intellect®
Design for Digital

# THE TAO OF NEW AGE CREDIT

## Balancing the equation for **profitable growth in your BNPL proposition**

SECTION 1

# BNPL: Spend has a New Friend!

## There were three triggers to this whitepaper

### Trigger #1

## My Wedding Anniversary

On the eve of our 5th Wedding Anniversary, my wife and I were enjoying a glass of wine and discussing (no, make that arguing) something about a recent TV advertisement. For the life of me, I still do not understand how we ended up looking for a brand new TV, online!

The one that we both liked as it usually happens was substantially over our budget, in fact overwhelmingly so. We almost dropped the idea and then we saw the zero interest, pay-in- instalments option.

***Buy Now, Pay Later.*** *Now, why would we ever say No to that?*

### Trigger #2

## Spend has a new friend!

A few months later, I happened to browse through a Forbes study that talked about how a whopping 42% of Gen Z and 69% of millennial customers would be keen to avail BNPL services, if offered. Intrigued, I picked up another report, by Motley Fool. This report stated that 38.37% of customers use Buy Now, Pay Later to make purchases that wouldn't otherwise have fit their budget (so clearly, we had company!). It also added that the typical BNPL user spent an average of $1,141 per transaction — a staggering 761% more than the $150 average for a non-BNPL transaction. Wow!!

***I now live in mortal fear when my wife starts surfing for a desired Golf Club set or for that matter, my son, for a pair of branded sun glasses. BNPL could indeed become their best buddy too!***

## Trigger #3

# Return is our birth right.

The TV was delivered to us within a couple of days after we bought it online. However, the very next day, we hit pay dirt in one of those Tambola nights at our Club and yes, won a television as a prize! Even before we could celebrate this surprisingly good stroke of luck, we decided to return the TV that we had bought online. To our surprise, we realized that the return would not be a smooth experience!

## So there, three different and supposedly random incidents. But all connected around the experience of BNPL that has quickly become the flavour of retail/online shopping across the globe.

As a concept, BNPL has been in existence for long. It is characterised by a Point-of-Sale Micro loan that can be paid later in interest-free instalments. The packaging of BNPL makes it irresistible for the customer, with a combination of interest-free credit, zero-documentation and a seamless integration with their check-out process.
**There are 4 interesting variants that are usually offered in the BNPL genre.**

- Fixed small ticket credit
- Treated as a personal loan
- Interest component borne by the customer
- Mandatory one-time credit check

- Specified limit tied to a store or a retail chain
- Repetitive spends allowed at the designated store(s)
- One-time evaluation
- Interest cost absorbed by the merchant


- Fixed Duration of 14 to 30 days
- No Interest
- No Fee

- Equated Installments of 3 to 36 months
- Lending may involve credit evaluation
- EMI decides at check-out
- Pre-agreed Interest mostly absorbed by the retailer

Over the last year and a half, as a combination of forced-digital (due to the pandemic) and a move away from brick & mortar stores, the BNPL proposition has become a panacea for a large population of customers. These include millennials, customers that are credit-averse and those with minimal credit history. This has led to an explosive growth in BNPL and multiple lenders across Banks & Fintechs undoubtedly want their share of this rather large pie. What a good time to be in the lending business!

**As with most good things however, there are a few catches.**

### The margin:
The BNPL business is synonymous with wafer-thin margins and this puts a drag on profitability and business viability.

### The asset quality:
Banks/Lenders regularly report 5-10% NPAs on their BNPL portfolio. This is a conservative estimate, by the way. The actual number could climb a lot higher in case of further economic downturn.

### Abandonment issue:
BNPL spends are mostly Discretionary spends by nature. This spending behaviour is also characterised by a very high product abandonment rate (on an average, 69% across industries). This automatically puts a lot of focus on the check-out process.

*And that's not all. Like the rest of us, the customers too are hooked on to the experience delivered by FAANG (Facebook, Amazon, Apple, Netflix, Google), which has now become a 'hygiene ask' in the retail business.*

**At this point, let us assemble the thought prompts that we have picked up so far.**

✓ The highly competitive and low margin BNPL business

✓ The huge opportunity for a lender / financial institution

✓ The magnitude of the experience benchmark

✓ The abandonment rates

Given this complex dynamic of the BNPL business, what should be the bank's strategy for profitable growth in its BNPL portfolio? This whitepaper aims to capture our experience of working with banks, NBFIs and ecommerce players in this genre.

## What we have observed quite clearly is that there are two distinct dimensions to the BNPL business:


## **We believe financial institutions require a holistic solution to crack the fine art of balancing sticky experiences while spotting, and leveraging on, opportunities that bring in additional revenue.**

SECTION 2

# Changing the lens: A shift in the business perspective

A lot has been said about digital being the equaliser so we will not go there. We begin with a perspective on three major shifts in the retail payments market that we see today.

## # 1 From transaction approach to sticky experiences

A fascinating outcome of the digital battlefield is that the boundaries of ecosystems are now blurring, if not getting eliminated altogether. Possibilities in terms of expanding the ecosystem or dipping into other ecosystems have opened up significantly. What a Bank /NBFI or an ecommerce player can do in today's digital era is literally what they imagine they can do! The battle now is to be the **primary engagement point** for the end customer. Whoever **owns** the customer, is definitely the king!

## # 2 From product-thinking to ecosystem thinking

We are also witnessing a rapid and transformational shift to an ecosystem perspective, moving away from the product-push that was prevalent and acceptable till a a couple of years back. Depending on the circumstances and their strategy, FIs can decide on the role they need to play in this ecosystem. For instance, they could be a marketplace creator or a participant or just the financing arm.

## # 3 From parallel tracks to interconnected tracks

The decision making process in the financial institution has acquired multiple hues. These are no longer run as a parallel agenda, rather it has morphed into an interconnected one. To highlight some of the key considerations:

(a) Juxtaposing the 'here and now' with an 'immediate future' agenda.

(b) Strategies for More products per customers (MPC) & More customers per product (MCP)

(c) New customers to woo, while preventing the flight of vulnerable customers

(d) Moments of truth in the customer experience map: enhancing delight and removing friction.

All three shifts resonate in the BNPL business as well. Needless to say, the entire customer experience from customer onboarding and purchase experience to the credit process has to be wired seamlessly.

Consider this.

7.57% of shoppers abandon the process if a page doesn't load in 3 seconds,

39% of mobile users abandoned because of difficulty of entering their personal information.

55% of shoppers will abandon if they have to re-enter their credit card or shipping information.

46% of shoppers abandon because the discount code does not work!
A seamless check out is actually tightly linked to the payment and credit experience, in effect.

Retargeted Ads can send 26% of shoppers back to the bank's site and personalising retargeted Ads can lead to ROIs of over 1300%

We are witnessing the power of context and connections, and the impact it can have on customer experience. This brings forward a very fundamental paradigm: **Business is now a Technology game!**

# Expand the view of BNPL: From Payment to Ecosystem!

The current market perception of BNPL hovers mostly around being *just another customer-friendly payment mechanism.* Is this truly an accurate picture? Or is it a myopic slice of what a full-fledged BNPL system **could be?** This is the central premise of what we are about to unravel.

A comprehensive BNPL process should have the ability to cover varied user journeys, stride across varied system modules, span across multiple stake holders, all of which need to come together to orchestrate a successful and profitable service offering.

Currently, most Fintechs in the BNPL space focus on the customer purchase journey and the check-out process. **This, in our opinion, is a big Blind Spot- a holistic BNPL process should include 3 core elements.**

And while we go into the details of each of these elements, let us recollect the 2 main dimensions that we highlighted at the end of section 1- that of stakeholder experience and an opportunity to monetize across the value chain. Considering we have enlarged our business horizon to the expanded eco-system, the following questions become relevant.

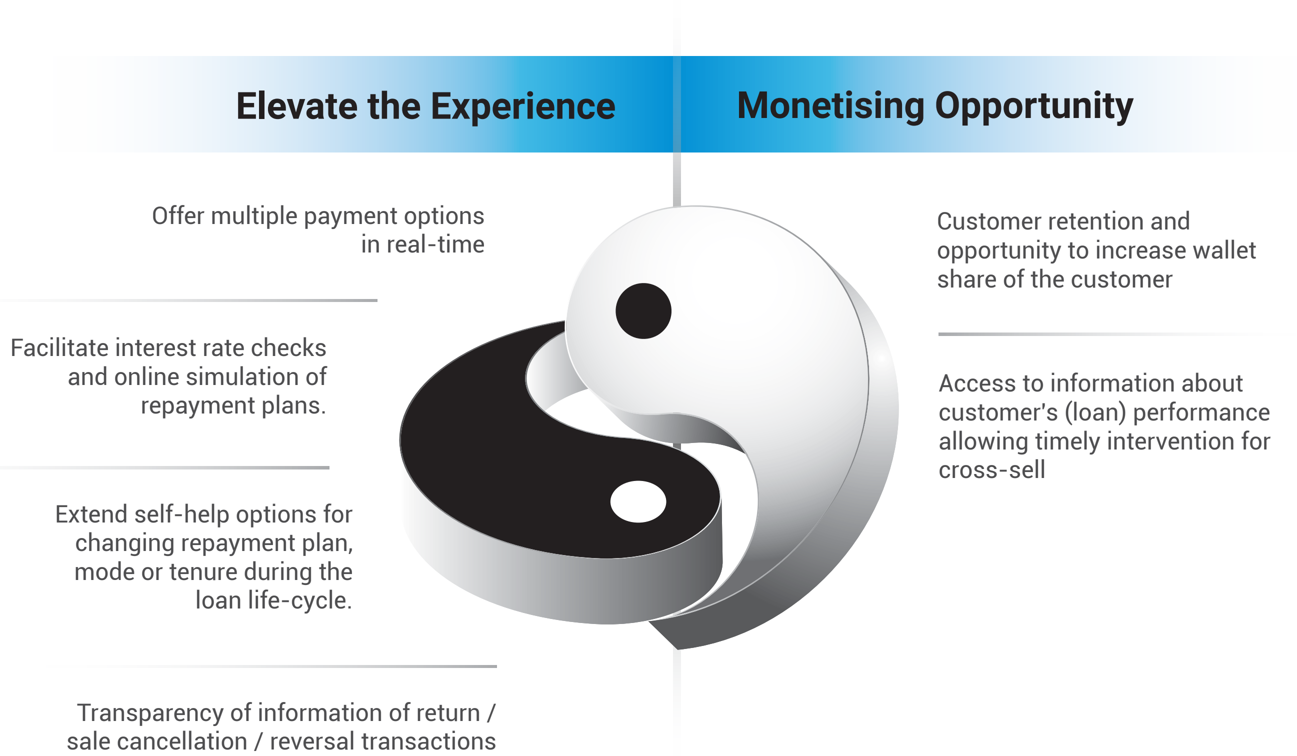
1. Has our problem of delivering superior experience across stakeholders become thrice as complex?
2. And with already squeezed margins, where can we identify opportunities for monetization?

It is our proposition that this balancing act between the experience paradigm and the monetization opportunity is the key to a robust BNPL Proposition. This Balancing act needs to be played for each stakeholder, and across the 3 core elements. Let's see how.

# Consumer Financing.

Going back to the online television purchase that started it all, we were provided with multiple options for the eventual payment, both upfront and flexible. Both options came with a one click checkout, with the credit option as well.

## Balancing the Consumer Financing Equation



# Merchant Servicing.

Merchant service is a critical part of the BNPL business model. It is here that the expanded view allows banks/lenders to create value-addition for every stakeholder in the ecosystem. Merchant servicing includes activities related to making a retailer / brand available on the platform.

As part of the television purchase experience, merchant servicing was the key process that put the specific television brand and model right on top of the consideration list.

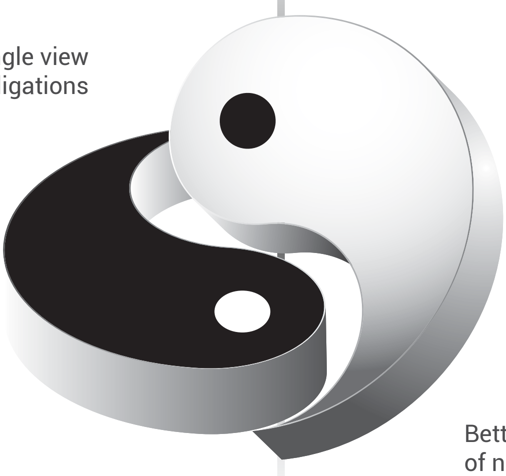
## Balancing the Merchant Servicing Equation

### Elevate the Experience

Compute and consolidate single view of merchant obligations

Automated payouts to merchants on a periodic basis

Provide self-help options to merchants for enquiries and for real-time updates



### Monetising Opportunity

Provision to charge the e-commerce platform a fee for offering merchant services

Opportunity to cross-sell banking services such as transaction accounts, cash management, payment services etc.,

Better bargaining power arising out of network effect empowered by access to a large merchant base

# Merchant Financing.

Efficient working capital management is one of the most critical aspects in a merchant's business model, and one that requires a bank's attention the most. From the bank's perspective, Merchant Financing could be the most remunerative amongst the three elements we are discussing, so it is imperative that they able to play a significant, and an efficient, part in the Financing lifecycle across the previous 2 elements of Consumer Financing and Merchant Servicing before providing their usefulness in Merchant Financing.

Handling the entire lifecycle provides the bank with access to real-time information on the sale, invoice generation and the payment terms. Such information can be harnessed to design and deliver contextual funding services to the merchants.

## Balancing the Merchant Financing Equation

### Elevate the Experience

- Project cash flow timelines for merchant liquidity planning
- Enable seamless conversion of outstanding invoices into merchant credit for better working capital management
- Eliminate procedural delays in availing credit by avoiding repeated credit evaluation
- Shift the risk of collections and payment delays away from the merchant by automating merchant credit

### Monetising Opportunity

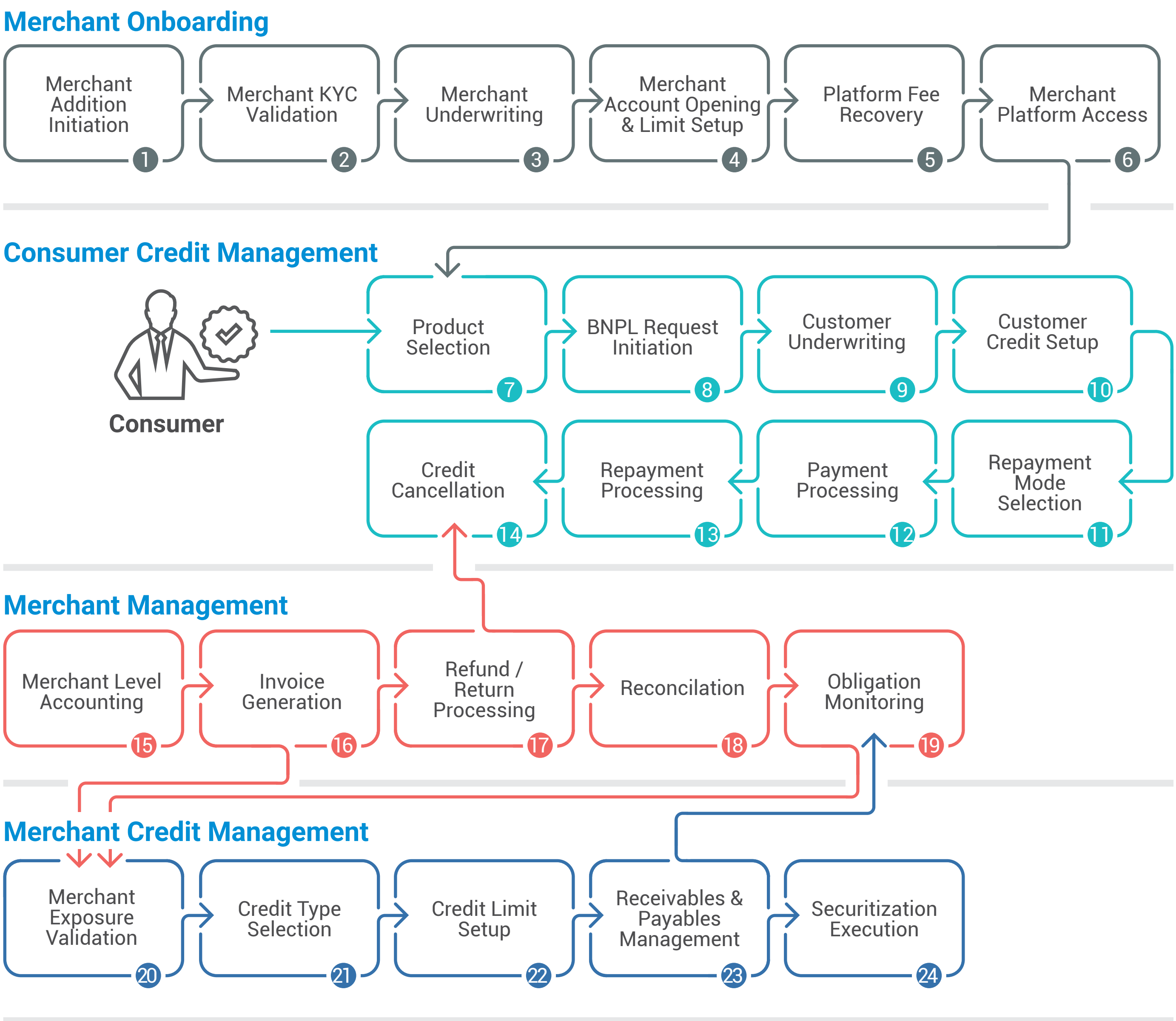
- Multiple financing opportunities for a captive set of merchants
- Credt optimization enabled by a consolidated view of merchant exposures
- Better margin realization through synergies from financing the entire supply chain

After familiarising ourselves with the points that characterise the user experience journey, and the opportunity areas for revenue generation, let's talk about the key stakeholder who can leverage this- the Banks/FIs.

By virtue of their ability to have an oversight (and be a partner) on the entire transaction lifecycle, banks are best suited to integrate the user journeys and deliver a seamless experience across the BNPL ecosystem. Earlier in the paper, we discussed about the threats, and how a low margin business with a high rate of product abandonment and a potential NPA issue can be a major headache. Now, by expanding the horizon and looking at additional user scenarios, we can enable the FIs to garner a significant pay-out, just by changing our perspective to a broader ecosystem.

And this is where the role of a contemporary technology platform becomes important - to seamlessly operate across this broader ecosystem and stitch together user journeys to make the BNPL process work for all the stakeholders. Mind you, this has to be done with a perfect balance of stakeholder experience and monetisation opportunity highlighted earlier.

We believe that the design of such a platform is what can clearly differentiate a truly best-in-class product on BNPL from the rest.




**Designing BNPL: A Connected Ecosystem Perspective**

## To summarize, the recommended 4-pronged approach for BNPL

1. Elevate the perspective to an ecosystem view, and a connected one at that.

2. Zoom in to catalogue the strategic touch points from an experience perspective.

3. Carve out the strategy to leverage the open money points.

4. Curate a transformational technology platform

SECTION 4

# Design of an advanced Technology Solution: iKredit360

The moment we talk about connected ecosystems and an elevated perspective, it becomes clear that this essentially becomes the core principle for the technology design.

The next step is to identify the elements that need to come together to achieve our objective. These include relationship engagement points, financial products, the lifecycle element, core systems within the financial institution, external ecosystem and the fabric that wires and connects all these systems. The method that is usually adopted by financial institutions is to source pieces of technology from various vendors. Unfortunately, 'bringing it all together' is easier said than done. Disparate systems/elements typically create limitations and friction.

Quite a few of the CIOs/CTOs we have worked with, highlight this as an impossible juggling act! Multiple systems with various origins, designs and architectures clash like tectonic plates. And when one has to synchronize these with the bank's existing systems and the external ecosystem, we can appreciate the gravity of the problem. The ask from a BNPL business perspective is already humongous!

That is the reason why Intellect's approach to our technology design is around a iKredit360 platform and definitely not a product push or a framework push. Imagine Intellect as the conductor of the credit orchestra, helping financial institutions create credit symphonies.

**We have a powerful proposition to bring all the elements together. Now, let us take a look at the 6 critical elements.**

**Element 1**

Relationship touch point or the engagement layer, like the Point of Sale (POS) / Web Portal / Marketplace Aggregators

**Element 2**

Core credit modules that form the heart of this platform including cards, payments, invoice financing and even liability sub products

**Element 3**

Credit lifecycle dimension, all the way from origination to debt management and merchant servicing

**Element 4**

Enterprise services for smooth orchestration, such as workflow and rule engine

**Element 5**

External ecosystem that the Financial institution needs to be wired to. It can be Fintechs that support instant credit scoring or the credit bureau or even a CRM system

**Element 6**

The glue to bind it all together - Connections. Where every element handshakes with the other and creates the foundation for open exchange of information and insights, backed by robust security protocols

This platform is the ***coming together*** of experience, choices, touch points, lifecycle and insights, all encompassed by a connected ecosystem (marketplace). The entire platform is cloud native, taking away the vagaries of cost and risk factors, allowing the bank to focus on the raison d'etre for their existence – their customers.

Intellect started work on designing this platform in 2019. The successes we have had with banks in Europe gave the much needed market validation, and has helped shape the product into a comprehensive Credit solution, which lends itself seamlessly to a product like BNPL

In the second part of this Whitepaper series, our Chief Solution Architects Viral Khandwala and Vivek Gautam explain how iKredit360 solutions are curated in the context of your transformational agenda. How do all the varied functional and technology elements converge together to form a harmonious platform? How do we leverage Cloud? Watch this space!

For more information on iKredit360, get in touch with us:
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With over 2 decades of experience in the Assets business, Harpreet specialises in the transformation of Lending and Retail Payments businesses across Banks and FIs. His expertise lies in the area of product development and management, corporate strategy, business planning and sales leadership, and has led to a compelling need to connect technology with business results. Harpreet is passionate about designing advanced credit solutions with a strong bias towards efficient execution.

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