The rise and fall of buy now pay later and residual opportunities for banks

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Over two centuries ago, if you were searching for a glamorous wooden desk, you could have visited one of the oldest furniture stores in the US, the renowned store Cowperthwait & Sons, and got yourself a deal by paying through instalments. This very concept has been rebranded time and time again and even after more than two centuries it is at the heart of the rapidly growing FinTech payments world.

The concept was originally coined 'Buy Now Pay Later (BNPL 1.0)' and has been ever evolving until more recently, when merchants have become so flexible in their payments plans that in the future they might want to rename it to 'Buy Now Pay Anything Later (BNPAL 2.0)'.

This blog will discuss the rise and fall of traditional BNPL and the residual opportunity that presents itself to banks.

BNPL and its rise and fall

BNPL can be considered an interest-free form of credit, and it first caught the attention of consumers as an online shopping option, but its presence in direct payments is growing.

It was originally pioneered by FinTechs and other digital players, such as Klarna, Affirm, Afterpay and Clearpay, but in varying forms, it continues to see new entrants from both disrupters and established banks.

Demand for BNPL has grown rapidly and providers have been quick to introduce new services so as not to miss the trend.

The last few years have seen the largest BNPL FinTech start-ups propel to unicorn status, and with the cost-of-living crisis dominating the headlines, the appeal of BNPL may be greater than ever. But with hugely fluctuating valuations and public opinion how many of them have created a lasting strategy?

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In the last 12 months we have seen the likes of Klarna being devalued to USD 6.7 billion from a height of approximately USD 46 billion [1], which can be attributable to a rising rate environment and a growing risk-off sentiment globally, both of which put downward pressure on valuations in the technology sector.

In 2022, Forbes reported that Affirm's BNPL model was suffering due to funding costs rising, causing its stock price to fall by 93% [2].

The other major BNPL FinTech's have also suffered similar headwinds with some abandoning the UK market to concentrate on other nations because of a surge of past-due payments and a lack of profitability. In addition to this, deep-pocketed Silicon Valley rivals such as Apple have also moved into the BNPL market with products like Apple Pay Later [3], therefore creating a greater level of competition.

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What is the residual opportunity for banks?

While most of the early BNPL players were FinTechs and other digital players, we see a great opportunity for banks to expand into this form of payment through both consumer and corporate credit cards as well as short-term unsecured lending.

> "...we see a great opportunity for banks to expand into this form of payment."

[1] Klarna valuation plunges 85% as 'buy now, pay later' hype fades (cnbc.com)
[2] Stock Down 93%, Affirm's BNPL Model Suffers As Funding Costs Rise (forbes.com)
[3] Klarna sees its value slashed by 85% in latest round of fundraising | Buy now, pay later | The Guardian

Many banks are exploring these opportunities, despite having previously distanced themselves from BNPL in its original form.

BNPL can bring clear benefits to the wider public, providing an alternative and cheap method of credit, with many advantages over alternative lending options, such as credit cards, with vastly preferable credit rates and less impact on individual credit checks.

As such, millions of people in the UK already use BNPL to split or delay payments, but while this can be a useful payment method for some, the customer journey often lacks the necessary care, information, and affordability checks to stop people falling into debt [4], especially as BNPL isn't sufficiently regulated [5].

Banks are therefore in a unique position, as they have a better understanding of a customer's financial situation (and therefore affordability and associated risk of default) - and can use this knowledge, alongside compliance procedures with existing lending regulations, to help BNPL become a great benefit to both consumers and banks themselves.

Banks can help their customers navigate these considerations alongside wider debt commitments with proactive advice, as well as by providing customers with a consolidated overview of their BNPL debt and other debt within their banking app or via monthly bank statements.

> "Banks are therefore in a unique position, as they have a better understanding of a customer's financial situation (and therefore affordability and associated risk of default)..."

[4] Buy now, pay later: what happens if you can't pay later? - Citizens Advice
[5] UK Treasury Closes BNPL Regulations Consultation | PYMNTS.com

A bank that can support its customers, particularly during challenging economic times has a better chance of building trust and earning longer-term loyalty.

Banks also have the flexibility to cater to risk appetite through managing both sides of the BNPL model, i.e., credit risks arising from an issuer side as well as from the acquirer's perspective for merchants, therefore providing a level of service that other BNPL providers simply cannot match.

Do they put in place appropriate limits to protect both customers and merchants?

Do they contribute to an ethical marketplace?

Focusing only on short-term profits can jeopardise a bank's reputation, while banks that focus on sustainable business models for BNPL will benefit in the long-run.

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Banks' ability to support a BNPL product, to the benefit of their customers will always centre on managing reputational and regulatory risks.

Banks also need to consider the impact of BNPL services on their broader ethical financial strategies.

"...banks that focus on sustainable business models for BNPL will benefit in the long-run."

Final thoughts

In summary, BNPL is an important and growing element of the payments industry. It delivers compelling benefits to consumers by expanding the payment options for low-income customers, while saving money by helping reduce the need to pay excessive credit fees.

There is significant value and ethical contribution in the BNPL proposition if delivered correctly – provided banks focus on the affordability and suitability of the product to their customers.

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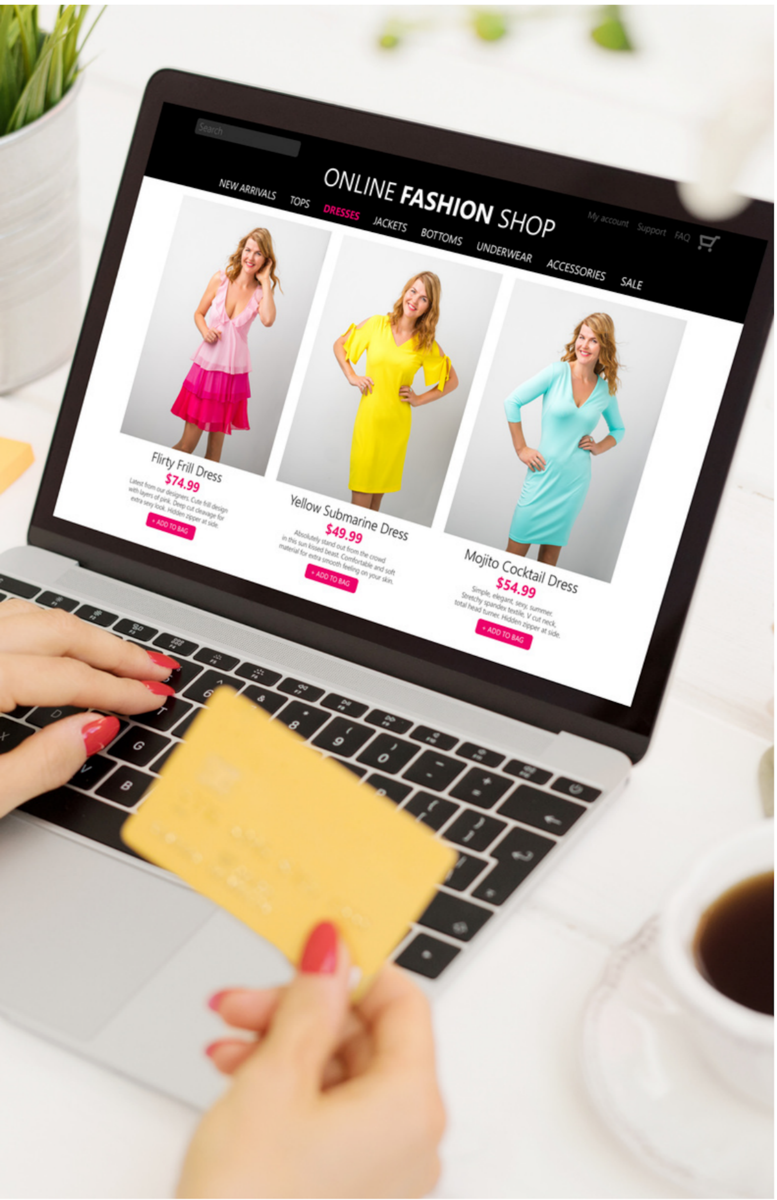

The handling of customer data and the potential to undermine the effectiveness of lending controls will lead to increased pressure from government regulators, therefore best practice processes and frameworks will be key.

Despite the financial challenges, the BNPL market has a valuable contribution to make to broader consumer credit, with continued growth rates anticipated to persist.

The product has suffered from emotive market commentary but if done properly and with due focus on the customer, it will be here to stay.

About us

Be | Shaping the Future UK (**Be UK**) are the UK arm of a leading pan-European financial services management consultancy (Be | Shaping the Future), with over 1,900 consultants located across 13 European countries.

We are one of the fastest growing consultancies in the UK with dedicated specialist teams in:

- Finance & CFO advisory
- Cards and payments
- Retail and commercial banking
- ESG
- Risk, regulatory and compliance

We work in partnership with our clients to deliver transformational change and strategic advice, powered by a unique culture, attaining a new quality and price standard.

The Retail and Commercial Banking team at **Be UK** is composed of innovative thinkers, strategic advisors and transformation specialists. Our key service areas include:

- Digital and business transformation
- Data analytics and innovation
- Operational excellence

Utilising our broad experience from across the banking sector, we ensure our clients take advantage of market disruption to achieve lasting value.

Bringing deep industry expertise and expert consulting capabilities, we support our clients to tackle their biggest opportunities and challenges to deliver fundamental and enduring change to their businesses.

Contact

For more information on how we can help with your banking, payments and transformation initiatives, please get in touch.

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David has over 25 years of banking and consultancy experience, having worked with global banks, building societies and dynamic challenger brands.
He specialises in digital transformation and data analytics to drive business innovation and change. Studying changing customer behaviour for many years, he has supported the sector to innovate and change, leading many industry firsts. He previously founded a FinTech start up to bring new insight and innovation to Personal Financial Management.

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