What is the Buy Now Pay Later business model and how does it function?

BNPL or Buy Now Pay Later, is a payment option that allows you to purchase without paying the entire amount at the time of purchase.

Generally, you join up with a firm that provides this service, and the money is made when you make the purchase. But, after the lender pays on your behalf, you must reimburse the money within a specific time frame.

Unlike a personal loan, the BNPL plan usually does not charge interest. You can pay it all at once or in no-cost Equated Monthly Instalments (EMIs). The lender must charge you interest on your amount if you do not repay the amount within the allotted payback period.

Additional postponement can affect your credit rating.

How Does the Procedure of BNPL Work?

Here is how BNPL typically operates-

- Customers make purchases at participating stores.
- Choose the 'Buy Now, Pay Later' alternative.
- Carry out the transaction after paying a minimal down payment of the total cost.
- A sequence of interest-free EMIs will be used to deduct the outstanding amount.
- EMI payments can be made with a credit card, debit card, check, bank transfer, or straight from a bank account.

How has this payment method grown recently and how has it influenced how people shop?

BNPL credit has three distinguishing features relative to standard credit cards.

First, rather than offering a revolving line of credit, BNPL products are structured as installment loans with a down payment due at sale and a fixed repayment schedule.

Second, BNPL loans are offered through retailers and are tied to the purchase of a particular product.

Third, BNPL companies often offer easier lending terms, with no or limited credit checks, often zero interest, minimal fees, and no or limited negative reporting to credit bureaus.

Consumer Behavior Analysis:

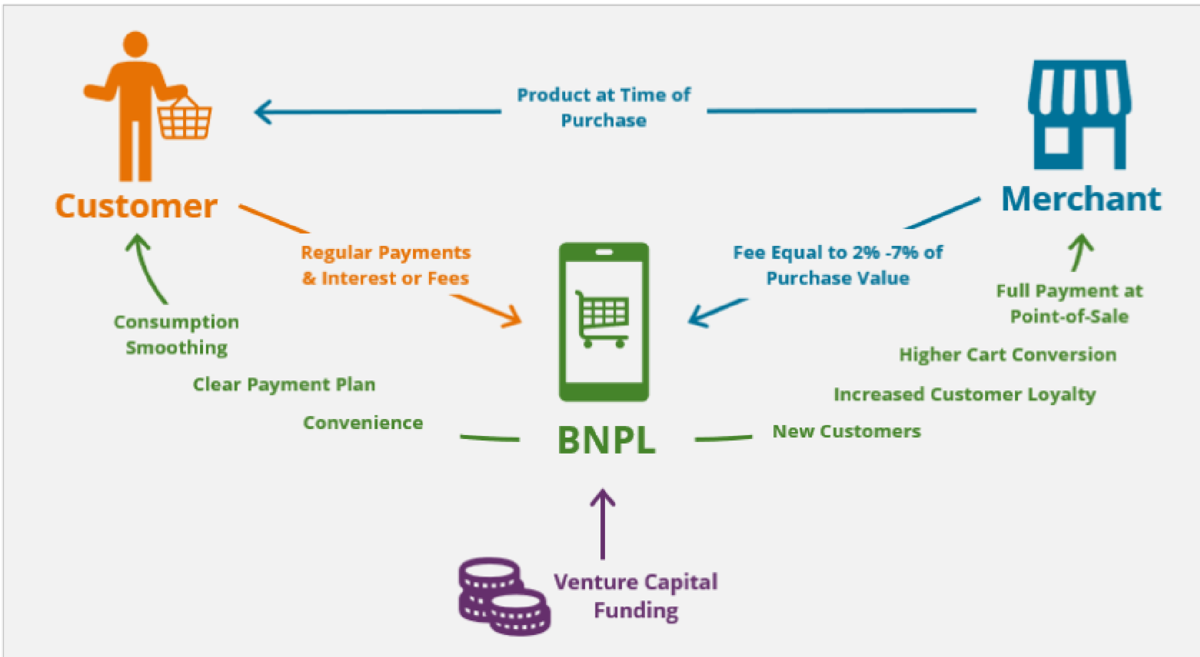
Our analysis proceeds in three steps. First, we use our transactions-level panel to provide the first evidence on granular patterns of BNPL use. We find that by 2021, BNPL spending was approximately 2% of total credit card spending, and the number of BNPL users was roughly one-fifth the amount of credit card users. Additionally by 2021, around 16% of all users had used BNPL at least once and around 30% of these users were persistent users. We also find that conditional on income and location of residence, BNPL users are less likely to use credit cards and be active savers, more likely to incur overdraft fees, and more likely to rent, than individuals who do not use BNPL. Higher-income users adopt BNPL earlier, and BNPL users spend a higher fraction of income on retail goods. Additionally we find that lower income users are more likely to use BNPL relative to credit cards, and higher income users are more likely to use BNPL for larger ticket items. These findings suggest that those who have less access to liquid resources are more likely to use BNPL.

Our second piece of analysis documents how BNPL access impacts spending levels across various expenditure categories. We find that BNPL use is associated with significant spend⍰ing changes. Using a difference-in-differences design, we compare weekly spending after first time BNPL use to weekly spending over previous episodes. Total spending increases by around $130 at the time of first BNPL use and remains elevated over the 24 weeks following 2 Electronic copy available at: https://ssrn.com/abstract=4198320 initial BNPL use. About $30 of this increase on impact is BNPL spend and the remaining is spending across other categories such as retail (non-BNPL), essential spending and other discretionary non-retail spending. Our findings show that the spending response to BNPL represents a significant shift of the expenditure basket towards retail spending. To build confidence in our findings, we instrument for BNPL use by exploiting heterogeneity in the timing of BNPL adoption by retailers in a consumer's past expenditure basket. We find that instrumented BNPL use causes a permanent increase in total spending of around $60 per week, again primarily concentrated in retail spending. BNPL use also results in increased likelihood of accessing savings and incurring overdraft, NSF and other late fees. We would expect consumers with positive discount rates to increase spending in the short⍰term when offered low-cost credit. However, most BNPL products require repayment within 6 weeks of purchase; justifying levels of spending as high as we observe would require either (i) unrealistically high discount rates; or (ii) widespread and binding liquidity constraints. In heterogeneity analysis, we find evidence that consumers who engage in net savings or have liquidity buffers – for whom liquidity constraints are unlikely to bind – also increase their spending significantly. Additionally, binding liquidity constraints cannot explain the observed increase in retail expenditure. We observe an expenditure basket reallocation to⍰wards retail even for credit card users, who presumably have sufficient liquidity to obtain their desired intertemporal allocation over short horizons.

Our final piece of analysis assesses to what extent BNPL use is associated with con⍰sumption smoothing. We find that BNPL use is correlated with a significant reduction in spending sensitivity to income, especially for lower income users who are more likely to be liquidity constrained. We confirm these results using our instrument for BNPL use.

BNPL Business Model

BNPL Business Model Most BNPL firms follow the same skeletal structure and provide the same benefits to merchants and consumers (see Figure 1). However, even among firms who identify as a BNPL, there are a variety of different payment plans, with different priorities for consumer well-being. Pay-in-4 plans and installment loans are some of the most common BNPL programs, though there are several other noteworthy models.



● **Pay-in-4**: This program is the most common form of BNPL. Pay-in-4 is used for smaller ticket items and is typically a six-week loan split into four equal payments, the first at point-of-sale, then one every two weeks. This model is usually zero-interest, charging late fees if consumers miss a payment. Some firms, like PayPal, charge neither late fees nor interest, a trend that may grow as the industry becomes more competitive.5 Firms that use the Pay-in-4 model earn revenue primarily through merchant fees, which are usually a percentage of the purchase price. These fees are often double the interchange credit card fees and can be as high as seven percent of the cost of the product.6 Merchants are willing to pay for BNPL services in exchange for the increase in sales and access to an expanded customer base. According to marketing material from Affirm, BNPL leads to increased cart sizes and higher sales rates on merchant check-out pages.7 Many Pay-in-4 BNPL platforms are also building integrated shopping apps. BNPLs draw consumers to the apps for access to Pay-in-4, where they advertise and promote their merchant partners.8 These apps are growing rapidly in popularity: per Bank of America, downloads for the top four BNPL apps (Affirm, Afterpay, Klarna and Zip) rose more than 20 percent in 2021 to over three million downloads.

● **Medium-Ticket Installment Loan**: Some BNPL firms also offer medium-term installment loans for larger-ticket items. These programs are usually for mid-sized purchases and consist of monthly payments for a period of six to twelve months. Because of the bigger ticket price on products, these programs usually charge consumers interest and, occasionally, fees from merchants. About 80 percent of consumers who opt into BNPL installment loans already have a credit card.10 Sometimes these loans are called "off-card financing solutions," though there are a growing number of card-linked installment offerings.11 Card-linked installment loans are most popular in Asia and Latin America, but, as previously mentioned, several cards have introduced post-purchase installment plans as credit card companies try to compete in the U.S. BNPL space. According to a recent report from 6 McKinsey, card-linked installments could soon become necessary to compete in the credit card market by integrating installment plans across purchases and monetizing pre-purchase offerings.12

● **Deferred Credit Line:** This model is very similar to a deferred interest store-branded credit card, only provided by a BNPL company. For these payment plans, interest is waived on purchases above a certain amount for a specified period of time. At the end of the deferral period, if the consumer has paid off the item in full, they owe no interest. If they have any remaining balance, however, they are charged interest on the full purchase amount (not just the unpaid balance). PayPal uses this model for their credit service.

● **Virtual Rent-to-Own:** In this model, consumers “rent” an item, paying in installments until they have paid the full cost of the item. Virtual rent-to-own models often target subprime consumers with high APRs. Goods are typically limited to items that could be repossessed, and roughly 80 percent are mattresses, furniture, electronics, or appliances.

● **Large-Ticket Installment Loan:** Companies that provide this BNPL model are usually category specialists (e.g., healthcare or home improvement). A consumer takes out a large loan for an expensive service or good and repays in installments over time. Banks are expected to target this space in the next few years to acquire high-credit customers. They could also leverage this model to cross-sell mortgage refinancing or other banking services.

While these models constitute the major types of BNPL at the moment, this list is not exhaustive, and new models that are attractive to both consumers and merchants are likely to emerge as the industry evolves.

One practice that will remain crucial for BNPL business models is integration into the consumer shopping experience. Most BNPL firms are incorporated into consumer check-outs — about 40 percent of consumers make their decision to use BNPL at the point-of-sale — and several others are integrated into the entire consumer shopping experience through all-in-one apps. As more shoppers make purchases via BNPL apps, BNPL firms have a unique opportunity to influence consumers’ choices of products and merchants earlier in the process. Further, while BNPLs have enjoyed rapid growth over the past few years in part because of the pandemic’s effect on e-commerce, there is evidence that BNPL is being used in brick-and-mortar settings more frequently. For example, French BNPL startup Alma reports that nearly one-third of their payment volume now comes from in-store purchases. Wider use of BNPL apps and availability of BNPL in-store will move BNPL firms further into consumers’ day-to-day transactions, giving them a stronger foothold in the electronic payments market.

Advantage and Disadvantage of BNPL

Pros of Buy Now, Pay Later

It's no secret that buy now, pay later services have taken off in popularity. From 2019 to 2021, the number of BNPL loans from five popular providers increased by 970%, according to a Consumer Financial Protection Bureau report. People like the chance to pay on their own schedule, use the service for online or in-store purchases and get inexpensive or free financing. Some of the pros of using a buy now, pay later include:

Split Up Payments

The major benefit of BNPL services is that you can break up payments into smaller, more manageable amounts. When making a big purchase, you don't need to have all the cash in your pocket that day.

Most buy now, pay later services split up costs over several payments scheduled two to four weeks apart. This payment cadence often fits with biweekly pay schedules to help replenish your bank account before the next payment hits.

0% Financing

If you make your BNPL payments on time, you typically won't pay any interest. Getting 0% financing is a draw for most buy now, pay later users. If you're looking to break up payments without a service fee or any interest, a BNPL arrangement can work well.

Get Financing Without a Credit Check

Some buy now, pay later services do not check your credit before approving you. For those who are new to credit or rebuilding their credit, BNPL may offer an attainable financing option.

Cons of Buy Now, Pay Later

Just because it makes spending easier, buy now, pay later isn't necessarily safer for your finances. Using buy now, pay later services can open users up to financial risks that may not be worth the convenience in the end. Some BNPL cons include:

Fees and Interest

If you miss a BNPL payment, you may be charged late fees or interest on your unpaid balance. Depending on the amount charged by the BNPL lender and how these fees are structured, they can add up quickly.

Should you stop making payments altogether, buy now, pay later services can also turn your account over to a collection agency. Besides accruing more fees and interest during this timeframe, your credit score could also be put in danger.

Possible Overdrafts

Frequent, automatically scheduled payments could increase the potential for bank account overdrafts if you aren't careful.

If you set BNPL payments to draft from your checking account automatically, it's important to remember the schedule and make sure enough funds are in your account. Add these dates to your calendar and make sure you leave enough after each paycheck deposit to meet the next payment date so you avoid late payments.

Easy to Overextend Finances

One of the biggest dangers of using BNPL services is that it can be easy to overextend your finances. Only looking at the cost of each payment may make it difficult to register the full cost of the item. Especially when you make several purchases with buy now, pay later arrangements, bills can rack up—and be challenging to juggle.

Miss Out on Rewards

If you typically shop with a credit card but are considering using buy now, pay later for a purchase, remember that you'll forgo your rewards and other credit card benefits. BNPL services typically do not have rewards structured like credit cards, which can be a deterrent for shoppers who have a great rewards card already. You also won't get other credit card benefits, like purchase protection.

There are workarounds, like paying off your buy now, pay later bill with a credit card to get rewards points, but this may be overly complicated for some shoppers and could end up costing you more if you can't pay your full credit card bill.

Returns Can Be Difficult

If you need to return a BNPL purchase, you could be in for a wait and possibly a difficult process. Unlike making a purchase with a credit card, the merchant will return the funds (assuming the return is approved) to the BNPL lender. The lender then passes on the return to you. While you wait, you must still make payments according to your BNPL plan or face late fees and penalties. If the purchase involves a dispute, completing the return could take weeks or months.

If the merchant provides the return in cash or store credit, you'll need to continue making payments on your BNPL plan until the amount is paid in full.

What are the impacts on businesses?

Benefits to Retailers Using BNPL

Implementing a BNPL strategy can significantly benefit your ecommerce business. Here's why:

1. **Increased Sales:** By offering flexible payment options, you can encourage customers to make purchases they might have hesitated on due to immediate financial constraints. This can lead to increased sales and average order values.
2. **Customer Attraction and Retention:** BNPL can make your business more attractive to potential customers, particularly younger demographics like Millennials and Gen Z who are looking for flexible, non-traditional credit options. It can also increase customer loyalty as customers appreciate the flexibility and convenience.
3. **Improved Cash Flow:** With BNPL, you receive payment at the point of sale, improving your business's cash flow. The BNPL service provider handles the risk of customer default or non-payment.
4. **Decreased Cart Abandonment**: Offering BNPL options at checkout can reduce cart abandonment rates. Many customers abandon their carts due to a lack of satisfactory payment options, and BNPL can address this issue.
5. **Enhanced Customer Experience:** Offering BNPL can improve the overall customer experience. It allows customers to manage their finances more effectively and purchase items they desire without having to pay the full cost upfront.

Indian companies offering Buy Now Pay Later services vs global market.

Indian BNPL Market

1. Major Players: Some of the leading BNPL providers in India include Lazypay, Simpl, ZestMoney, KreditBee, and ePayLater12. These companies have partnered with various merchants to offer flexible payment options.

2. Market Size and Growth: The BNPL market in India is expected to reach approximately USD 14 billion by 20241. The market has been growing at a compound annual growth rate (CAGR) of 22.9%, with significant adoption in tier 2 and tier 3 cities1.

3. Consumer Base: The primary users of BNPL services in India are millennials and younger generations, who prefer the convenience and flexibility of spreading payments over time3.

4. Popular Sectors: BNPL services are widely used for purchasing consumer electronics, fashion, healthcare, and retail products3.

Global BNPL Market:

1. Major Players: Globally, companies like Klarna, Afterpay, Affirm, and PayPal dominate the BNPL market1. These companies have a strong presence in regions like North America, Europe, and Australia.

2. Market Size and Growth: The global BNPL market is projected to grow at a CAGR of 16% from 2022 to 20261. The market is driven by the increasing demand for short-term credit and the growing preference for online shopping4.

3. Consumer Base: Similar to India, the global BNPL market is popular among younger consumers who value the ability to manage their finances more flexibly

Resources:

- https://groww.in/blog/what-is-buy-now-pay-later
- https://assets.equifax.com/marketing/US/assets/bnpl-sustaining-growth-and-building-profitability.pdf
- https://www.hbs.edu/ris/Publication
- https://www.experian.com/blogs/ask-experian