

Responsible lending in a cost-of-living crisis

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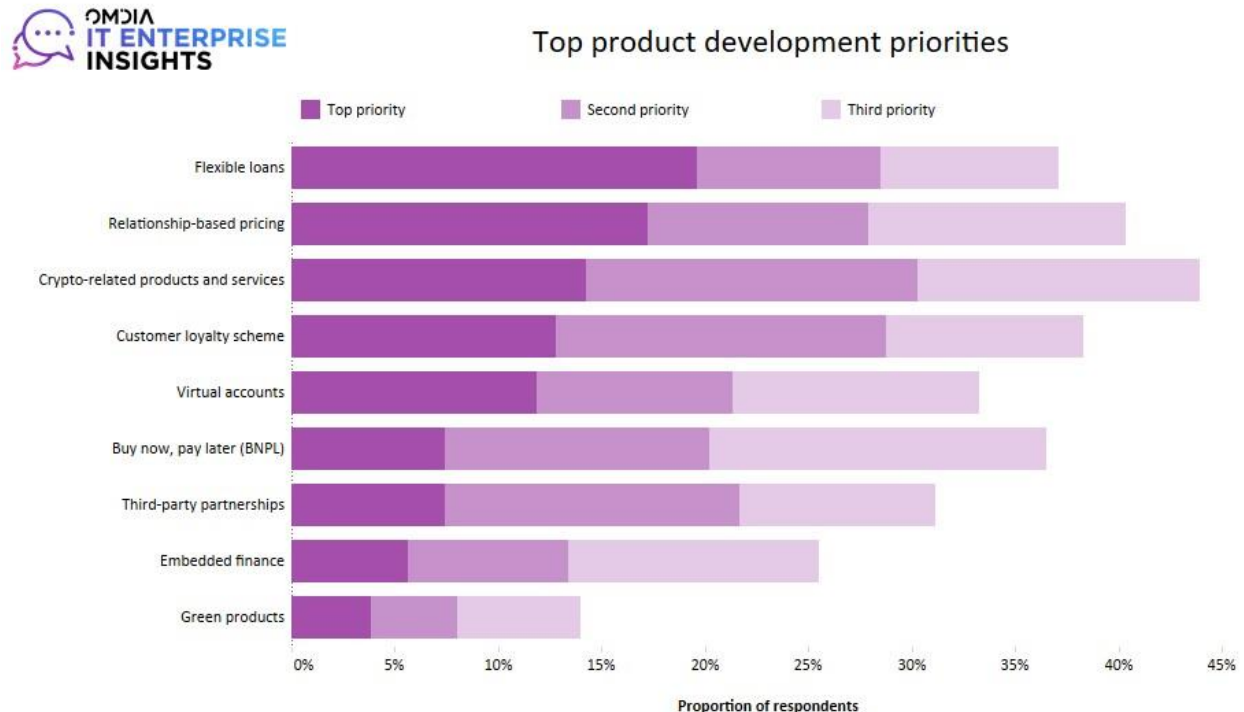
Economic uncertainty and poor access to credit have the biggest impacts on SMBs

All organisations have recovered from the impact of the COVID-19 pandemic and the ensuing global supply chain issues. The big concerns now are inflation, rising interest rates, and the availability and affordability of the skills needed to run or grow the business. According to the *Omdia Horizons 2023* report, 38% of European respondents stated that “persistent global and wage inflation” will have the biggest impact on their business for the next 12 months, which rose to 48% for businesses with fewer than 500 employees.

The uncertain macroeconomic conditions have had the most profound impact on small and medium-sized businesses (SMBs), which typically are responsible for 90% of all jobs in an employment market. The Federation of Small Businesses (FSB) reported that business costs rose for 92% of UK small businesses in 1Q23 (versus the previous year), and 34% said that late payments had increased too. In addition, 51% of small businesses rated the availability and affordability of finance as “poor” or “very poor”, with a further 18% having applied for finance but were still awaiting a decision from the lender.

Flexibility of credit is key both in terms of the type of credit that is given and how it is priced to the consumer or business. In today’s cost-of-living crisis, it has never been more apt to lend responsibly and at the same time be adaptable for consumer and business needs. Long gone are the days when banks should be incentivised to profit from consumers getting into unmanageable debt cycles; that is, charging high fees for overdrafts or revolving credit-card balances. Therefore, it is unsurprising that flexible loans was the top-ranked product-development priority for 20% of respondents in Omdia’s *IT Enterprise Insights: Retail Banking – 2023 – Survey* (see **Figure 1**), with the industry recognising that it needs to ensure the future of credit is affordable, inclusive and accessible.

Figure 1: Flexibility in lending is the most important product development for retail banks



Sample size: 337
 Question: What are your top product development priorities over the next 18 months?
 Vertical: Retail banking. Primary business line: All. Country: All. Enterprise size: All.

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Source: Omdia

Responsible lending: credit cards with “BNPL-esque” flexibility

Credit cards have been the dominant method of unsecured lending for decades, but they still exclude many customer segments from accessing credit. Buy now, pay later (BNPL) emerged as an alternative, linked to the exponential growth online (thanks to the convenience of using BNPL at checkout), because it allowed users to spread payments into affordable chunks while not being subject to late fees or high interest.

However, BNPL providers don’t always carry out hard credit checks to verify that customers have the means to pay back the loans, which has prompted regulators to scrutinize the industry in closer detail for fear that consumers are being encouraged into unmanageable debt cycles. The rise of BNPL has surprised not only the regulators but also traditional credit bureaus, which have only recently started to factor BNPL payments into their credit reporting. Both the UK’s and the EEA’s regulatory bodies are proposing stricter rules that require more-transparent reporting and more-stringent affordability checks, which may make BNPL a less-attractive solution—reflected in it being low down in the retail banks’ product-development priorities (see **Figure 1**).

The new generation of “BNPL-esque”, or BNPL 2.0, products can combine the flexibility of BNPL with the convenience of credit cards. Zilch, a UK BNPL provider founded in 2018, which views itself as part of the BNPL 2.0 evolution, offers consumers a virtual card that can be used either as a “debit” product, and

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receive up to 5% cashback from selected retailers, or as “credit”, by paying back the purchase over time in four instalments.

Similarly, Funding Circle launched FlexiPay in autumn 2023, which allows small businesses the ability to free up liquidity by providing a credit card that, crucially, can be paid back in flexible instalments and used for any everyday expense. Both solutions require hard credit checks; Zilch and Funding Circle are regulated by the Financial Conduct Authority and report to the credit reference agencies. The concept of “BNPL-esque” payments is arguably better suited to, and more sustainable in, business-to-business (B2B) applications. For B2B merchants and companies there is a strong argument for a new approach to trade credit, and to ensuring that the future of credit is affordable, accessible and responsible.

Appendix

Further reading

[*Market Landscape: BNPL and the Changing World of Credit*](#) (June 2023)

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