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An Investigation on Klarna Financial Technology Fintech

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Abstract: Studying the organisational structure is always essential in understanding how businesses operate both externally and internally. In that sense, by researching on the structure of business oragnisations, it is predicted for the researcher to obtain some valuable results. This approach can be seen as using a case study method in which detailed investigations are conducted into the organisation structure, which yield fruitful observations. The current study delves into Klarna, a prominent Swedish Fintech company, focusing on its history, corporate governance evolution, impact on the financial and business sectors, technological aspects, and the challenges it faces. Klarna has revolutionized the financial industry with its Buy-Now-Pay-Later (BNPL) services, but it also confronts corporate governance, technological, regulatory, and financial challenges. This analysis underscores the significance of Klarna's transformation in the financial and business sectors while acknowledging the hurdles it must overcome to ensure its sustained growth. Klarna needs to embraces these chanllenges to move forward to future prospects.

Keywords: Corporate Governance, Technological Challenges, Klarna Financial Technology

1. Introduction

Klarna, a financial technology company of Swedish origin, has emerged as one of the most prosperous entities in the fintech industry. The aforementioned company, established in the year 2005, holds a dominant position in the industry as a provider of financial services pertaining to the Buy-Now-Pay-Later model. Its operations span over more than seven international regions. The company has employed digital financial technology to provide consumers with direct, post-delivery payment options as well as installment payment plans, thereby enabling them to engage in shopping activities and settle payments according to their individual preferences [1]. This essay undertakes a critical analysis of Klarna, with a specific focus on three main issues. Section one of this paper examines the historical background of Klarna and the progression of its corporate governance. In contrast, section two delves into the transformative impact of Klarna on the financial and commercial sectors. Section three of the paper examines the technologies employed by Klarna, as well as the associated technological, economic, and regulatory issues that the company faces. This section also analyses the potential impact of these challenges on Klarna's future development.

2. Klarna's evolution

2.1. A brief history of Klarna

Klarna, a financial technology company, was established in the year 2005 in the city of Stockholm, located in the country of Sweden. The company's inception was establishing itself as a financial technology (Fintech) entity that provided online payment solutions to consumers seeking deferred payment options through the Buy Now, Pay Later framework. Following its initial introduction in Sweden, Klarna swiftly expanded its operations to encompass the neighbouring countries of Norway, Denmark, and Finland between the timeframe of 2006 to 2008. With the increasing influx of investors, Klarna successfully extended its operations to additional European markets and introduced the Klarna Checkout in 2012 [2]. The implementation of this Checkout platform has resulted in a significant transformation of Klarna, expanding its capabilities beyond a mere payment option to a multifaceted platform. This evolution has empowered clients with a range of payment choices, including immediate payment, post-delivery payment, and deferred payment alternatives. Globally, the Klarna checkout platform has garnered subscriptions from more than 400,000 merchants and boasts a customer base of over 140 million individuals. Furthermore, the platform facilitates a substantial volume of daily transactions, surpassing 2 million in number [3].

Klarna changes in corporate governance

2.2. First-line defence: board of directors

The Board of Directors serves as the primary safeguard in the realm of Corporate Governance within Klarna. The initial advisory board was officially established in the year 2007. At the outset, the Board consisted of three executive members, who were the founders, as well as investors. The inclusion of a board to provide oversight of corporate governance is a fundamental tenet of the OECD's corporate governance guidelines. The fourth principle of the Organisation for Economic Co-operation and Development (OECD) emphasises the importance of establishing a board of directors to oversee the performance of managers and guarantee that the firm achieves satisfactory returns for its shareholders [4]. Additionally, as a primary safeguard in the realm of corporate governance, it is imperative for the Board to guarantee the corporation's adherence to relevant legislation and to ensure that the organisation operates in the best interests of all stakeholders [4].

In response to Klarna's expansion into worldwide markets, it became imperative to enhance the diversity of expertise within the board of directors. This was done to effectively manage corporate governance and maintain risk exposure within acceptable thresholds [5]. The independence of Klarna's Board is attributed to the fact that the company's CEO is solely responsible for operational activities. The implementation of an independent, diversified, and smaller-sized Board has been recognised as a viable corporate governance strategy for mitigating agency expenses [6]. The compact composition of the board, consisting of seven members, facilitates the decision-making process. On the contrary, an autonomous committee suggests that it can address the predicament faced by the organisation by assessing whether the risks assumed by the Chief Executive Officer (CEO) fall within acceptable thresholds.

2.3. CEO-duality problem

Nevertheless, the presence of a Chief Executive Officer (CEO) who concurrently holds a position on the Board of Directors has been identified as a potential obstacle to maintaining board independence, particularly within the context of Fintech companies. This issue is sometimes referred to as the CEO-duality problem [10]. Two of the founders have been subsequently removed from the Board, leaving only the CEO as the sole remaining founder and board member. The

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presence of Sebastian Siemiatkowski in the roles of founder, CEO, and board member is likely to give rise to agency concerns within the corporate governance structure of Klarna. The underlying principle of the agency theory posits that the presence of a Chief Executive Officer (CEO) on the Board of Directors may potentially compromise the autonomy of the Board and diminish the effectiveness of corporate governance systems [7]. Nevertheless, other studies [8] have presented contradictory findings about the impact of CEO duality on independence. According to Najaf et al., an increase in the number of independent directors has the potential to address issues pertaining to CEO quality by means of enhanced supervision. According to the findings of Nguyen et al., enterprises characterised by significant shareholding are not influenced by CEO duality, as the presence of such shareholders grants them greater control over the organisation. Therefore, it was crucial for Klarna to implement modifications aimed at increasing the number of independent members on the Board and granting shareholders the authority to elect board members. These measures were necessary to mitigate the issue of CEO duality and bolster the autonomy of the Board, ultimately resulting in an enhancement of their corporate governance practises.

Second-line defence (Risk control). Klarna additionally possesses an additional layer of corporate governance procedures that bear the responsibility for risk control, compliance, and assurance. The second line of defence within Klarna is responsible for managing risk through the establishment of risk frameworks, offering risk guidance to the Board, and ensuring compliance with external norms and regulations. The risk control team is responsible for conducting risk reporting and providing training to both management and staff [1]. As Klarna develops its activities internationally, it encounters varying rules and regulations. Therefore, the implementation of a second line of defence is crucial in order to guarantee Klarna's compliance and mitigate any potential sustainability risks that may arise from its operations in other regions. Klarna also releases autonomous corporate governance reports that illustrate exemplary corporate governance practises. Research findings suggest that companies that possess superior corporate governance practises tend to exhibit higher levels of transparency and reveal a greater amount of information through their reporting mechanisms [9]. Klarna's commitment to transparency in its reporting practises has played a vital role in attracting substantial investments from various global stakeholders. This influx of capital has enabled Klarna to successfully get a bank licence in 2017, leading to its transformation into Klarna Bank AB [2]. According to the criteria set forth by the Organisation for Economic Co-operation and Development (OECD) in 2008, the presence of an anti-misconduct strategy is indicative of enhanced governance. Therefore, the presence of a secondary defensive system within Klarna to ensure adherence to the risk mechanism is indicative of enhanced governance and plays a crucial role in minimising agency issues.

2.4. Internal audit

Klarna has implemented the third line of defence strategy by engaging external auditors to perform internal audits. Throughout its history, Klarna has engaged the services of prominent auditing firms, including Deloitte and Ernst & Young, with the latter currently serving as the internal auditor [10]. The provision of risk management services is a key function of internal audit, which is achieved through conducting regular assessments of governance structures and control systems [11]. The third-line defence paradigm is widely acknowledged within the financial industry as a robust approach to enhancing risk management in corporate governance [12]. Nevertheless, the concept has garnered substantial criticism for being primarily a compliance technique, with arguments suggesting that further measures are necessary to effectively mitigate the potential for financial malfeasance [13]. However, according to Eulerich, it is contended that if the internal audit function maintains its independence and the Board acts promptly on suggestions, it has the potential to assist financial services in risk mitigation. Nevertheless, emerging financial technology companies like

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Klarna encounter various challenges that might potentially undermine their operations. These challenges include the danger of fraudulent activities, compliance with anti-money laundering regulations, safeguarding against cyber threats, and ensuring data privacy. Consequently, it raises the inquiry as to whether regulatory oversight in the form of external audits is necessary to mitigate these risks [14]. The user's text is not sufficient to be rewritten in an academic manner. In July 2021, Klarna underwent an investigation by the Swedish authorities for a customer data breach, when customers were granted temporary access to one another's information [15]. This observation suggests that despite the implementation of three-tiered defences for corporate governance, Klarna, similar to other Fintech firms, confronts notable risks and may have difficulties in ensuring effective governance.

3. Klarnas financial services offering and how Klarna has transformed the financial and business sectors

Klarna provides three distinct categories of financial services, namely direct payment, pay after delivery, and instalment plans. In the context of online transactions, consumers utilise the Klarna checkout system, which is seamlessly incorporated into e-commerce platforms, to facilitate direct payment. This system is preferred due to its ability to take a wide range of prominent credit and debit cards. Klarna offers a pay-after-delivery service that enables online customers to engage in a try-before-you-buy approach when making purchases through e-commerce platforms linked with Klarna. This service allows customers to defer payment until the delivery of their purchased items. Nevertheless, the most noteworthy financial offerings provided by the company are to their Buy Now, Pay Later (BNPL) services. These services afford clients the option to either settle their purchase in four instalments without incurring any interest, or alternatively, pay the full amount within a 30-day timeframe. Consumers are required to repay the loan within the specified time period, failure to do so will result in the imposition of late fees amounting to a maximum of $7. Individuals who fail to make timely payments are then referred to a debt collection agency [3]. Similar to other Buy Now Pay Later (BNPL) platforms, Klarna's business strategy is based on two primary sources of revenue: merchant fees and late payment costs imposed on users. Merchants are subject to a set-up cost, a monthly fee, and a transaction-based percentage charge by Klarna. The payment methods of pay after delivery and BNPY do not impose any charges to customers, save in cases of late payments [16].

Klarna possesses a distinctive value proposition, as it provides payment solutions to both customers and merchants. This has resulted in its emergence as a prominent worldwide Fintech entity, operating across more than 40 markets and attaining a valuation of $45.6 billion [17]. The available data suggests that Buy Now Pay Later (BNPL) services are experiencing a rise in popularity on a global scale [18]. This trend indicates that Klarna, as a prominent player in the sector, is expected to witness further expansion due to its distinct value proposition.

How Klarna has transformed the financial sector

To begin with, the services provided by Klarna have caused significant disruption within the credit card finance sector. Alcazar and Bradford assert that BNPL financial services are strategically focusing on young consumers who face financial underservice, particularly individuals with limited credit limits. The credit limit associated with the Buy Now Pay Later (BNPL) option is comparatively lower when compared to that of a conventional credit card. Additionally, the utilisation of BNPL services necessitates only a light credit check for eligibility assessment. The Buy Now Pay Later (BNPL) model has caused significant disruption within the banking system by presenting itself as a viable alternative to credit cards for making payments [19]. Due to this rationale, the financial services sector has been transformed by Buy Now Pay Later (BNPL) firms such as Klarna, as they have facilitated the convenient access to credit services for the youth

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demographic, circumventing the stringent creditworthiness restrictions typically connected with conventional credit card offerings. One example is Klarna, which provides Buy Now Pay Later (BNPL) services for a minimum cost of $10, without the typical credit underwriting prerequisites. Moreover, Klarna only performs a mild check during the point-of-sale transaction. During the checkout process, the user is provided with a virtual credit card that can be utilised in the same manner as a conventional credit card [3]. This phenomenon mitigates the necessity for individuals to possess conventional credit cards, as the latter incurs elevated operational expenses and entails a lengthier application process. Alcazar and Bradford provide a succinct overview of the reasons for the widespread adoption of Buy Now Pay Later (BNPL) products. They assert that the appeal of BNPL lies in its streamlined approval process at the point of sale, which stands in contrast to the conventional credit card system that necessitates a credit score history for approval.

Klarna has also revolutionised the conventional finance industry by enabling users to obtain unsecured loans without incurring any interest. One example is Klarna's Pay-in-4 plan, which enables customers to engage in credit-based shopping by initially paying only the first instalment and thereafter settling the remaining three instalments at a later time. The Pay-in-30 plan additionally affords buyers the opportunity to defer payment until after they have received their interest-free merchandise. In the event that clients are able to fulfil their repayment obligations within the predetermined timeframe, no costs for payback will be incurred [17]. In contrast to conventional credit loans provided by financial institutions, customers are subjected to stringent evaluations to ascertain their repayment capacity. Furthermore, it should be noted that the acquisition of such loans incurs both interest and fees [16]. Klarna has successfully onboarded a substantial customer base of over 147 million individuals, facilitating about 2 million transactions on a daily basis [3]. This noteworthy achievement underscores Klarna's significant impact on the conventional financial industry, as it continues to revolutionise the sector. In addition, it is worth noting that Klarna's Buy Now Pay Later (BNPL) services are accessible in prominent international countries, including Sweden, the United Kingdom, the United States, Australia, Finland, Norway, and Denmark [3]. This widespread availability further underscores Klarna's potential to significantly impact the worldwide financial services sector.

How Klarna has transformed the business sector

The services provided by Klarna have also had a transformative impact on the business sector, enabling a daily volume of over 2 million transactions involving direct payment, payment after delivery, and payment by instalments. Klarna facilitates the inclusion of various sorts of merchants into its platform, assuming responsibility for paying the full amount to these merchants. Subsequently, Klarna proceeds to collect the installment payments from customers. Merchants can derive advantages from this phenomenon in terms of augmenting order size and enhancing conversion rates. The substantial number of over 400,000 merchants who have registered for Klarna checkout serves as a strong indication that Klarna has the potential to significantly impact both physical and online business operations in a transformative manner. Nevertheless, the growing influx of users enrolling in Klarna BNPL has prompted concerns regarding its potential to contribute to a consumer debt problem, particularly among young people [16].

Additionally, Klarna's innovative concept of the "Super App" has the potential to revolutionise the business industry by providing consumers with a comprehensive shopping solution. The Super App provides users with the opportunity to utilise the Buy Now, Pay Later (BNPL) payment option. Additionally, through the utilisation of the app, customers have the ability to search for products from various merchants, regardless of whether they are subscribed or not. Furthermore, users can conveniently track pricing fluctuations and complete transactions within the app [17]. According to the E-Market research, the Klarna super App, which integrates shopping assistance and payment administration, has the potential to significantly impact the e-commerce industry [20]. According to

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a recent poll, the year 2021 seen a significant number of downloads of the Klarna app, surpassing 45 million. Additionally, Klarna shops across the globe experienced a substantial influx of clicks through the Klarna app, exceeding 301 million [17]. Considering the uncertain sustainability of Buy Now Pay Later (BNPL) services and the impending competition from other established BNPL providers, it is probable that the Super App will assist Klarna in diversifying its range of services and developing a novel revenue model.

To provide the BNPL services, Klarna's three leading technologies are as follows:

The payment platform application serves as the primary technological infrastructure that underpins Klarna's business strategy. Klarna operates a dual-platform system, catering to both consumers and merchants. Merchants have the option to integrate Klarna Payments into their checkout process, enabling them to offer Klarna as a payment method to their customers. The Klarna payment platform affords customers the option to select Klarna payment at the time of checkout, enabling them to either make an immediate payment or defer it for a later date. The Klarna application has been adopted by numerous prominent e-commerce platforms, with an estimated user base of around 140 million individuals and a merchant count of 400,000. Moreover, Klarna handles a substantial volume of transactions, processing over 2 million on a daily basis [3].

Mobile computing technology refers to the field of study and development that focuses on the design, implementation, and utilisation of computing devices that are portable and may be used.

Klarna has incorporated mobile computing technology into its operations and has successfully produced an application for Android and iOS smartphone platforms. The Klarna mobile application can be obtained by users through the App Store or Google Play store, or by scanning a QR code to install it on their mobile device. Users have the ability to utilise the application in order to make purchases from any electronic commerce platform that is connected to Klarna [3].

Cloud computing technology refers to the utilisation of remote servers hosted on the internet to store, manage, and process data, rather than relying on local servers or personal computers. This Klarna leverages cloud computing technologies to facilitate its services and drive its corporate growth. In December 2019, Klarna transitioned its operations to Amazon Web Services (AWS), a prominent provider of private cloud services [21]. Fintech organisations have extensively embraced cloud computing technologies, which offer several advantages in terms of flexibility, scalability, security, privacy, and innovation [22]. Klarna leverages private cloud technologies to effectively expand its payment services while upholding the requisite level of security, a notable obstacle faced by Fintech enterprises [23].

4. Challenges Klarna is facing

The present discourse centers around the various technological difficulties that are encountered in contemporary society. Financial technology (FinTech) organizations encounter several technological obstacles in relation to cybersecurity, including but not limited to data breaches, malware attacks, cyber fraud, denial of service incidents, and phishing attempts [24]. Klarna accumulates substantial quantities of personal data from its clients. This presents the issue of data security vulnerabilities. In the year 2020, the authorities in the United Kingdom initiated an investigation against Klarna following the company's act of sending marketing emails to individuals who were not users of their services [14]. On May 27, 2021, Klarna experienced a temporary shutdown of their application due to a data breach incident, resulting in the unintended exposure of users' personal information [25]. Data security breach occurrences pose a significant threat to the development of Klarna as they have the potential to damage its brand, deter customers, and subject the company to legal proceedings and regulatory attention.

One further technological problem pertains to the phenomenon of reduced obstacles to entry resulting from technological advancements, which in turn attracts conventional enterprises to

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introduce their own models of Buy Now Pay Later (BNPL) services. As an illustration, financial institutions such as Citi introduced their own Buy Now Pay Later (BNPL) services in Australia in October 2021, while Scotiabank debuted a similar offering in Canada in August 2021. Additionally, Visa has expressed intentions to introduce its own BNPL product in the United States [26]. The utilization of cloud computing technologies allows incumbents to forgo the necessity of maintaining their own platforms. Consequently, the potential impact of competition on Klarna's growth and market share may be adverse. In November 2021, Klarna introduced a comprehensive application that integrated several functionalities, with the aim of maintaining a competitive edge [17]. The present discourse revolves around the regulatory issues that are encountered in several domains. Klarna and other Buy Now Pay Later (BNPL) companies have been functioning within a regulatory framework that is currently characterized by certain limitations. Nevertheless, regulatory authorities have raised concerns regarding the role of Buy Now Pay Later (BNPL) services in contributing to the escalation of consumer debt. One of the primary issues pertains to the inadequate implementation of comprehensive affordability assessments by BNPL services, resulting in consumers accruing debts from several lenders due to excessive spending on non-essential items [29]. Several countries have previously implemented regulations aimed at strengthening consumer protection in the context of Buy Now Pay Later (BNPL) services. In Sweden, the government has implemented legislation stipulating that Buy Now, Pay Later (BNPL) services should not be presented as the initial choice during the checkout process [27]. Australia has successfully established a code of conduct for Buy Now Pay Later (BNPL) companies [27]. Similarly, in the United Kingdom, Klarna faced rebuke from the advertising regulator due to influencer marketing articles that portrayed Buy Now Pay Later (BNPL) as a means to enhance one's mood. The Consumer Financial Protection in the United States expresses concern with the classification of Buy Now Pay Later (BNPL) services as loans, advocating for them to be granted equivalent safeguards as credit cards and other types of consumer credit [27]. Nevertheless, it has been argued by many experts that attempts to regulate Fintech are likely to be ineffective due to their operation outside the existing regulatory framework [28]. Nevertheless, certain jurisdictions, like Australia, have broadened their regulatory frameworks to encompass Buy Now Pay Later (BNPL) services [29]. Consequently, Klarna may encounter substantial obstacles in terms of compliance, potentially impacting its growth trajectory. For example, the Bank of England and the US Federal Reserve have already implemented increases in interest rates, while it is anticipated that the European Central Bank will also undertake a similar action within the current year [30]. According to Ramnarayan, Klarna's business strategy is highly dependent on a low-interest rate environment. Therefore, alterations in legislation aimed at increasing interest rates will have an impact on Klarna's profit margins, which are now under pressure.

The topic under consideration pertains to the various difficulties encountered in the realm of finance.

The primary financial obstacle confronting Klarna is to the potential risk of bad debt, which arises when consumers are unable to fulfill their obligations in servicing their Buy Now Pay Later (BNPL) model debt. In the year 2020, Klarna allocated around $25 million for the purpose of funding delinquent debts [31]. According to the survey conducted by Kwok and Larsen, approximately 33% of users of Buy Now Pay Later (BNPL) services fail to make one or more payments. According to the survey conducted by Bain & Company in 2021, it was found that 6% of the surveyed consumers reported having outstanding debt with several Buy Now Pay Later (BNPL) providers. Additionally, 10% of the respondents acknowledged utilizing BNPL services after reaching the maximum limit on their credit cards. This suggests that an increase in the number of defaulters may pose financial issues that could impact the company's growth and profitability.

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Additionally, the financial ramifications for Klarna arise from the emergence of rules aimed at controlling the Buy Now Pay Later (BNPL) industry. Alcazar and Bradford conducted a survey which revealed that several regulatory bodies are currently exploring strategies to safeguard consumers through the implementation of restrictions on fees, late payment penalties, and other transaction-related charges associated with Buy Now Pay Later (BNPL) services. Therefore, the presence of regulatory obstacles and the potential for substantial default losses indicate that Klarna's financial prospects are uncertain.

5. Conclusion

In summary, Klarna persistently disrupts the financial and commercial sector through the strategic utilization of financial technologies, thereby establishing itself as a prominent market leader in providing Buy Now Pay Later (BNPL) financial services. In light of the imperative of sustainability, Klarna has undertaken modifications to its corporate governance framework in order to align with the demands posed by its expanding business operations. The organization presently employs a corporate governance model characterized by a three-line defense approach. However, it continues to encounter the persistent issue of CEO duality and the need for enhanced board independence. Klarna's financial services, namely pay-after-delivery and pay-later, have significantly impacted the financial industry, specifically by introducing disruption to the credit card and traditional banking industries. Additionally, Klarna's agile services have also made an impact on the business sector. Nevertheless, Klarna's development may encounter some impediments, such as data security concerns and regulatory and financial issues, which are considered significant technological obstacles.

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