



MACQUARIE University

AFIN8014: FINTECH AND INNOVATION **THE BUSINESS REPORT FOR ZIP COMPANY**

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Executive Summary

Over the past few years, Buy Now, Pay Later (BNPL) has been gaining a larger portion of the digital payments market, with varying market value estimates, however placing it already in the hundreds of billions. This report addresses the growth of one such BNPL digital retail finance and payment tool- Zip and its impact on the digital payments landscape. The report provides insights into Zip's key market trends and consumer behaviour, the factors driving the popularity of this payment option, the technology used by it, the technology barrier faced by it and its potential for future growth.

The report also outlines the operational and financial risks associated with Zip, laws and regulations governing it, competition faced by Zip and the main advantages it has over the other BNPL services in the market.

Lastly, we recommend that investing in Zip during this period is not advisable, as Australian law for BNPL services become more stringent and Zip's international expansion during pandemic resulted in loss. However, Zip's strong customer base and competitive position in the market make it an attractive target for horizontal acquisition.

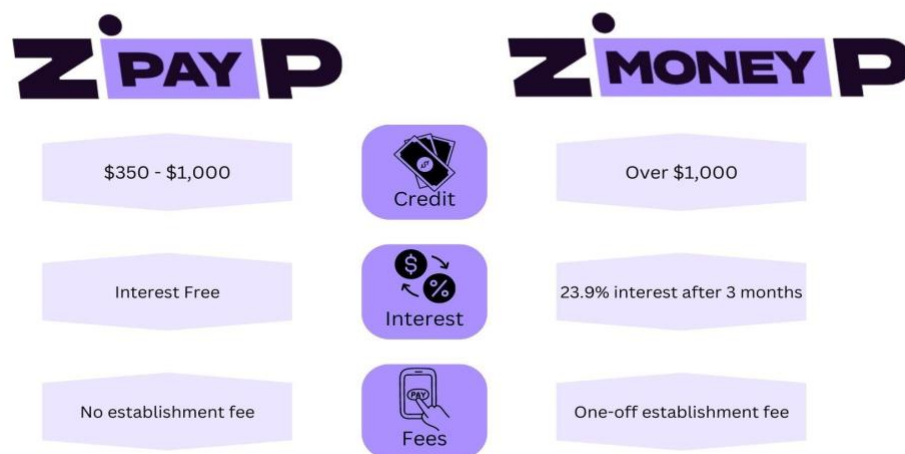
1. Zip

Zip was founded in 2013 in Australia and offers a Buy Now, Pay Later (BNPL) service (Zip, 2023a) and is one of the leading providers in the BNPL market (Clarke & Murgia, 2022). They were also ranked #7 on Deloitte's Technology Fast 500 APAC- a list of the fastest-growing technology companies in the Asia-Pacific region (Deloitte, 2021). In addition to Australia, they also operate in New Zealand and the US.

1.1. Zip Pay and Zip Money: individual customers

Figure 1:

Difference between Zip Pay and Zip Money with regards to credit, interest and fees



Note. This figure shows the differences between the two offerings that Zip provides to their customers and the differences for credit available to the customer, interest rates and fees.

Adapted from “How does Zip Pay and Zip Money work?” by Zip, 2023,

<https://zip.co/au/how-zip-works>

As seen in Figure 1, they have two offerings, Zip Pay and Zip Money depending on the customer's credit needs, which both charge a \$7.95 monthly account fee. For both Zip Pay and Zip Money, individual customers can make purchases on credit in over 40000+ retail stores or online, and pay back in instalments. They offer a flexible repayment schedule where the customer can choose the period from weekly to monthly.

1.2. Zip Business

Zip collaborates with businesses so that their customers can accept their payments. They charge one fee per transaction, but do not require businesses to do a lock-in contract or pay a setup fee (Zip, 2023a).

2. Target market

2.1 Technology

Figure 2:

Customer Shopping Journey and app features from pre purchase to post purchase



Note. This figure shows the Zip app’s features during pre-purchase, purchase and post-purchase interaction from the customers side. The figure is presented to show how Zip engages customers at every level of the customer journey. Adapted from “How does Zip Pay and Zip Money work?” by Zip, 2023, <https://zip.co/au/how-zip-works>

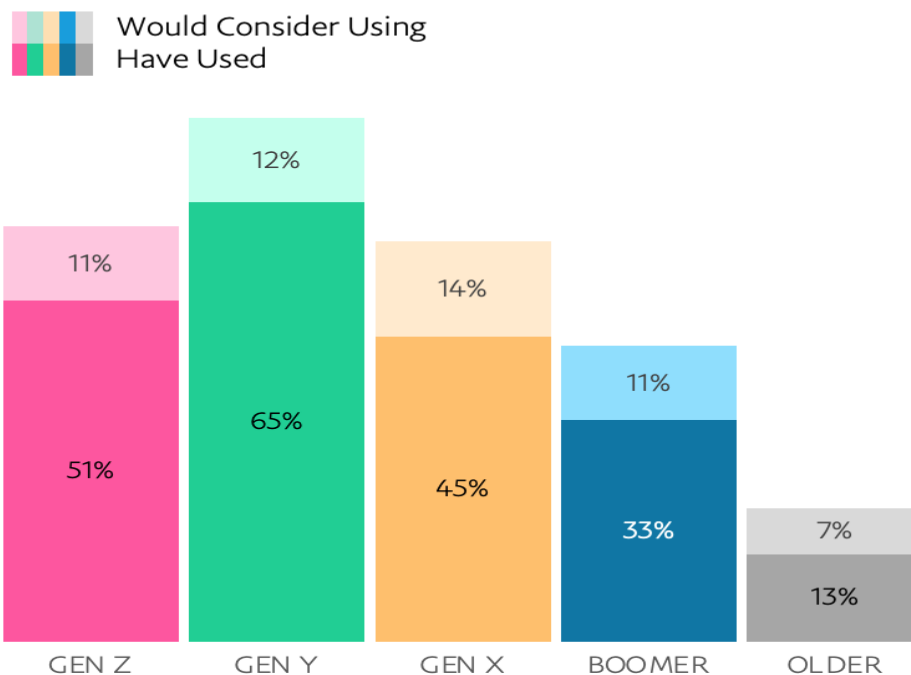
Zip is more than just a credit payment option, their app offers their customers an integrated shopping platform that engages and increases the customer experiences during the entire purchasing process as seen in Figure 2. This concept of a multi-purpose integrated app is also known as a super app, which has become increasingly popular with 66% of Australian consumers being interested in using one in 2022 (Pymnts).

2.2. Age Group

Figure 3:

Paypal 2021 - BNPL Consumer Adoption for customers by Age Generation in Australia

BNPL Consumer Adoption by Age (Australians 18+ who shop online)



Note. The percentage of consumers from each generation using BNPL services. Each age group in the stacked bar graph shows percentage that have used and percentage that would consider using BNPL services. From: PayPal. (2021, August). *eCommerce Trends Report 2021*. <https://www.paypalobjects.com/marketing/web/au/paypal-2021-e-commerce-trends.pdf>

As shown in figure 3, BNPL services are more common amongst young people according to research done by PayPal in Australia (2021). The report also showed that retailers which offered BNPL services increased customer acquisition and customer experience particularly amongst the younger customers.

This makes sense considering younger people in general have a lower income due to having spent less time in the labour force and are thereby in need of using BNPL services. Beyond just credit payments, young people have higher expectations on technology and appreciate the convenience of an integrated shopping platform which Zip's app provides. However it is not just young people that find convenience important, a total of 53% of Australians consider ease of use being an important aspect of BNPL (Paypal, 2021).

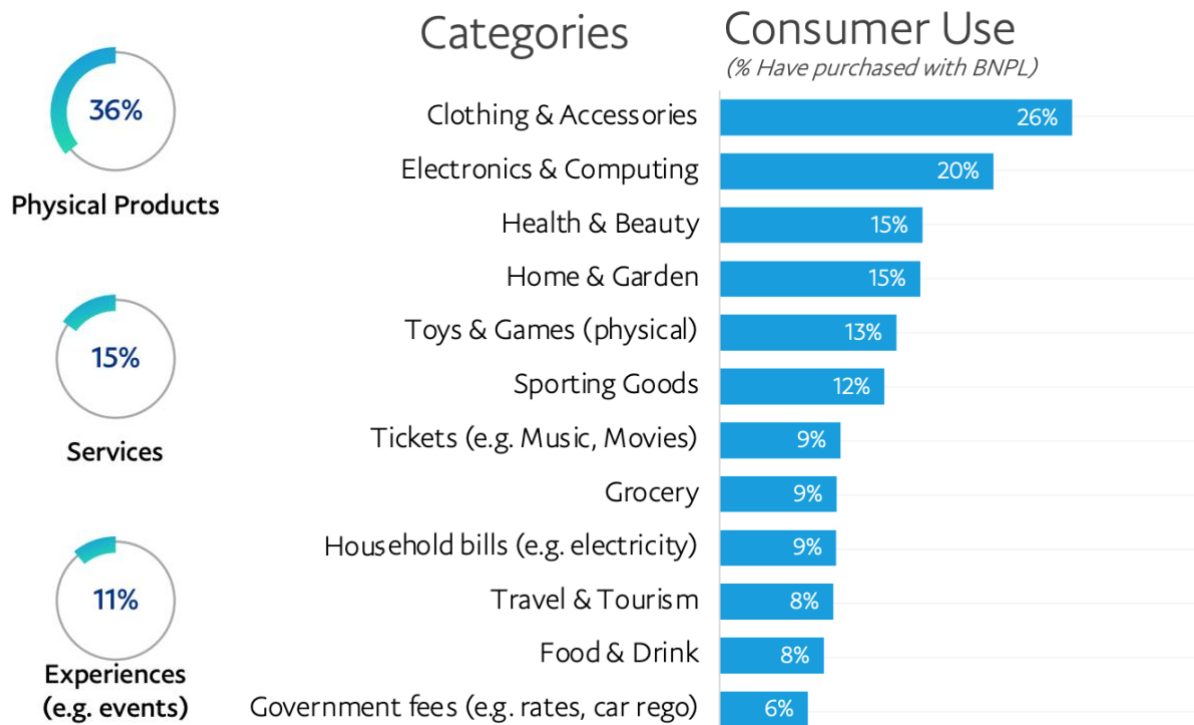
2.3. Income Level

Considering that BNPL services offer more than just the option to buy on credit, their service is used fairly evenly across income levels (Clarke & Murgia, 2022). However, the credit service option is more popular amongst customers with a lower credit score (Clarke & Murgia, 2022) but is currently seeing an increase across higher-credit customers (McKinsey, 2021). This is aligned with Zip's two offerings, Zip Pay and Zip Money, which distinguishes between lower- and higher-credit customers in order to capture and offer the best solution to both customer segments.

2.4. Spending Habits

Figure 4:

Spending habits of BNPL customers with regards to product category.



Note. This figure shows the BNPL spending habits of Australians with regards to product category which is relevant for marketing purposes. From: PayPal. (2021, August).

eCommerce Trends Report 2021.

<https://www.paypalobjects.com/marketing/web/au/paypal-2021-ecommerce-trends.pdf>

As seen in figure 4, 36% of customers buy physical products, mainly clothing and electronics according to Paypal's report (2021). Understanding the spending habits of individual customers is important for Zip, as it can help them with marketing to attain new customers or rewards to engage existing ones. For example, Zip offers specialised offers with the retailers KMart and Bunnings (Zip, 2023a).

3. Technology

Zip heavily relies on their technology stack both in terms of internal operations and for their BNPL services.

3.1. Technology used by Zip

A. React Native: Zip uses it for its mobile app development which allows it to build cross-platform apps for both iOS and Android using a single codebase (Zip, 2023c). Zip is integrated into mobile React Native apps through:

- **Standard Checkout-** it is mostly homogeneous to traditional integration and has robust features and options for creating and managing orders.
- **Virtual Card Checkout-** it is executed most quickly when standard visa credit cards are accepted. However, identical rails are used in case of standard Visa credit card transactions.

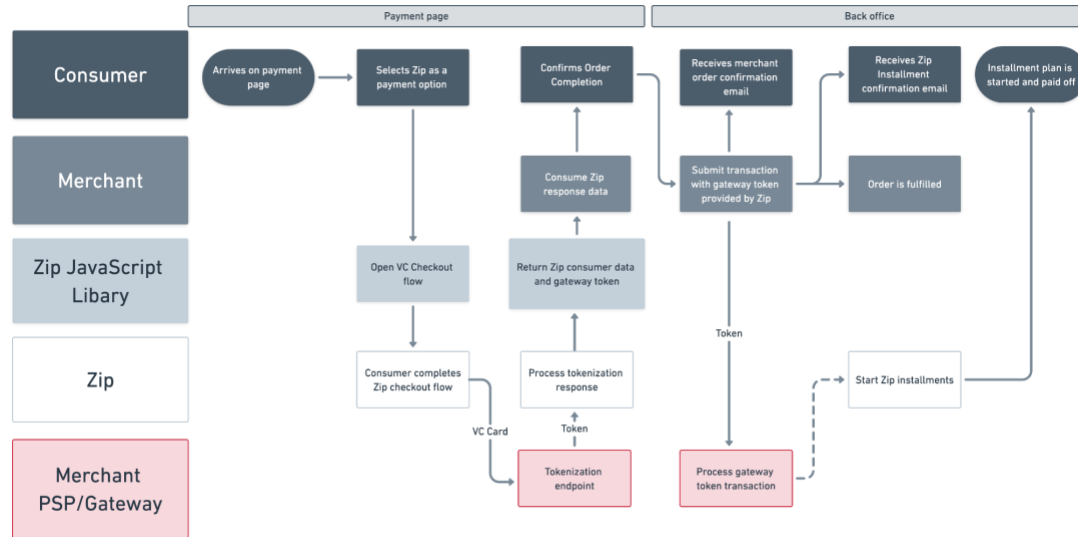
When customers choose Zip as a payment option during the standard checkout process of a merchant's eCommerce site, the merchant retrieves the Merchant Fee for Payment Plan (MFPP) (Zip, 2023e). ACH via Stripe Connect is used for charging fees during Virtual Checkout Integrations. Zip offers standard virtual checkout and express virtual checkout.

B. Twilio: Used for its SMS messaging capabilities, which enables Zip to send notifications and alerts to at least 500,000+ of its customers. (Twilio, n.d).

C. Braintree:

Figure 5

Gateway Tokenisation Workflow



Note. Workflow of Zip’s PSP/Gateway Tokenisation. This figure explains the technology and business processes at different levels.

From: (Zip, 2023d). *Tokenization* <https://docs.us.zip.co/docs/tokenization>.

Figure 5 shows how Zip will tokenise the virtual card on behalf of the merchant, rather than return the card details in plain text (Zip, 2023d). Zip uses Braintree as its payment gateway/tokenisation, which provides secure and reliable processing of credit and debit card payments. Fiserv is also supported by Zip for tokenisation.

D. Snowflake Data Cloud: Used by Zip as its data warehouse, which provides fast and scalable analytics and reporting capabilities and seamless integration with dbt (Dbt, n.d). Zip opted for dbt Cloud which is a cloud-based Integrated Development Environment and are now exploring the potential of macros and incremental models in greater detail. Zip uses Snowplow for its sheer volume of events, Fivetran for third-party data ingestion and Census to enhance the marketing team’s capabilities, getting access to all of their customers’ 360-degree data in Snowflake.

A zip plug-in or cartridge is available for integration into online stores for ecommerce platforms like Shopify, Neto Bigcommerce, Magento 1 & 2, Opencart, Prestashop, and Woocommerce (Zip, 2023b), assisting order management functions like capturing, cancelling, or refunding orders and sharing cart information with Zip to be offered with better credit offers.

Zip also uses widgets to inform customers of what it is and its functionality, designed in a way of better integration with a variety of online platforms on desktop and mobile apps (Zip,2023e). Zip uses 2 kinds of widgets: Zip Widget is used for the identification of early customers when they are browsing and assessing products while shopping and Payment Widget used for customers to visualise the due dates and amount of their payments.

3.2. Technological Barriers

As a financial service company Zip must comply with strict regulations around data privacy and security, and in fact it is an immediate concern to the Consumer Financial Protection Bureau (Lux et al., 2022). BNPL providers as licensees, must meet all obligations of the licence, including the reportable situations regime, ASIC reporting requirements, as well as Credit Act's requirements, such as information sharing. (The Australian Government the Treasury, 2022). Maintaining the security and integrity of customer data requires significant investments in infrastructure and cybersecurity, and any security breaches could damage customer trust and company reputation. Zip operates in a highly regulated industry, and compliance with regulations such as anti-money laundering laws, consumer credit laws, and data privacy laws can be complex and time consuming. Due to the competitive nature of BNPL fintechs, Zip must continually innovate and improve its products and services to stay ahead of the competition. There is no ongoing effort to overhaul the regulatory framework of payment systems in BNPL which has remained unchanged since the Wallis inquiry of 1997, it is vital to innovate the payment

system in Zip, keeping in mind consumer's convenience as they wield the power of choosing among all the BNPL providers (Hendy, 2022).

4. Risk

Zip (2022) has found that developing a framework for risk tolerance and a business continuity plan are the main initiatives in FY22.

4.1. Operational risk

4.1.1 Expansion risk

Musabegovic et al. (2019) stated that when fintech companies decide to expand globally, the complexity of financial services will enhance due to their creative products and services making operational risks to be more challenging to monitor and control. Based on Zip's annual report (2019), Zip paid \$50 million to purchase PartPay to promote market entry to New Zealand, the UK and South Africa. By the acquisition of QuadPay in the middle of 2020, the company had access to the US retail industry, which is 15 times larger than the Australian market.

Figure 6

Revenue and loss for Zip during 2021 and 2022 financial year

		30 JUNE 2022 \$'000	30 JUNE 2021 RESTATED ² \$'000
Revenue from ordinary activities ¹	Up 57%	620,003	393,919
Loss from ordinary activities after income tax attributable to members	Up 63%	(1,105,093)	(678,148)
Total comprehensive loss attributable to members	Up 46%	(1,015,468)	(697,439)

Note. Table of revenue, loss after income tax and total comprehensive loss for financial year 2021 compared to financial year 2022. From: Zip. (2022). *Annual report 2022*.

https://zipco.colliercreative.com.au/wp-content/uploads/2022/10/ZPC0027-Interactive-AR22_P2a.pdf

Although the rise of the \$150 million capital budget for going global faster-upgraded revenue expectations for Zip by 40% of investors (Eyers, 2020), the company might face execution risk in an emerging industry across multiple overseas countries (Thomson, 2020). Indeed, due to significantly greater bad debts and operational expenses in 2022, Zip had a record loss of \$1 billion (Figure 6) and its lofty valuation plummeted by nearly 95%. In order to minimise cash from its international operations by the end of 2023, Zip shrunk its global markets and concentrated on its primary markets in Australia, New Zealand, and the US.

4.1.2 Cyber risk

According to the Annual Cyber Threat Report (2022), there was a rise in cybercrime reports of around 13% higher than in the last year. Zip recognised that the inherent dependability of data, the possibility of information leakage, and malicious software attacks make cybersecurity extremely susceptible, therefore it implemented a cyber security program to prevent cyber risks. Zip was ranked higher than the worldwide averages for the Financial Services industry with a score ranging from 720 to 760 out of 900 by BitSight (Zip, 2022).

4.2. Financial risk

Figure 7

Financial Performance Report Comparison for the year 2021 and 2022

FOR THE YEAR ENDED 30 JUNE	2022 \$'M	2021 RESTATED* \$'M	MOVEMENT %
Revenue	620.0	393.9	57.4%
Cost of sales ¹	(469.0)	(266.8)	75.8%
Gross profit	151.0	127.1	18.8%
Expenditure	(1,257.8)	(870.9)	44.4%
Loss before income tax	(1,105.4)	(743.4)	48.7%
Gross profit	151.0	127.1	18.8%
Add: Movement in bad debt provision and amortisation of funding costs	52.7	54.4	(3.1%)
Cash Gross Profit	203.7	181.5	12.2%

Note. Table of Financial Performance for Zip, compared between the year 2021 and 2022 and the % difference between the years. The figure is presented to show how Zip's financial performance has been impacted from business decisions. From: Zip. (2022). *Annual report 2022*.

https://zipco.colliercreative.com.au/wp-content/uploads/2022/10/ZPC0027-Interactive-AR22_P2a.pdf

After the record loss of \$1 billion in 2022, Zip's liquidity remains an issue. Figure 7 shows that after divesting businesses to focus on 3 main markets, Zip's revenue increased and interest decreased which offset an upsurge of 0.9% in bad debts.

Furthermore, as Zip grew more conservative in its client acquisition, Zip was able to reduce its bad debts from \$135.2 million to \$79.6 million. However, in early 2023, the company supervised almost \$200 million in cash outflows with only \$78 million in available cash and liquidity (Kretser 2023).

5. Regulation

In Australia, Zip is regulated as a fintech firm primarily by both the Australian Securities and Investments Commission (ASIC) and the Senate Economics Reference Committee. The Australian Finance Industry Association (AFIA) released the Code of Practice in March 2021 to establish basic standards for the BNPL industry that support Zip to evaluate customers' financial backgrounds to minimise risks. Specifically, Zip is required to follow the Code's nine key obligations, which include evaluating whether its services are acceptable for new customers and completing extra inspections for transactions of more than \$2,000 and \$3,000 each with existing clients or new ones respectively (Australian Finance Industry Association, 2021).

Although Australian authorities have not yet issued a complete set of laws for BNPL, they have announced regulation drafts for BNPL companies. According to Tonkin (2022), late 2021 witnessed an upsurge of consumers taking on BNPL debt, therefore, more stringent restrictions should be enacted to legally oblige BNPL firms to minimise harm to those who take on extra credit. ASIC is planning new rules for the BNPL companies, including requiring BNPL's clients to provide income and spending information before giving them credit (Australian Securities and Investments Commission, 2023). In Zip's submission to the government, the company argued that the costs of requiring a thorough check of users' financial information should be spent on more complex financial activities. And products that offer larger lines of credit for longer periods of time are subject to stricter regulation, and a \$5,000 threshold has been proposed by Zip to determine which credit products are bound by stricter obligations (Koob, 2023).

6. Advantages

6.1. Disrupting traditional financial services

Firstly, Zip's advantages come from its BNPL business which differentiates itself from traditional lending and payment companies, while this new industry is rising in the Australian market. According to McKinsey (2021), 30 percent of Australian adults had an account with a BNPL provider, and recent statistics from RBA (2022) showed that 2022 BNPL transaction value is \$16 billion, accounting for 2% credit card purchases. The robust growth of this industry is forecasted to persist, with 20.5% in 2023 and a CAGR of medium-to-long-term growth of 10.9% in 2023-2028 (Researchandmarkets, 2023).

6.2. Future Prospects

Secondly, along with recent development of the BNPL industry, Zip maintained its competitive advantage with a strong customer base, with over 3.2 million customers in 2022 with net growth of around 400,000 (Zip, 2022). Although a recent announcement of business closure in several countries for restructuring (Sharples, 2023), Zip still maintained a solid position in its main markets, which are the US and Australia (Zip, 2022); and expected a positive cash flow in 2024 after years of negative ones (Lee & McKay, 2023).

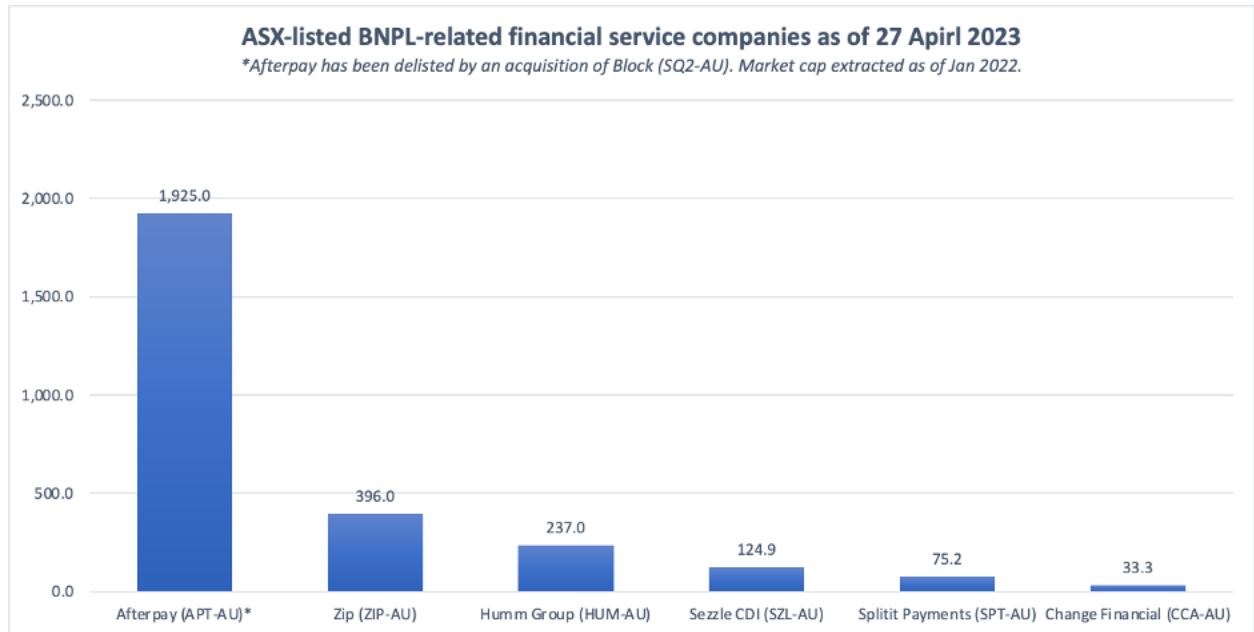
6.3. Partnerships

Thirdly, their current and new partnership with in-store and online merchants developed significantly (Zip, 2022) with a notable cooperation with Qantas last year that supported their category's expansion (Bavin, 2022).

7. Competition

Figure 8

Market capitalisation (\$millions) for Australian BNPL companies 2023



Note. This figure shows the market capitalisation for BNPL companies in Australia. The figure is presented to show how Zip compares to its competitors. From: Factset. (2023b).

Zip comp - Peer group. <https://my.apps.factset.com/navigator/company-security/comps/ZIP-AU>

According to Figure 8, Zip is the second-largest BNPL company in Australia by market capitalization, and Afterpay is identified as its main competitor. The common feature of these two companies is they primarily focus on BNPL services business but there are also some differences, while other small companies spread their focus on additional aspects of payment services (Factset, 2023b). Zip differentiated from Afterpay by providing more flexible payment options, rather than a fortnightly repayment schedule (Crawford & Borman, 2022). Additionally, rather than requiring first-time users to pay first repayment upfront as Afterpay, Zip requested monthly minimum \$40 repayment with no upfront (Knight, 2023). To maintain its competitive position given that many new Fintech companies may penetrate the market,

core market focus, cost-cutting management, and accelerating innovation will be implemented (Allen, 2022). According to their recent annual report, more investment will focus on innovation for merchants such as API (Application Programming Interface) and solutions based on demand; for customer experience such as tokenization and express checkout (Zip, 2022).

8. Impact of COVID-19

8.1. During The Pandemic

Figure 9

Zip's Market Price between January 2020 to April 2023



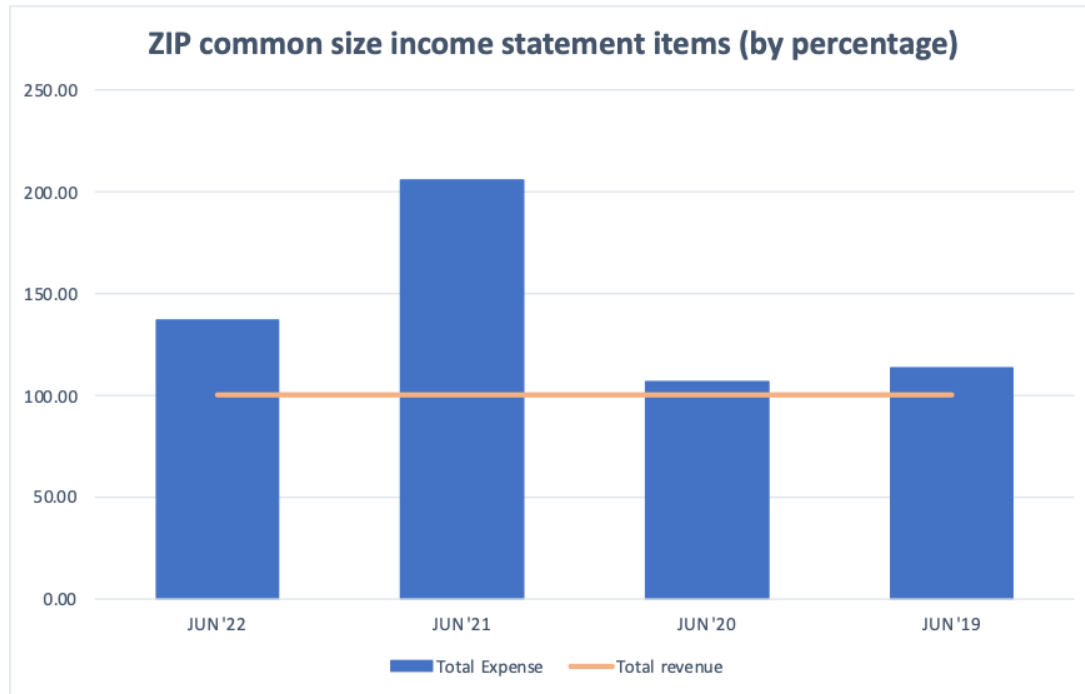
Note. The figure shows the market price for Zip between January 2020 and April 2023. The figure shows how Zip's got affected by the 2020 Covid Pandemic and the period following. From: TradingView. (2023). *Zip Co price chart*.

<https://www.tradingview.com/chart/?symbol=ASX%3AZIP>

COVID-19 brings potential advantages for Zip in 2020, then it severely affects the growth rate of the company during 2021-2022, as reflected in Figure 9.

Figure 10

Zip Common Size Income Statement Items (by percentage) from financial year 2022 to 2019



Note. This figure shows total expenses as a percentage of total revenue for Zip. The figure illustrates how Zip's relative expenses have increased over the past four years. From: Factset. (2023a). *Zip Co common size income statement*.

<https://my.apps.factset.com/navigator/company-security/income-statement/ZIP-AU>

When COVID-19 hit in 2020, the robust increase in demand for online shopping supported Zip in driving its online customer base from 67% to 80% during this time, resulting in larger BNPL transaction volume (Kruger, 2020). Zip took advantage of lower interest rates and online shopping trends to expand its business by providing credit to SMEs with cooperation with eBay (Cotton, 2020); while at the same time announcing its acquisition of BNPL QuadPay for \$400 million to expand the business to the US (Eyers, 2020). These activities are reflected on Zip's income statement, with expense figures accounting for over 200% of its revenue in 2021, according to Figure 10.

8.2. Post Pandemic

However, the situation got worse for Zip in 2021-2022. According to Butler (2021), the new BNPL entrance of PayPal and major banks following BNPL trend created intense competition in this field. Next, the interest rate started rising quickly in 2022 along with the difficult situation for Australian tech companies, which significantly decreased the share price by nearly 90% of Zip in this period as illustrated in Figure XX (Mickleboro, 2023). Then, Zip reported a loss of \$1 billion in 2022 as a result of \$821 million in impairments of goodwill and intangible assets in several countries where Zip ceased operation (Yeates, 2022). Post-Covid high-interest rate and inflation rate are massive obstacles to Zip, as it decreases customer spending globally, put more pressure on Zip's huge debt account, while investors' expectation for Zip positive cash flow in 2024 also poses notable challenges on its operation (Sharples, 2023; Kretser, 2023).

Conclusion

Regarding investing purposes, investors probably should not invest in Zip during this period. The Australian law for BNPL companies is becoming more stringent to ensure the rights and minimise risks for users. Zip took advantage of the Covid 19 epidemic to develop an international expansion in a hurry, leading to a record loss of 1 billion in 2022. Although Zip narrowed the global market and focused on the key markets in Australia, New Zealand and the US, reducing bad debts and liquidity problems is still the company's dilemma. Furthermore, interest rates and inflation rates increased rapidly after the pandemic which negatively influenced Zip operation, reflecting a significant drop in Zip stock prices. The expectation of a positive cash flow in 2024 is still an enormous challenge for Zip.

On the other hand, the M&A trend in the BNPL industry may pave the way for other companies to make an acquisition of Zip. Horizontal acquisition of Zip may be considered by large financial institutions, which is similar to the deal of Square acquiring Afterpay. It is because Zip has a strong customer base and a competitive position in the market with proven technology and innovation. Meanwhile, the acquirer may consider incorporating Zip business into its existing ecosystem and efficiently restructure it to penetrate the BNPL industry more rapidly.

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