

Case Study: The Rise of Buy Now, Pay Later (BNPL)

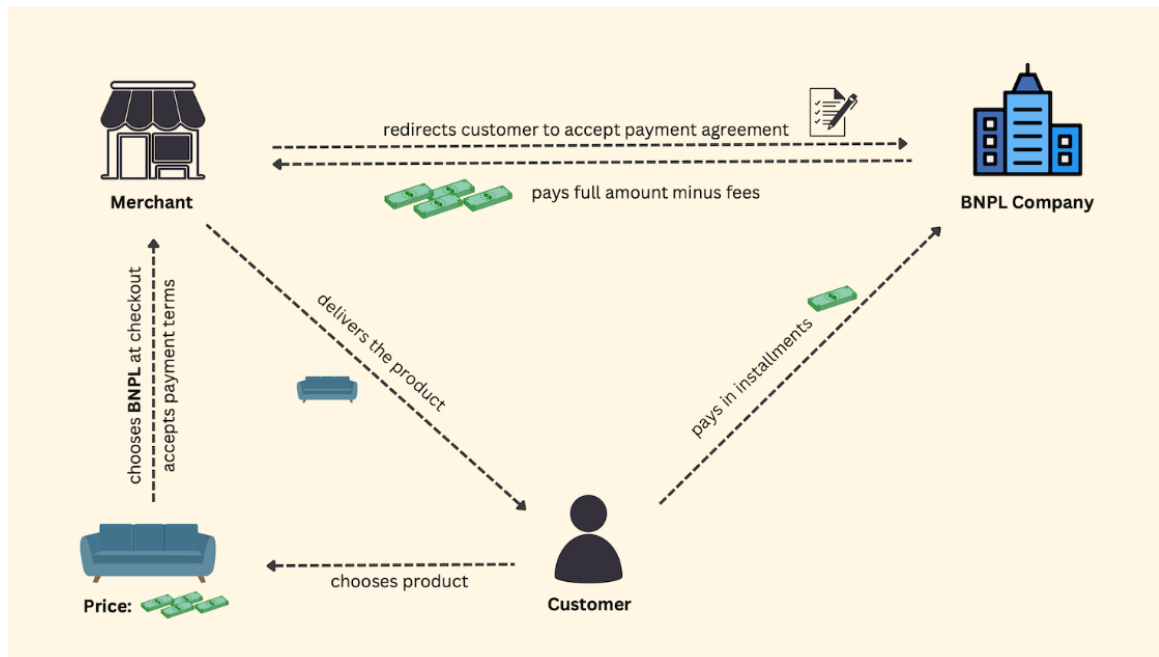
By Kosala Ram Gangaiah

Introduction

Buy Now, Pay Later (BNPL) is a modern credit solution that allows consumers to purchase goods and services immediately and pay for them over time. This payment method has seen a meteoric rise in popularity, driven by its appeal to consumers seeking convenience and flexibility. This case study aims to explore the growth of BNPL services, assess their impact on consumer spending habits and credit risk, and analyze their implications for the fintech sector.

What is “Buy Now, Pay Later” Business Model?

The BNPL business model is designed to offer consumers an alternative to traditional credit cards and loans. Here's how it functions:



BNPL - Workflow

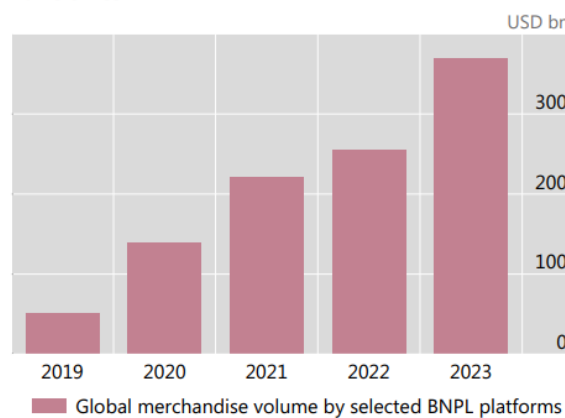
- **Consumer Purchase:** A consumer selects the BNPL option at checkout when making an online or in-store purchase.
- **Instant Approval:** The BNPL provider conducts a quick credit assessment and approves the transaction almost instantly.
- **Payment Schedule:** The consumer agrees to a payment plan, typically involving equal installments over a set period, often with little or no interest if paid on time.
- **Merchant Payment:** The BNPL provider pays the merchant upfront for the full purchase amount, taking on the credit risk.
- **Consumer Repayment:** The consumer repays the BNPL provider according to the agreed schedule, potentially incurring fees or interest if payments are late.
- **Revenue Model:** BNPL companies earn revenue through merchant fees, consumer fees for late payments, and in some cases, interest charges.

Growth Trajectory of BNPL Services

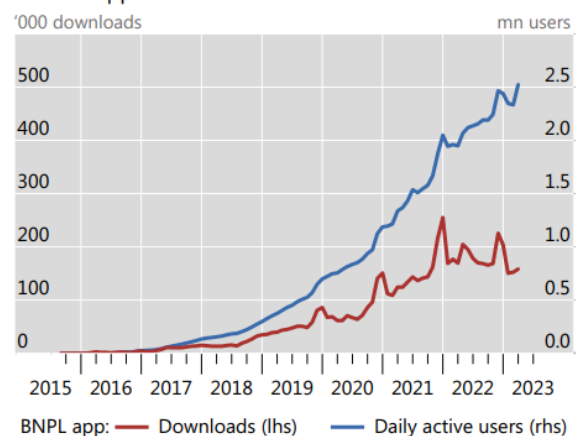
The BNPL sector has witnessed explosive growth in recent years, fueled by several key factors:

- **E-commerce Boom:** The surge in online shopping, accelerated by the COVID-19 pandemic, has created a fertile ground for BNPL services to flourish.
- **Consumer Demand for Flexibility:** BNPL appeals to consumers seeking flexible payment options without the burden of traditional credit.
- **Millennial and Gen Z Adoption:** Younger consumers, wary of credit card debt, are increasingly turning to BNPL as a preferred payment method.
- **Global Expansion:** BNPL companies are rapidly expanding their reach into new markets, driven by strategic partnerships with retailers and e-commerce platforms.
- **Technological Advancements:** The integration of BNPL options into digital payment ecosystems has streamlined the consumer experience, further boosting adoption.

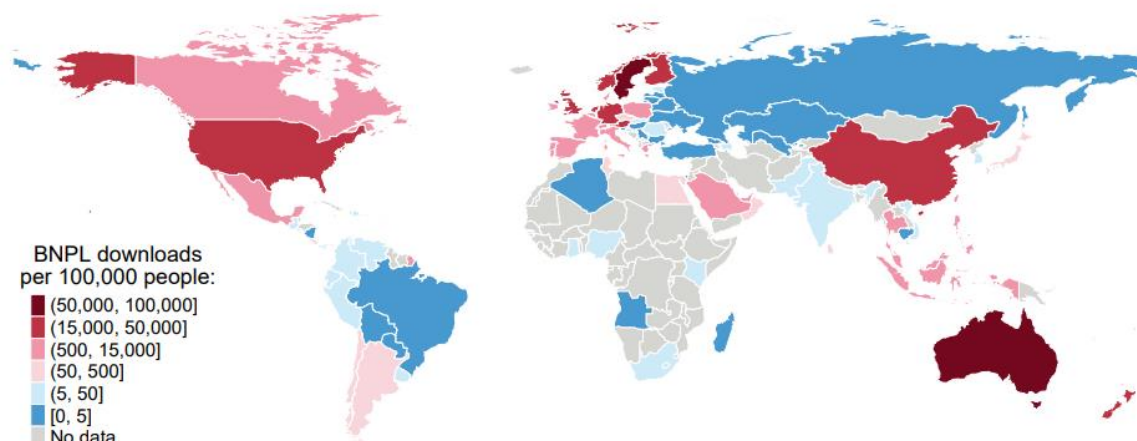
A. Volumes



B. BNPL app downloads and users



The rise of buy now, pay later



BNPL popularity across the world

Market Penetration and Impact on Consumer Spending Habits

Consumer Behavior Analysis

BNPL has significantly influenced consumer spending habits, as evidenced by the following trends:

- **Increased Spending:** BNPL encourages consumers to spend more by breaking down large purchases into manageable instalments, thereby reducing the perceived financial burden.
- **Impulse Buying:** The ease of BNPL transactions can lead to impulsive buying decisions, as consumers are less constrained by immediate budget limitations.
- **Financial Inclusion:** BNPL offers credit access to consumers who may not qualify for traditional credit cards, thus expanding financial inclusion.
- **Debt Accumulation:** While BNPL provides flexibility, it also poses risks of debt accumulation, particularly for consumers who struggle to manage multiple instalment plans.

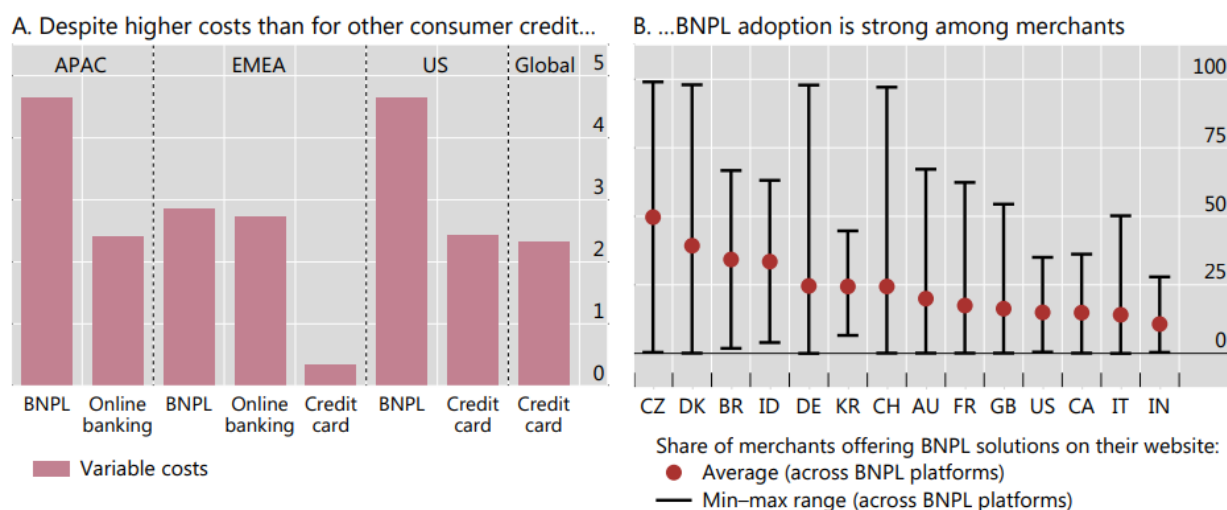
Growth Drivers

Several factors have contributed to the rapid growth of BNPL services:

- **Simplicity and Convenience:** BNPL offers a seamless and user-friendly experience, making it an attractive payment option for consumers.
- **Lack of Interest Charges:** Many BNPL plans offer interest-free periods, making them a cost-effective alternative to credit cards.

- **Digital Integration:** BNPL providers have successfully integrated their services into digital wallets and payment platforms, enhancing accessibility.
- **Targeted Marketing:** BNPL companies employ targeted marketing strategies to appeal to specific consumer segments, such as young adults and frequent online shoppers.

In per cent



BNPL adoption by merchants

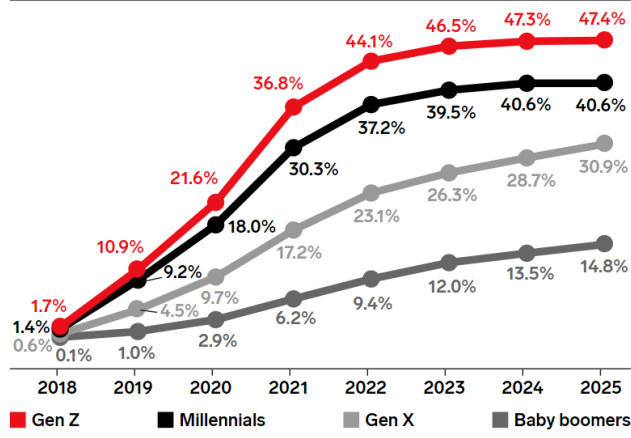
According to Berg et al (2023), e-commerce merchants who offer BNPL as a payment option benefit from expanding sales, as some customers make purchases they might otherwise not have made, while others spend more than they had initially planned. In some cases, merchants also benefit from non-payment services such as marketing and the data analytics provided by BNPL platforms. This results in a higher share of website visitors who finalise a purchase and an increase in both the number and value of sales.

User Segmentation and Growth Categories

BNPL appeals to a diverse range of consumers, but certain segments show higher adoption rates:

US Buy Now, Pay Later (BNPL) User Penetration, by Generation, 2018-2025

% of digital buyers in each group

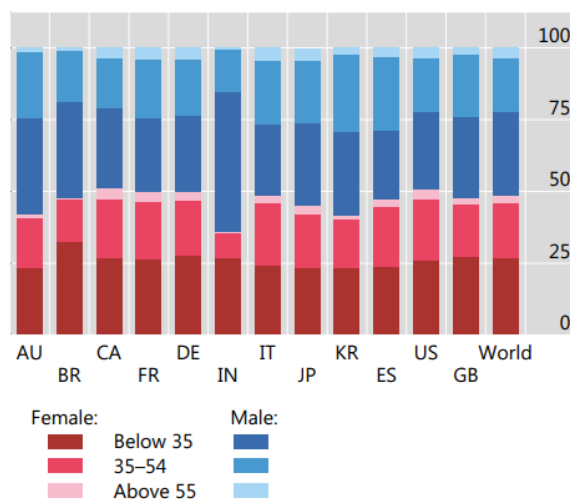


BNPL – User Segmentation

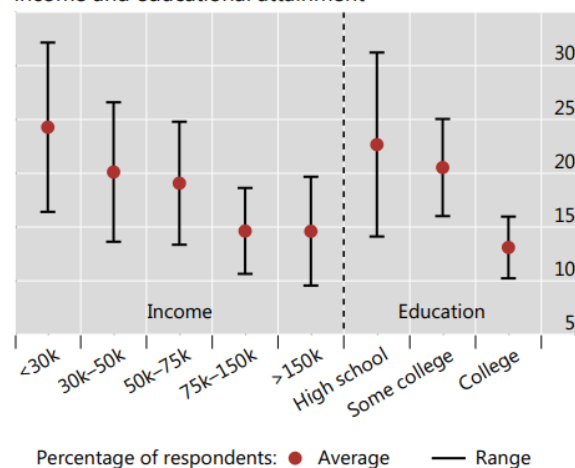
Millennial and Gen Z shoppers are demanding more flexible, inclusive and transparent ways to pay rather than traditional interest-bearing options. That's why they love buy now, pay later (BNPL) solutions. And they are not the only ones. For merchants and marketplaces, BNPL is a way to increase conversion and cart size. For payment companies and banks, it's a new source of transaction flows and interest revenue, bypassing traditional networks.

U.S. BNPL users, by generation (2018-2025)

A. Youngsters are the lion's share of the BNPL user base



B. In the US BNPL is used by consumers with lower income and educational attainment



BNPL is popular with young, lower-income and less-educated adults

- **Millennials and Gen Z:** These generations are more likely to embrace BNPL due to their preference for digital solutions and aversion to traditional credit.
- **Tech-Savvy Consumers:** Individuals comfortable with digital technology are more inclined to use BNPL for online purchases.

- **Budget-Conscious Shoppers:** Consumers seeking to manage their finances by spreading out payments are drawn to BNPL services.
- **Emerging Markets:** BNPL is gaining traction in emerging markets where traditional credit systems are less developed.

Impacts on Businesses

BNPL offers several advantages and challenges for businesses:

Advantages

- **Increased Sales:** Merchants offering BNPL options often experience higher conversion rates and increased average order values.
- **Attracting New Customers:** BNPL can attract new customers who may have been hesitant to make large purchases without a payment plan.
- **Competitive Advantage:** Offering BNPL can differentiate businesses from competitors, especially in sectors with high price sensitivity.

Challenges

- **Merchant Fees:** Businesses incur fees from BNPL providers, which can impact profit margins.
- **Credit Risk:** While BNPL providers assume credit risk, businesses may face reputational risks if consumers struggle with repayment.
- **Integration Costs:** Implementing BNPL solutions requires integration with existing payment systems, which can involve upfront costs.

Global and Indian Market Comparison

Key BNPL players

Global BNPL Players:

The global BNPL market is characterized by significant diversity and competition. Key players include:

- **Afterpay (Australia):** One of the pioneers of BNPL, Afterpay has expanded its services globally, with a strong presence in the United States and Europe.
- **Klarna (Sweden):** Klarna is a leading BNPL provider in Europe and has made significant inroads into the US market.
- **Affirm (USA):** Affirm offers transparent financing options with a focus on responsible lending practices.

Indian BNPL Players:

The Indian BNPL market is rapidly evolving, with several players competing for market share:

- **ZestMoney:** ZestMoney offers BNPL services tailored to the Indian market, focusing on financial inclusion and affordability.
- **Simpl:** Simpl provides a seamless checkout experience with one-click payments and flexible repayment options.
- **LazyPay:** LazyPay offers a range of credit solutions, including BNPL, with a focus on convenience and accessibility.

Comparative Analysis

Global BNPL Market:

- The global BNPL market size was valued at **USD 30.38 billion** in 2023 and is projected to grow to **USD 167.58 billion** by 2032, exhibiting a CAGR of **20.7%** during the forecast period.
- The market is driven by the increasing number of e-commerce platforms and rising adoption across millennials in developed countries.
- Leading players like Affirm Holdings, Inc., Perpay, Inc., Afterpay Limited, and PayPal Holdings Inc. are expanding their services across various categories such as travel & tourism, consumer electronics, e-commerce & retail, healthcare insurance, and banking.
- The U.S. Federal Reserve data indicates that credit card utilization is around **21%**. Integrating BNPL into credit cards could potentially increase customers' credit limits significantly.

Indian BNPL Market:

- India's BNPL services market generated a revenue of **USD 8 billion** in the current year and is expected to register a CAGR of **10%** for the forecast period.
- The market has seen a transaction value growth of **32.5% CAGR** between 2022 to 2026, reaching an estimated **INR1.1 trillion (\$15 billion)** by 2026².
- The adoption rate of BNPL services in India is high among the 26 to 35 age group, with **22%** of consumers having used these services².
- Providers are focusing on the travel industry to drive BNPL transaction volume and value, with expectations of a **20.5% annual growth** to reach **USD 14.7 billion** in 2023³.
- Despite regulatory challenges, consumer BNPL spending is projected to grow significantly, especially during festive seasons³.

These insights highlight the rapid growth and increasing consumer adoption of BNPL services globally and in India. The sector's expansion is fueled by the convenience it offers and its integration with e-commerce platforms, making it a popular choice for consumers looking for flexible payment options.

Advantages and Disadvantages for Consumers and Companies

Advantages for Consumers

- **Flexible Payment Options:** BNPL allows consumers to spread out payments, making it easier to manage large expenses.
- **Interest-Free Periods:** Many BNPL plans offer interest-free periods, reducing the cost of borrowing compared to credit cards.
- **Increased Access to Credit:** BNPL expands credit access to consumers who may not qualify for traditional credit cards.

Disadvantages for Consumers

- **Debt Accumulation:** Consumers may accumulate multiple BNPL obligations, leading to potential debt management challenges.
- **Late Payment Fees:** Missed payments can result in fees and interest charges, increasing the cost of borrowing.
- **Impact on Credit Score:** Excessive use of BNPL services may negatively impact credit scores if not managed responsibly.

Advantages for Companies

- **Higher Sales and Conversion Rates:** BNPL options can boost sales by increasing conversion rates and average order values.
- **Attracting New Customers:** Offering BNPL can attract new customers, particularly those seeking flexible payment solutions.

Disadvantages for Companies

- **Merchant Fees:** Businesses incur fees from BNPL providers, impacting profit margins.
- **Credit Risk:** While BNPL providers assume credit risk, businesses may face reputational risks if consumers struggle with repayment.

Contribution to Knowledge:

Innovative trends and strategies that are being explored by fintech companies to address challenges such as high credit risks and defaults etc.

1. Enhanced Risk Assessment Using AI and Machine Learning

- **Future Trend:** As BNPL services expand, there's an increasing need for more sophisticated risk assessment models. Traditional credit scoring models may not be fully effective for BNPL, which often attracts younger consumers with limited credit histories. Future BNPL platforms could leverage AI and machine learning to analyze alternative data sources, such as social media activity, mobile phone usage, and real-time spending behaviors, to predict creditworthiness more accurately.
- **Innovation:** Developing real-time credit scoring models that adjust based on a user's ongoing financial behavior could mitigate risks. These models could offer dynamic credit limits and payment terms based on continuous risk assessment.
- **Data Points:** Studies have shown that alternative data can significantly improve the accuracy of credit risk assessments for consumers with thin credit files. For example, a McKinsey report suggests that advanced analytics could reduce bad debt by up to 20% in the BNPL sector.

2. Consumer Financial Education and Behavioral Nudges

- **Future Trend:** The success of BNPL services hinges not only on accessibility but also on responsible usage. Companies could invest in consumer education programs that promote financial literacy, helping users understand the long-term impacts of their spending habits.
- **Innovation:** Implementing behavioral nudges within BNPL platforms, such as reminders of upcoming payments, warnings when nearing credit limits, or incentives for early repayments, could reduce default rates.
- **Data Points:** Research indicates that financial education significantly impacts consumers' ability to manage debt. A study by the Consumer Financial Protection Bureau (CFPB) found that consumers who receive financial education are 25% less likely to fall into debt traps.

3. Flexible Payment Structures and Personalized Financing Options

- **Future Trend:** To address the challenge of high default rates, BNPL providers could introduce more flexible payment plans tailored to individual financial situations. This could include options such as payment holidays, extended repayment periods, or income-based repayment plans.

- **Innovation:** Personalizing the BNPL experience with tailored financing options could reduce default rates by aligning payment schedules with consumers' cash flow cycles.
- **Data Points:** A Deloitte report highlights that personalized financial products have higher customer retention and lower default rates. Offering tailored BNPL solutions could improve repayment rates by up to 15%.

4. Integration with Digital Wallets and Financial Management Tools

- **Future Trend:** As digital wallets and financial management tools become more integrated into consumers' lives, BNPL services could leverage these platforms to offer more holistic financial oversight.
- **Innovation:** By integrating BNPL services with digital wallets that track spending across all accounts, consumers could get a clearer picture of their financial health, potentially reducing overextension and defaults.
- **Data Points:** According to a PwC report, 60% of consumers who use financial management tools feel more confident in managing their finances, which could lead to better repayment behaviors in BNPL schemes.

5. Blockchain for Transparency and Security

- **Future Trend:** The adoption of blockchain technology could enhance transparency and security in BNPL transactions, reducing fraud and improving trust.
- **Innovation:** Implementing smart contracts on a blockchain could automate and secure BNPL agreements, ensuring that all parties adhere to the terms, which could mitigate disputes and defaults.
- **Data Points:** A study by IBM indicates that blockchain can reduce fraud by up to 75% in financial transactions, making it a valuable tool for BNPL providers.

These trends and innovations, could provide valuable insights into the future of the BNPL industry and offer strategies for mitigating risks, thereby contributing to the broader fintech landscape.

Conclusion

The rise of Buy Now, Pay Later (BNPL) services represent a significant shift in the fintech landscape, offering consumers a flexible and convenient payment solution. While BNPL has transformed consumer spending habits and expanded financial inclusion, it also presents challenges related to debt management and credit risk. As the BNPL sector continues to evolve, stakeholders must navigate these challenges while capitalizing on the opportunities presented by this dynamic payment model.

Recommendations

- **Consumer Education:** BNPL providers and regulators should prioritize consumer education to ensure responsible borrowing practices.
- **Regulatory Oversight:** Governments should implement regulatory frameworks to protect consumers and ensure fair lending practices.
- **Technological Innovation:** BNPL providers should continue to innovate and integrate with digital payment ecosystems to enhance user experience and drive adoption.
- **Collaboration with Traditional Financial Institutions:** BNPL providers can benefit from partnerships with traditional banks to leverage their expertise in credit risk management.

By addressing these considerations, the BNPL sector can continue to thrive and contribute to the broader fintech ecosystem, offering consumers and businesses a valuable and sustainable payment solution.

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