Buy Now Pay Later

Contents

Topic of Research

The Rise of Buy Now, Pay Later (BNPL)
Explore the growth of BNPL services and assess their impact on consumer spending habits and credit risk in the fintech sector.

Introduction

The global payment sector is a changing and prone to disruption environment. The market is demanding more flexible, dynamic, and performing payment methods and customers are looking for alternative ways of credit.

In this sense, buy now pay later (also known as BNPL) is one of the new products that gained a lot of force in the previous years and came out as an alternative to credit cards and as a solution for customers that are keen to explore new credit options, especially the under 30.

This study is an overview of as BNPL, consists of an instrument to finance purchases at the point of sale, a relatively new trend in the consumer market that has rapidly gained force in the last 7 to 8 years.

Buy Now Pay Later (BNPL), A Rapidly Growing financing:

BNPL is a short-term finance product that allows customers to purchase in instalments (Blackbullion, 2021) at an agreed payment schedule and generally accruing either no interest or below the market interests, which make them more flexible and especially attractive for consumers that may not be able to get traditional lines of credit. (Congressional Research Service, 2021).

In other words, BNPL is a form of point of sales financing. With BNPL financing, a consumer can purchase an item now and pay for it later on a predetermined payment schedule. While retailers have offered BNPL financing for much of history in the form of instalment plans, it is now often offered online. This modern form has generally been developed by technology focused, nonbank financial companies, also known as financial technology (or “fintech”) companies.

Business Model of BNPL

The 3 core Aspects of the BNPL Model

Average Revenue Per Customer (ARPC):

- ARPC is the average revenue generated from each customer using the BNPL service, including fees and interest.

$$\text{ARPC} = \frac{\text{Total Revenue}}{\text{Number of Active Customers}}$$

Cost Per Customer Acquisition (CPA):

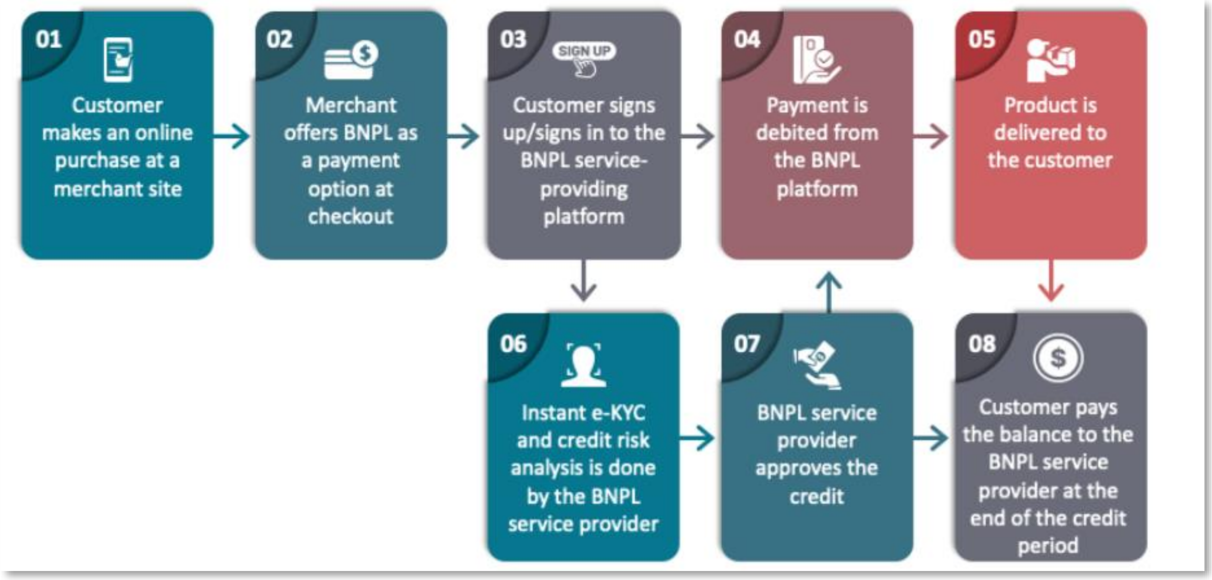
- CPA measures the cost to acquire each new customer, factoring in marketing and onboarding expenses.

$$\text{CPA} = \frac{\text{Total Acquisition Costs}}{\text{Number of New Customers}}$$

Churn Rate:

- Churn rate indicates the percentage of customers who discontinue using the service within a specified period, impacting overall profitability.

Functioning of BNPL



The flowchart in the image outlines the process of a customer making an online purchase using a Buy Now, Pay Later (BNPL) service. Let's break it down:

1. Customer makes an online purchase at a merchant site.

The customer selects product and proceeds to checkout.

2. Merchant offers BNPL as a payment option at checkout.

The merchant provides the BNPL service as an alternative payment method.

3. Customer signs up/signs in to the BNPL service providing platform.

The customer creates an account or logs in to the BNPL platform.

4. Payment is debited from the BNPL account.

The BNPL service deducts the purchase amount from the customer's account.

5. Product is delivered to the customer.

The merchant ships the product to the customer.

6. KYC and credit risk analysis is done by the BNPL service provider.

The BNPL provider performs Know Your Customer (KYC) checks and assesses credit risk.

7. BNPL service provider approves the credit.

Based on the analysis, the BNPL service approves the credit for the customer.

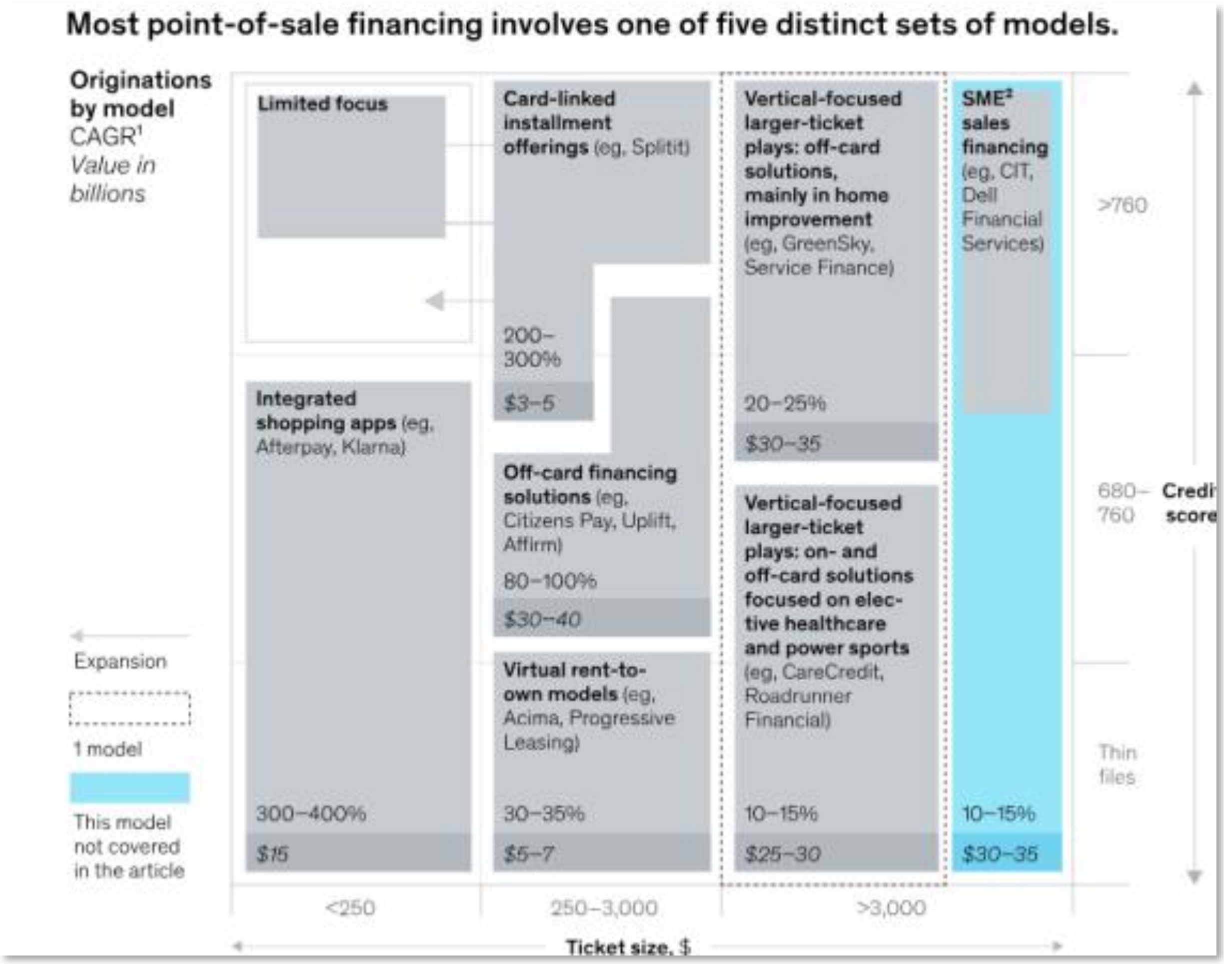
8. The customer pays back to the BNPL service provider at the end of the credit period.

The customer settles the outstanding balance within the specified credit period.

BNPL has 5 Business models to compete

The growth in BNPL for consumers involves five distinct sets of providers and models, each with varying strategies and value propositions (find the following image) Understanding these models gives a sense of the segments they target, the merchant and consumer needs they address, and business models' banks and traditional lenders are competing with.

- Integrated shopping apps
- Off-card financing solutions
- Virtual rent to own models
- Card-linked instalment offerings
- Vertical focused larger ticket plays



1. **Integrated Shopping Applications:**

Overview: Contrary to common belief, leading BNPL providers are not just financing options but integrated shopping platforms that engage customers throughout their purchase journey, from prepurchase to post purchase.

Scale & Growth: Providers like Klarna and After pay have grown rapidly, especially during the COVID19 pandemic, with ticket sizes averaging $100$110. Their engagement rates are high, with consumers using these services 1520 times a year. The BNPL market grew by 300400% in 2020, with $15 billion in originations. By 2023, originations are expected to reach $90 billion annually.

Monetization: These platforms generate revenue through affiliate marketing, cross selling banking products, and merchant partnerships. ROA is high, between 3035%, with loss rates of 68%.

Challenges for Competitors: Traditional banks struggle to compete due to the lack of comprehensive solutions that cover the entire shopping journey.

2. **Off-Card Financing Solutions:**

Overview: Services like Affirm and Uplift offer financing for midsized purchases ($250$3,000) with monthly instalments, typically over 8 to 9 months. These are often used for high-ticket items like electronics and furniture.

Market Dynamics: About 80% of users have credit cards but prefer BNPL for better payment terms. Digital channels dominate, with 25 to 30% of originations expected to be instore by 2021. Around 65% of these loans go to prime or higher credit score consumers.

Engagement: Engagement is lower than integrated apps, with repeat usage of 2 to 3 times a year. There’s a risk of commoditization as card linked instalments grow in popularity.

3. **Virtual Rent to Own (VRTO) Models:**

Overview: Targeting subprime consumers, VRTO services like Acceptance Now and Progressive Leasing offer financing with high APRs for categories like furniture and electronics.

Consumer Base: 95% of consumers have credit scores below 700, and 70% are below 600. Merchants often receive rebates from VRTO providers on originated volumes.

Integration: These services are integrated digitally and instore as secondary financing options, providing a broader credit offering for merchants.

4. **Card Linked Instalment Offerings:**
   Overview: Popular in Asia and Latin America, these models link BNPL services to existing credit cards at the point of sale. Adoption in the U.S. has been slow, primarily due to competition from 0% APR solutions offered at purchase.

   Potential: Card linked instalments have significant growth potential in the U.S., especially if they integrate with prepurchase journeys. Average ticket sizes are around $1,000.

   Adoption: Currently, these services are available through fintechs like Split It or network solutions like Visa Instalments.

5. **Vertical Focused Larger Ticket Plays:**
   Overview: These models focus on financing higher ticket purchases in specific verticals like healthcare and home improvement. Category specialists like CareCredit and GreenSky dominate this space.

   Market Dynamics: Ticket sizes range from $2,000- $10,000 in healthcare and $5,000$50,000 in home improvement. The focus is on elective procedures and large home renovation projects.

   Competition: As the space becomes more competitive, players face margin pressure and need to focus on specific subcategories. Banks have an opportunity to target high credit customers and cross sell other banking services.

The Rise of BNPL: Transforming Consumer Shopping Behaviour.

Credit cards have long been one of the most popular methods of making payments and accessing unsecured borrowing in the United States, accounting for 37 percent of consumer purchases by dollar value in 2021.[1] But their market position is gradually being undermined by the growth of point-of-sale (POS) financing offerings that combine instalment lending with the convenience of card payments. US issuers could by 2025 lose up to 15 percent of incremental profits to newer forms of borrowing, based on our simulation of the potential impact of buy now, pay later (BNPL).

Enter the BNPL Players- Traditional layaway has been a staple in the US, but the rise of technology-enabled Buy Now, Pay Later (BNPL) presents a significant challenge to credit card issuers. Consumers are increasingly opting for BNPL due to its lower interest rates, predictable payments, and seamless integration with online shopping platforms. Despite the challenges BNPL providers face, such as rising interest rates and potential risks, BNPL has reshaped consumer expectations and influenced the lending landscape.

Providers like Affirm and Afterpay offer point-of-sale borrowing for small- and mid-ticket items, potentially cutting into credit card issuers' volumes. BNPL is particularly popular among younger consumers, with significant adoption by Gen Z and millennials. As these younger consumers age, BNPL could continue to siphon off credit card usage, especially if these providers retain their user base.

Moreover, BNPL providers are influencing the broader retail ecosystem by creating shopping apps that foster consumer loyalty and frequent transactions. Established payment providers are responding by entering the BNPL space themselves, evidenced by moves like Block's acquisition of Afterpay and PayPal's introduction of BNPL options.

How BNPL Could change the payments landscape and how BNPL is shaping consumer shopping behaviour

We see four trends in BNPL that are likely to affect—or are already affecting—the strategies of issuers, as well as banks, fintechs, and other payments providers. BNPL apps are playing a greater role early in shopping journeys and offering a broader range of services. At the same time, payment networks are making BNPL widely available, and financial institutions are getting into the game.

Trend 1: BNPL Apps as Shopping Starting Points

BNPL providers are evolving into integrated shopping apps, combining consumer financing with shopping. This approach builds customer loyalty and generates additional revenue through affiliate fees. As rising interest rates impact BNPL providers' margins, this trend of leveraging shopping integration is expected to grow.

Trend 2: Expanding Beyond Instalment Lending

BNPL players are diversifying their offerings with new financial and loyalty products, targeting young consumers to increase lifetime value. Examples include Klarna's credit card and Affirms Debit+ card, which extend BNPL services to offline and non-integrated merchants. These innovations could lead to broader financial services, further embedding BNPL in consumer financial habits.

Trend 3: Payment Networks Enabling Wider BNPL Adoption

Payment networks like Mastercard and Visa are integrating BNPL into their systems, making it more accessible across a broader range of merchants. This development allows consumers to choose BNPL at the point of sale, enhancing convenience and potentially increasing adoption in sectors with lower BNPL penetration.

Trend 4: Financial Institutions Expanding into POS Lending

Banks and financial institutions are entering the POS lending market, either by creating their own BNPL solutions or through acquisitions. Their established customer bases, brand strength, and financial resources give them a competitive edge, making POS financing a potential growth channel and a way to cross-sell traditional banking products.

These trends highlight how BNPL is increasingly influencing consumer shopping behaviour by integrating financing into the shopping journey, expanding service offerings, and becoming more widely accessible through payment networks and financial institutions.

Reason behind the Growth of BNPL

Buy now, pay later (BNPL) has made it easier for millions of people worldwide to buy goods and services by spreading the payment.

Already the preferred payment option for merchants and consumers in many parts of the world, BNPL is now revolutionizing point of sale and online payment.

Ease of payment makes BNPL attractive to both merchants and customers. From the merchants' perspective, there is a growing need to replace or upgrade outdated payment systems to avoid losing sales during the purchase process.

Typically, carts get abandoned if the checkout process isn't smooth enough or if the payment options are too restrictive. There are also issues over engaging customers, converting potential customers into sales and obtaining data on customer preferences.

Not wishing to be left out, banks and credit card companies are also investing in BNPL, often partnering fintechs to integrate BNPL technology into existing offerings to give customers more choice and a better experience.

Business benefits of BNPL include:

- Higher value purchases – because the customer pays in instalments
- Increased average order value – the amount of money a customer spends when making a purchase from your website
- More orders and more customers
- Better conversion rates
- More chance of reaching people denied other forms of financing
- Faster credit approval
- Higher repeat purchase rate
- Potential to source and analyse better data for personalized marketing

According to a 2022 McKinsey survey, 15% of US consumers were ready to use BNPL, a 4% increase from 2021. BNPL, or Buy Now Pay Later, can benefit both consumers and businesses:

- Consumers

  BNPL allows consumers to spread out payments for goods and services, which can make it easier to buy things. BNPL can also increase conversion rates, purchase frequency, and cart value for online shoppers.

- Businesses
  BNPL can increase sales and customer engagement, especially for online stores. BNPL companies can also generate revenue from transaction fees and interest charges, and use consumer spending data to develop new products and services

Reasons for using BNPL service	Percent
To make purchases that otherwise wouldn't fit in my budget	48%
To avoid paying credit card interest	37%
To borrow money without a credit check	25%
To safeguard personal data	21%
I don't like to use credit cards	19%
My credit cards are maxed out	17%
I can't get approved for a credit card	14%
I don't have bank accounts	8%
Some other reason	6%

Understanding the BNPL consumer

Although most popular among younger generations, BNPL is growing across age segments to help manage cash flow.

• Younger consumers lacking long credit histories are looking for new ways to borrow for purchases and are averse to taking on more debt as they work to reduce existing debts, such as college loans. • However, point-of-sale financing appeals not only to consumers with thin credit files, but to well-established consumers as well. Nearly two-thirds (65 percent) of receivables originated by POS lenders are from consumers with credit scores higher than 7001.

Usage of BNPL by Age Group

Age	Used BNPL[1]	Growth[2]
18-24	61%	62%
25-34	60%	28%
35-44	61%	21%
45-54	53%	26%
55+	41%	98%

1. As of March 2021
2. Between July 2020 and March 2021

While many purchases made with BNPL options are discretionary, such as electronics and clothing and fashion, it also plays a role in covering basic household purchases:

Most popular uses of BNPL

Purchase	Used BNPL[1]
Electronics	48%
Clothing and fashion items	41%
Furniture or appliances	39%
Household essentials	33%
Groceries	24%
Books, movies, music, or games	23%
Others	9%

Consumers are widely adopting POS financing, and 71 percent of adopters have used it more since the beginning of the pandemic3. Most are using this method to break up larger payments so they can better manage their budget, while some are just looking for access to a different type of credit.

Impacts on Businesses

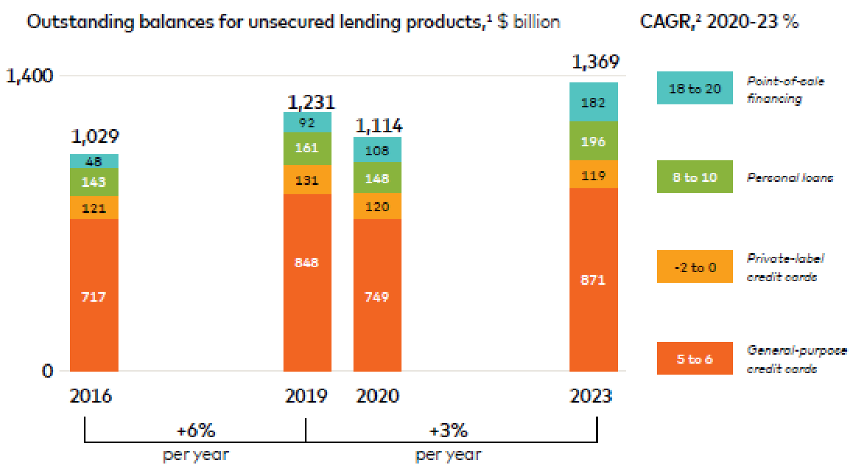
POS financing is the fastest-growing payment alternative in North America. Now is the time for Banks, Fintechs and Merchants to act.

Growth in today's BNPL landscape is being driven by fintechs that are building end-to-end consumer experiences akin to online marketplaces. This approach is quickly building stickiness with consumers, driving repeat behaviour. Traditional financial institutions may be at risk of disintermediation from the point of purchase and miss out on opportunities to acquire and retain new, younger consumers for future growth. For merchants, providing choice of payment options is critical as consumer spending habits change. Merchants are already seeing value in these solutions, as most POS financing options enhance cart conversion, increase average order value, and attract new younger consumers. Merchants that have long sought to win consumers' loyalty by offering private label credit cards (PLCC) are also seeing value in integrating BNPL into the checkout experience to attract new consumers not currently shopping with them, or to offer financing for a specific purchase without requiring consumers to acquire a new card.

BNPL solutions are proving to be a sales enabler for merchants

+45% of BNPL users said they used these services to split up purchases that otherwise wouldn't fit into their budget.

Point-of-sale financing is growing faster than other unsecured lending, expected to be $182B by 2023



Source: McKinsey & Company, Buy now, pay later: Five business models to compete

However there are some hurdles to even more consumer adoption

83% of BNPL users wish it was accepted by more businesses[2].

20% of BNPL users believe their service would take advantage of them[2].

BNPL in India Vs Global Market

To compare Indian companies offering Buy Now, Pay Later (BNPL) services with those in the global market, we can focus on several key insights:

Indian BNPL Market Overview

1. Prominent Players: In India, companies like LazyPay, ZestMoney, Simpl, and ePayLater are leading the BNPL market. These companies are leveraging the growing e-commerce sector, targeting younger consumers, and integrating with popular online platforms.

2. Market Penetration: The Indian BNPL market is relatively new but rapidly growing, driven by increased digital adoption, a large young population, and the demand for credit alternatives. However, awareness and adoption are still lower compared to more mature markets like Europe or Australia.

3. Regulatory Environment: Indian BNPL providers operate under a more regulated financial environment, with a focus on consumer protection and financial inclusion. This contrasts with regions like Europe, where the regulatory landscape is still evolving in response to BNPL's growth.

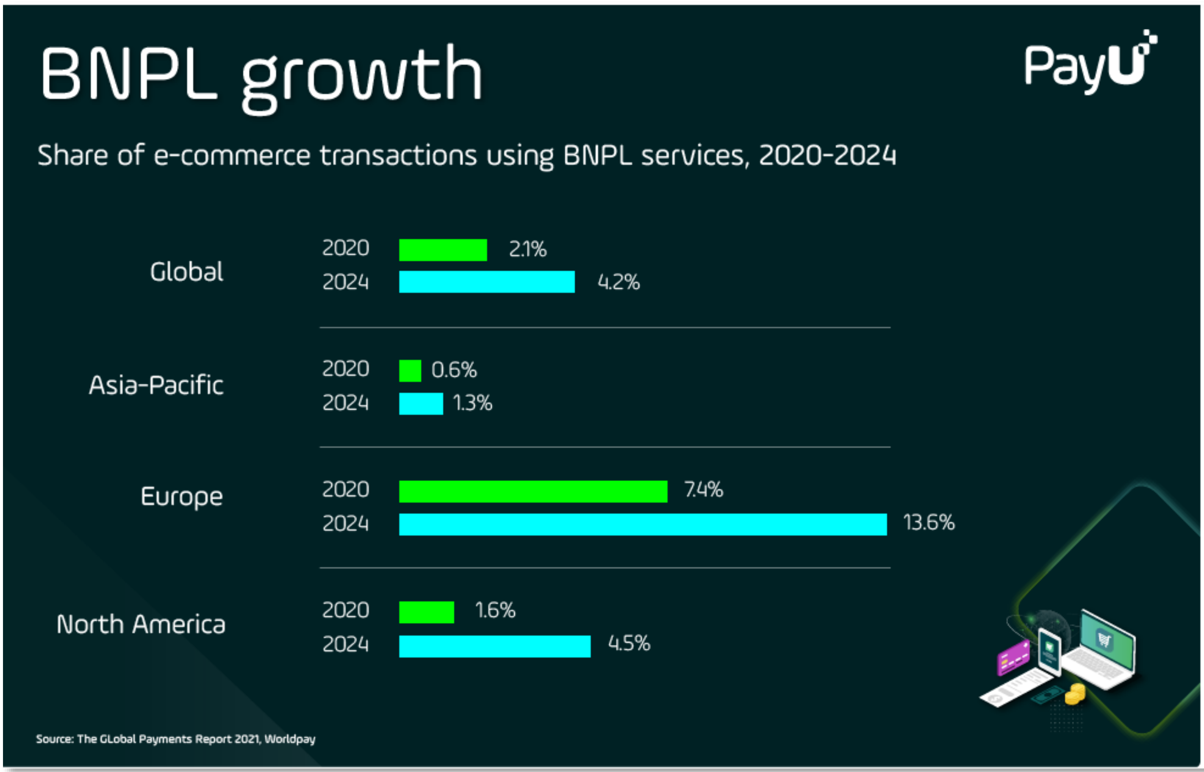
Global BNPL Market Insights

1. Europe: The European BNPL market is dominated by players like Klarna, PayPal, and Divido. These companies have a strong presence due to high e-commerce growth, a mature digital payment ecosystem, and early adoption of BNPL. Klarna, for instance, is valued at $31 billion and operates in nearly 40 global markets, making it a leader in the BNPL space.

2. Asia-Pacific: In the Asia-Pacific region, BNPL growth is significant, with companies like Paidy in Japan and Cashalo in the Philippines leading the market. These companies cater to markets with lower credit card penetration and are focused on providing alternative financing options to a digitally savvy consumer base.

3. North America: The North American market has seen rapid growth in BNPL adoption, with companies like Affirm, Afterpay, and PayPal leading the charge. The US, in particular, has seen an 81% year-over-year increase in BNPL users, driven by integrations with major retailers and the appeal of interest-free instalments.

4. Australia: Australia is one of the fastest adopters of BNPL, with companies like Afterpay and Zip dominating the market. These companies have also expanded internationally, particularly into North America, leveraging their established models to capture new markets.



Key Comparisons

Growth Drivers: While global BNPL players have benefited from early adoption, high e-commerce penetration, and mature digital payment ecosystems, Indian companies are leveraging the rapid growth of digital payments, a young consumer base, and the need for accessible credit.

Market Size and Penetration: The European and Australian markets are more mature with higher BNPL penetration, whereas the Indian market is still in the early stages but growing rapidly.

Product Offerings: Indian BNPL providers are expanding their services to include prepaid cards and other financial products, similar to global players like Klarna and Affirm, who offer a range of financial services beyond BNPL.

Regulatory Challenges: Indian BNPL companies face stricter regulatory scrutiny, focusing on consumer protection and financial stability, which could impact their growth and operational strategies compared to their global counterparts.

This comparison highlights the unique challenges and opportunities faced by Indian BNPL providers as they navigate a rapidly evolving market while learning from the successes and challenges of their global peers.

Implications

Implications for Financial Institutions and Fintech Players

Rising interest in BNPL solutions is a call to action for the financial services industry to leverage their trusted position and enable new tools. But failure for banks to act could be costly, as an estimated $8B to $10B in annual revenues have already diverted away to Fintechs[2].

Financial institutions and Fintechs can offer a holistic engagement and acquisition strategy with financing tools for before, during, and after the point of purchase, especially has financial apps are used frequently by most consumers. BNPL can also be integrated into a purposeful graduation strategy to enhance their relationship with current customers and appeal to new segments.

Risks of Inaction

- Missed revenue opportunity from new payment volume
- Missed acquisition of new, younger consumer segments to other non-traditional lending platforms
- Lack of brand presence at the point of payment

Opportunities

- Leverage existing relationships with consumers and trusted brand positioning to personalize instalment offers and create a seamless acquisition experience, especially from banking apps
- Utilize BNPL as a tool to engage younger demographics, promote financial wellness and graduate relationship over time into higher yield products like credit
- Create touchpoints with consumers throughout the purchasing journey to introduce other value-added services like rewards and benefits Partner with

Implications for Merchants

Risks

- Costly system integration and impact to UX flow
- Difficulty retaining control over the customer and their shopping experience
  Increased operational costs related to customer service, chargebacks and processing fees
- Liability exposure on fraud, late payments and delinquency
- Reputational concerns around transparency of loan terms and repayment through BNPL providers

Opportunities

- Generate incremental customer acquisition and revenue from various customer segments
- Drive ROI by displaying relevant short-term and long-term instalment offers at checkout on high-ticket items or to first-time buyers
- Minimize operational costs by integrating BNPL solutions into existing payment infrastructure
- Promote trust and financial wellbeing through transparent instalment offers with responsible lending terms

Conclusion: The Impact and Future of Buy Now, Pay Later (BNPL)

The rapid growth of Buy Now, Pay Later (BNPL) services has significantly altered consumer spending habits, offering flexible payment solutions that appeal especially to younger generations. By integrating seamlessly with online shopping and providing interest-free instalments, BNPL has become a preferred alternative to traditional credit cards, reshaping the lending landscape.

The rise of BNPL has presented opportunities for fintech companies to capture market share from traditional financial institutions. However, it also introduces new challenges, such as the potential for increased credit risk and regulatory scrutiny. For financial institutions and fintech players, adapting to the BNPL trend is crucial. They must leverage their existing relationships and trusted brands to innovate and offer comprehensive financing solutions that cater to evolving consumer preferences.

Looking ahead, BNPL is poised to continue growing, driven by the demand for more flexible and accessible credit options. However, success in this space will depend on balancing growth with responsible lending practices and adapting to a dynamic regulatory environment.

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