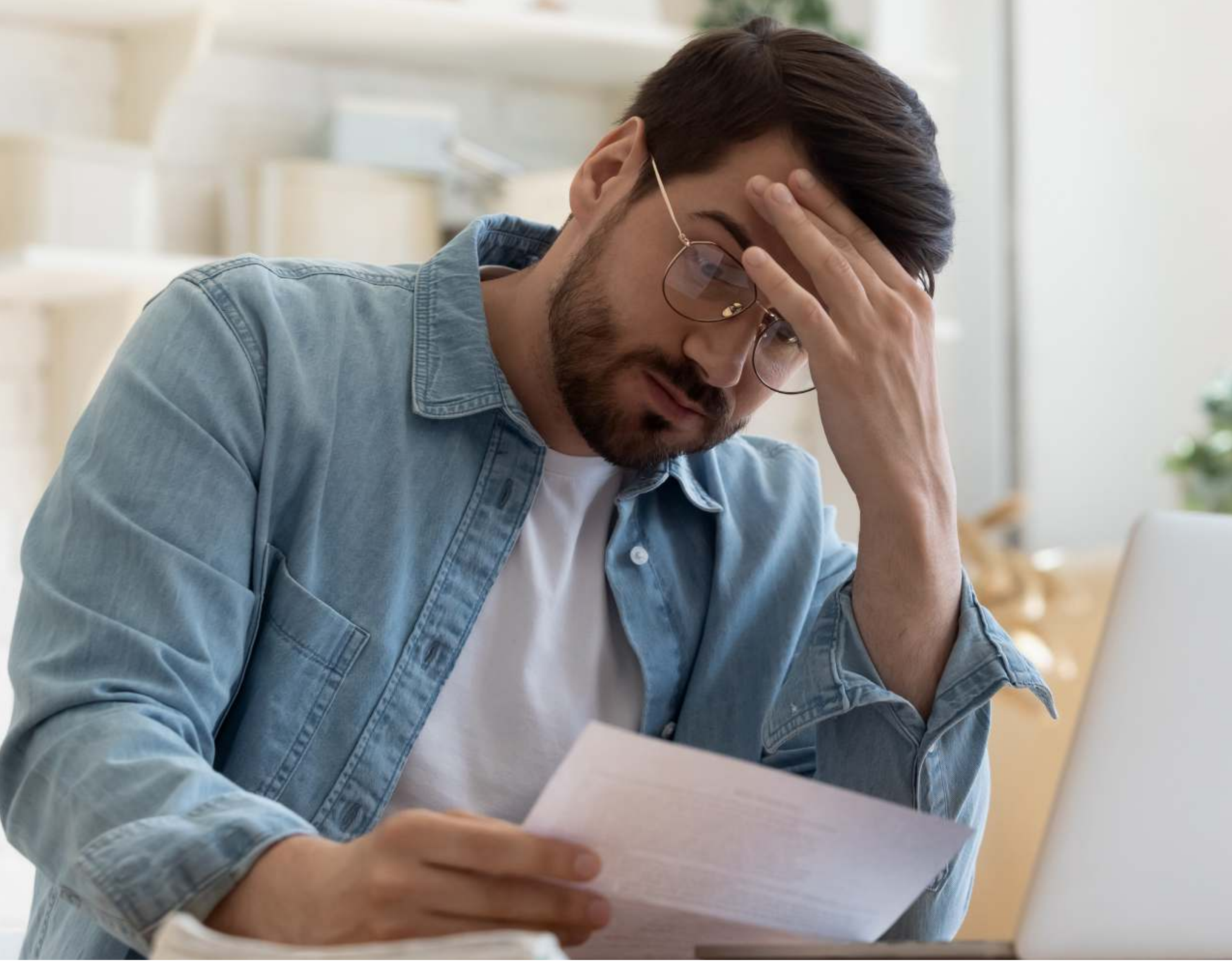
Incumbent card issuers have distinct advantages which they must fully exploit. They have well-established relationships with consumers and merchants. They also have valuable insights into consumers' preferences and have a stronger servicing backbone to deal with disputes, chargebacks and late payments. Card-issuers are regulated as banks, and hence the cost of compliance and reporting is already built into their P&L and their DNA.

> Banks need to build tailored solutions that support their customers and help them remain competitive

This window however may be short-lived because pure-play BNPL players are working hard to get their act together. Their costs are rising but their market share is also growing consistently. It is just a matter of time that some of the big pure-play BNPL players will come out stronger from the BNPL 2.0 phase. No action or even delayed action from banks will result in continued erosion of their unsecured lending P&L, millennial/Gen Z customer base and higher cost of new customer acquisition.

Infosys: Navigate your next in BNPL 2.0 with a trusted full-stack partner

Banks must holistically evaluate the pre-purchase, at-purchase and post-purchase points of consumers' buying journeys and design their BNPL value propositions based on the needs of their customers and bank's core capabilities.



Building a BNPL capability from ground up may not be feasible for all banks due to cost constraints and time to market, while licensing a third party's solution is also not ideal, as this means potentially not having control over innovation, development, data and customer experience. More often than not, alternative pathways will need to be explored and tailored solutions are needed.

One prudent pathway for banks is to leverage their core internal capabilities (like servicing, fraud, underwriting) and marry them with a white-label third-party platform. Banks will need to consider the level of control they want to wrest on data and the user experience. In addition, banks must ensure that the regulatory reporting and financial risk is fully thought through and integrated with their core systems and operationalized.

Banks need to balance the level of control they want to wrest on data and the user experience

These decisions are complex and require a thoughtful approach. It also necessitates a partner who can help execute across the stack of domain, technology, and operations in a product/platform agnostic fashion.

Infosys is a full stack player in the payments space with a global footprint. Since we work with the large and regional banks and with fintechs in unsecured lending space, we have a ringside view of what it takes to design, develop and operate BNPL products and platforms.

We believe that in BNPL space incumbents are not doomed and fintechs are not ordained. BNPL 2.0 presents a real opportunity for the incumbents to come back in the game. They will need a trusted partner in the journey.

References

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