Innovation, Disruption and Consumer Harm in the Buy Now Pay Later Industry

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Buy-now-pay-later ('BNPL') has had a profound impact in on the global market for consumer credit in an extremely short space of time. BNPL emerged in Australia in 2015 with the launch of Afterpay. Afterpay experienced exponential growth here, before expanding overseas in 2018. Australians are still among the most prolific users of BNPL in the world. In 2022, the Reserve Bank estimated that there were around 7 million active Australian BNPL accounts and in 2023 the industry peak body claimed that 38% of Australians had used a BNPL service at least once. According to the Bank of International Settlements, global BNPL sales increased more than six times over between 2019 and 2023 and there are now more than 2.5 million daily active users of BNPL worldwide.

My paper today presents the findings from an empirical study I conducted with my colleagues, Ian Ramsay and Paul Ali, at Melbourne Law School.[1] In this study we set out to gauge the impact of BNPL on Australian consumers. We conducted a series of focus groups with consumer advocates and an online survey of 1,128 consumers who had used BNPL, either alone or in conjunction with payday loans or pawn loans. The title of my paper is drawn from our forthcoming article, which discusses this data and places it the context of the Australian Government's current reform agenda. An advance copy of this article is available on SSRN. While I won't have time to engage deeply with the concepts of innovation and disruption, in

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[1] This paper is based upon the following peer-reviewed article: Lucinda O'Brien, Ian Ramsay and Paul Ali, 'Innovation, Disruption and Consumer Harm in the Buy Now Pay Later Industry: An Empirical Study' (2024) 47(2) *University of New South Wales Law Journal* (forthcoming). This article has been accepted for publication, subject to editorial revision. A pre-publication, author-produced version of the article is available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4635958>. See also Lucinda O'Brien, Ian Ramsay and Paul Ali, 'Innovation, Disruption and Consumer Harm in the Buy-Now-Pay-Later Industry', *Oxford Business Law Blog* (online), 12 January 2024 <https://blogs.law.ox.ac.uk/oblb/blog-post/2024/01/innovation-disruption-and-consumer-harm-buy-now-pay-later-industry>. This research was funded by the Australian Government through the Australian Research Council (LP160100082).

my presentation today, I hope to give you some sense of how BNPL does present a real challenge to traditional consumer credit products, and does this in a way that creates headaches for regulators, but offers some tangible benefits for consumers.

1. What is BNPL?

BNPL allows consumers to buy and receive goods or services immediately and pay for them over time, usually in four equal instalments. It's extremely easy to access. Australian consumers can qualify instantly with just a few clicks, as they go through the online 'checkout' when making an online purchase. While they may need to provide some form of identification, such as a driver's licence number, there is no need to provide proof of income or undergo a credit check. Consumers can also use BNPL to make in-store purchases with many retailers.

BNPL was originally marketed as a way to spread the cost of small discretionary items such as clothing and footwear, and targeted to young consumers. But it's since expanded into many other areas. It can now be used to pay for furniture and electronics, car repairs, airline tickets, dentistry and veterinary care. Financial counsellors report that some of their clients use BNPL to buy supermarket gift cards, which they then use to purchase groceries. At least one Australian BNPL service can be used to pay bills for utilities, such as gas or electricity.

Proponents of BNPL say that the product generates higher sales for retailers, while helping consumers to 'manage their spending responsibly'. The industry peak body says that 'the BNPL payments model provides consumers with several key benefits, including consumption smoothing, budgeting support, [and] a convenient lower cost alternative to traditional credit…' BNPL uses algorithms to approve or decline a consumer's application – we don't know exactly what these algorithms do, but according to the peak body, they 'assess a variety of structured and unstructured data collected from both traditional sources (such as bank transaction history and tax returns) and new sources (which may include location data, phone and social media usage data, browsing history, utility bills, and other payment schedules)'. By integrating into the online checkouts of thousands of retailers, BNPL providers offer instant, seamless access to very small amounts of credit. Although they can charge late fees for non-payment, they are typically free for consumers, as long as they repay on time. They derive most of their profits from merchant fees, which can be quite high – up to six per cent of the cost of each transaction.

BNPL companies have taken market share away from payday lenders and mainstream banks. They market themselves as a cheap and safe alternative to traditional credit, and this sales pitch has been hugely successful, especially among young consumers. Yet there are growing concerns that like traditional credit, BNPL can encourage excessive spending and lead to unmanageable debt. Consumer advocates say that the product is causing significant harm, particularly among vulnerable groups.

Currently, Australian BNPL providers operate outside the scope of consumer credit laws. The Australian Finance Industry Association (‘AFIA’) has developed a voluntary Code of Practice for BNPL providers. Yet BNPL is not currently subject to the *National Consumer Credit Protection Act*. This means that unlike banks and payday lenders, businesses offering BNPL are not required to comply with the *NCCPA*’s ‘responsible lending obligations’. In other words, they don’t have to ask consumers for things like payslips or bank statements, before offering them BNPL.

Australia is at the forefront of global efforts to regulate BNPL. In November 2022, the Australian Government set out three potential models for regulating BNPL: the first, an enhanced form of self-regulation, with an updated industry code; the second, full application of the *NCCPA*, including the responsible lending obligations; and the third, a ‘modified’ application of the *NCCPA*, with unique responsible lending obligations ‘scaled to the level of risk’ posed by BNPL products.

Consumer advocates lobbied strongly for full application of the *NCCPA* saying ‘it’s credit, and it should be regulated like other forms of credit’. The industry said that it wouldn’t be viable if it had to comply with the full responsible lending obligations, because it would be far too costly, given the very low value of most BNPL transactions. Afterpay told a 2018 Senate Inquiry that its average transaction value was $150. It also argued that its product had built-in mechanisms to prevent people from getting into excessive debt. These included a freeze on accounts if someone is late on a single payment; low spending limits, which start off at only a few hundred dollars and increase incrementally with a positive repayment record; and low late fees – these are $10 per missed payment, but can’t exceed a cap of $68 in total for each purchase.

In May 2023, the Government confirmed it would apply a ‘tailored’ or ‘modified’ version of the responsible lending obligations to BNPL. But it still hasn’t published any draft legislation, for reasons that are not entirely clear.

2. Our empirical study

a. The survey

In 2019, we decided to conduct an anonymous online survey of Australian consumers who had used BNPL, payday loans or pawn loans within the previous three years. We sought to gather evidence regarding the ways in which consumers used the products; the extent to which they had used them simultaneously; and the extent to which the products had caused them harm.

We conducted the survey in collaboration with a Sydney-based independent market research company, Pureprofile. Respondents could answer the questions relating to one, two or all three products, depending on how many they had used in the preceding three years. Pureprofile recruited the survey participants from its 'panel' of consumers, who register for the purpose of participating in research studies. The survey launched on 12 December 2019 and closed on 21 February 2020, with 1,472 complete responses.

Overall, 77 per cent of all respondents (1,128 individuals) answered the questions about BNPL. This indicates that BNPL was the most popular of the three products. Of these, 458 individuals had only used BNPL. The others had used BNPL in conjunction with at least one other product – either a payday loan or a pawn loan, or both. To gauge the impact of BNPL on consumers, relative to other products, we compared the responses of these 458 (the 'BNPL only' respondents) with those of the 152 who had only used payday loans, and the 111 who had only used pawn loans.

The respondents were asked to describe the impact the product had had upon their capacity to 'manage their money and spending habits'. You'll see from Table 1 that respondents who had used BNPL were more likely than the users of the other products to say that it had helped them to manage their money. They were less likely to say that BNPL 'made it harder' for them to manage their money. All results here were statistically significant.

You'll see from Table 2 that the users of BNPL were also less likely to say they had experienced financial hardship, or specific harmful impacts, such as falling behind with rental payments, as a result of using the product. Almost 70 per cent said that they hadn't experienced any of the 12 harmful impacts mentioned in our survey – compared with only 29 per cent of payday loan users and 27 per cent of pawn loan users. All these results were statistically significant.

Table 3 shows the responses of the 280 individuals in our sample who had used both BNPL and payday loans, when asked about the impact of each product on their finances. The results with asterisks after them are statistically significant. You'll see that these respondents were somewhat more likely to say that BNPL helped them to manage their money and that their payday loans made it harder.

Table 4 shows the responses of the 98 individuals who had used both BNPL and pawn loans. Here, more emphatically, the respondents were more likely to say that using BNPL helped them to manage their money, and more likely to say that using pawn loans made it harder. All these results were statistically significant.

b. Focus groups

We conducted the focus groups with consumer advocates online, using Zoom, in August and September 2022. We conducted six focus groups involving a total of 36 participants. Most were financial counsellors. There were also consumer law solicitors, policy specialists and staff who worked directly to provide emergency relief to people in financial crisis. Most were drawn from our five formal research partners, under the terms of our Linkage Grant: Consumer Action Law Centre, Financial Counselling Australia, Good Shepherd Australia New Zealand; Mallee Family Care and Westjustice, two organisations based in Victoria.

The advocates said that their clients typically used BNPL not for discretionary purchases but to pay for essentials, such as groceries, medication and children's educational expenses, as well as car repairs, servicing and fuel. They said BNPL was attractive to people on very low incomes with urgent needs because it offered 'instantaneous' access to funds, unlike government emergency payments and the no-interest loans ('NILS loans') offered by community organisations. Several said their clients viewed BNPL as a valuable 'safety net' for use in emergencies. Some said their clients liked the anonymous, automated nature of BNPL, because it meant that they did not have to answer intrusive or embarrassing questions about their finances or their personal lives.

Counterbalancing this, the advocates were unanimous in expressing deep concern at the ease with which their clients could access BNPL debt. Several spoke of clients who had become caught in a 'debt spiral', relying on BNPL to purchase basics, including groceries, because so much of their income was being swallowed up by their existing BNPL repayments. The advocates felt that the AFIA Code – the voluntary industry code – was largely ineffective in protecting such vulnerable consumers from harm.

Yet even so, some advocates expressed the view that BNPL was less harmful than payday loans or credit cards, because of its much lower cost and the low spending limits built into many BNPL products. Some suggested that if their low income clients could not access BNPL, they would be forced to use payday loans instead. They felt that the fees charged by payday lenders were 'far worse' than those charged by BNPL providers.

3. Implications for the Government's reform agenda

Overall, our study found that while BNPL carries risks, particularly for vulnerable groups, it also helps some low income consumers to meet urgent expenses in a flexible and cost-effective way. It does this in a way that is less likely to cause harm than pawn loans and payday loans – according to the consumers we surveyed. It also has some advantages over payday loans and credit cards, according to the consumer advocates in our focus groups. These include the relatively low fees charged to consumers who miss a payment, and the fact that accounts are frozen if a payment is missed, preventing any further purchases. As a highly accessible form of credit, BNPL has particular benefits for consumers on very low incomes who use it as a safety net or emergency fund. Without BNPL, some of these consumers would have no option other than a very expensive payday loan.

On this basis, we conclude that the Government's preferred approach – applying a modified form of the responsible lending obligations – will reduce the risks posed by BNPL. At the same time, it will preserve access to BNPL for lower-income earners, and reduce the risk that they will resort to other more expensive and harmful forms of credit.

But before we congratulate the Government too much, it's important to remember that it still hasn't released draft legislation, nine months after announcing its preferred model. I'm sure it's being lobbied furiously by industry bodies and consumer groups but I don't think that's the only reason. The 2022 discussion paper was vague about what the 'tailored' responsible lending obligations might look like – and I suspect the Government has had some difficulty drafting them. This may be because the BNPL model – with its reliance on algorithms – is so different from the sort of lending that has been regulated by the *NCCPA* up until now. And in this sense, I think BNPL is genuinely disruptive – not only to the market, but to the way in which we currently regulate and, indeed, define consumer credit.