Buy now, pay later: yes, but at what cost?

The practice of split or deferred payment, known as Buy Now Pay Later (BNPL), is becoming increasingly popular among consumers in the UK and worldwide. But not without its risks. To prevent excessive debt, which is the main danger of BNPL, methods exist. This is the case with credit scoring, a tool making it possible to measure the risk posed by the loan applicant. We take a closer look…

Temps de lecture : minute

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It is undisputed: the coronavirus pandemic has boosted e-commerce like never before. This is certainly the case in the UK, where it rose from *30% of total sales in 2020 to 40% in 2021*, in France (27% to 32%) and Spain (44% to 52%). In the United States, where consumers spent $1.7T online during the crisis, e-commerce has jumped by 55%, according to a study by Adobe.

This explosion in e-commerce has been driven by *"unprecedented changes in purchasing habits",* according to Michael Diguet, CEO of Algoan, a French start-up that specialises in providing support to credit and financial institutions. Among these emerging trends is Buy Now Pay Later (BNPL), a practice of split or deferred payment offered by British companies Klarna and Clearpay, the Italian Scalapay and the French companies Alma and Pledg.

This type of new generation "harmless" loan, is currently experiencing strong growth in many countries. *"It is particularly popular among young people, who do not have a good image of the traditional method of* *credit,"* says Diguet. When they use BNPL, they have the impression that it is an act of payment.

40% refusal of payment following BNPL

Although merchants pay a commission, they also benefit: "*BNPL increases the number of purchases by 60% and turnover by 20%,*" says Diguet. Although becoming very popular, it still only represents less than 3% of world trade according to Fidelity National Information Services (FIS). The growth potential is therefore enormous, and will keep investors interested for a few years to come at least.

Nonetheless, *"we must not forget that BNPL is a form of credit, and credit carries risks"* Diguet warns. The main risks being: fraud and default on payment (or rather on repayment, as it is a form of credit). These two major risks are encountered in traditional consumer credit of course, but the fact it is free, fluid and fast, makes BNPL so attractive, and encourages consumers to accumulate debt (loan stacking). Around 40% of Italian, Spanish and French consumers have already received a payment refusal after using BNPL, according to a study by Algoan.

Coupled with the high fees charged by some BNPL merchants for payment defaults (up to 25% of purchase amount), this accumulation can sometimes lead to over-indebtedness. On a larger scale, this risk can also endanger the fintech itself, which stands as a guarantor of the debt in the event of default.

An end to the "excessive simplicity" of credit scoring methods

"This is why regulators around the world are working on BNPL regulation," Diguet continues. "*This trend comes from the UK, where there have been problems of over-indebtedness over the festive season, and these*

problems went right up to the politicians".

If inspired by the regulations governing consumer credit around the world, this BNPL regulation could force startups to be more transparent – *"requiring them to state that it is a loan and not payment, for example"*, says the CEO of Algoan. Most importantly, *"there will certainly be a credit-worthy assessment, to ensure that the borrower is able to repay the loan,"* he adds.This will involve the implementation of the best possible credit scoring methods. Unfortunately, in the case of short-term split payments (two to five payments), BNPL players currently apply very simple methods of credit scoring, *"or methods which only rely on basic elements, such as the type of bank card used, and ambiguous indicators (browsing habits and online reputation, etc.)",* explains Diguet. Mainly intended to curb fraud, these techniques *"will not be able to prevent overindebtedness",* he notes. Furthermore, the CEO of Algoan also believes that these techniques will *"certainly be insufficient in future regulations".*

Open banking, the ideal solution for preventing overindebtedness

With the exception of France, in most countries BNPL players can also rely on the credit scoring of Credit bureaus, who collect the users' banking data each time they carry out a transaction, without giving them the option.

Meanwhile, Algoan offers a credit scoring solution more powerful than that of the BNPLs and more ethical than that of the financial institutions, since it is based on open banking data. This "opening up" of banking data, which is completely transparent and respectful of personal data, is now recommended by the European Union. Moreover, the buying by Apple of an Open Banking Credit Scoring startup in the UK a month ago shows the strong interest and confidence of the market in this technology.

For the startup's CEO, it is certain: open banking will become an obligation throughout Europe and the world. “*To avoid over-indebtedness, we, as fintech players, must assess people's creditworthiness before granting them credit,”* he insists. *“But unlike other forms of credit, BNPL requires a real-time decision. The only way to do a real-time credit analysis is through open banking. BNPL startups need to offer this possibility to their customers, at least as an option.”* A point that should be welcomed by the European regulators.

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