

# The Buy Now Pay Later (BNPL) revolution:

Accelerating Embedded  
Finance adoption



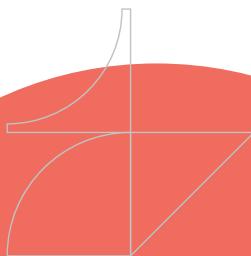
# What is BNPL and why is it taking the world by storm?

Buy now pay later (BNPL) is an embedded finance method offered at point of sale (POS) or cart checkout points, allowing consumers to make payments in installments or pay on the invoice after a determined period. Unlike traditional POS financing methods, BNPL users pay 0% interest rates to the BNPL app in most cases.

BNPL took the small and medium business (SMB) and e-commerce worlds by storm in the face of challenges such as supply chain issues, labor shortages and rising prices during the holiday season of 2021. PayPal reported a 400% Y-O-Y growth amounting to 750,000 BNPL transactions on the Black Friday of 2021<sup>1</sup>. PayPal also reported having more than a million first-time users in one month.

## This article can be viewed in two parts:

- ▶ The first part traces the exponential growth of BNPL, examines industry players, their dynamics and regulatory concerns impacting the industry.
- ▶ In the second part we present Zensar's perspective on how these macro and micro economic drivers along with evolving customer preferences are expected to shape the BNPL ecosystem driving product innovations, experience, & technology spend in the times to come.



## The size and scale of BNPL

Here are some statistics to help us understand the size of the BNPL market



Globally, an estimated \$995 billion is expected to be spent through BNPL options by 2026<sup>2</sup>.



In the US, the BNPL market is expected to grow by 1200% to \$124 billion by 2023 from \$3 billion in 2019<sup>3</sup>.



The market for BNPL at POS was estimated to be \$8 - \$10 billion in 2019, and is now growing at a rate exceeding 40 to 50%<sup>4</sup>.



Players like Affirm, Afterpay, and Klarna etc. are expected to triple their global current ecommerce market share from 1% to 3% by 2023.

# Current trends influencing the BNPL market

BNPL is gaining popularity as an embedded finance option for e-commerce. 2.8% of the world's ecommerce payments are expected to be in the BNPL format by 2023, growing approximately 2X since 2019. In North America, the expected share will be 3% in 2023, with 3.3X growth since 2019. In addition, BNPL is moving away from the traditional online payment substitute model. The recently opened Flava supermarket in the UK is a BNPL only supermarket. In the US, Afterpay has introduced BNPL for gym memberships and at Belk stores.

However, there are also some cautionary tales. Australia's Afterpay reported a loss of \$156.3 million while Zip faced losses of \$652 million in just one financial year due to delinquency. Similar red flags across the globe have compelled regulators like CFPB, FCA etc. to look into BNPL to bring in more stringent risk and regulatory reporting guidelines.

## BNPL: Market entry models

There are several models available to support go-to-market (GTM) strategies in the BNPL space:

### Renting out the balance sheet -

The entrant can partner with established BNPL players to originate. This strategy offers entry to the market with minimal investment. Cross River Bank is currently riding the BNPL trend with this model by providing Affirm with funding capacity.



Figure 1: Key criteria in renting the balance sheet -

The scale spans from red to green with red indicating less favorable and green indicating more favorable

### Marketplace partnership -

The entrant can lend in online ecosystems that bring multiple lenders to merchants. This avenue offers greater consumer access and brand presence at a low initial investment. For merchants, it offers higher approval rates and limited integration fatigue.

### Rent-a-platform partnership -

The entrant can rent the existing BNPL financing technology platforms to monetize their merchant relationships and balance sheet without having to invest in building an in-house lending infrastructure. This path monetizes the existing merchant relationships but requires greater investment in business development.

### Card platform partnership (or post-purchase BNPL) -

The entrant (Bank/ FI/ Card Network) can enhance their card offerings with installment loans within existing credit card accounts to capture a larger share of borrowing and monetize unutilized credit lines available on credit cards. Integrating card-enabled installments at the POS can be an industry disruptor and first movers may be able to see significant upside in wallet share.

## BNPL Origination: Common distribution models and entities

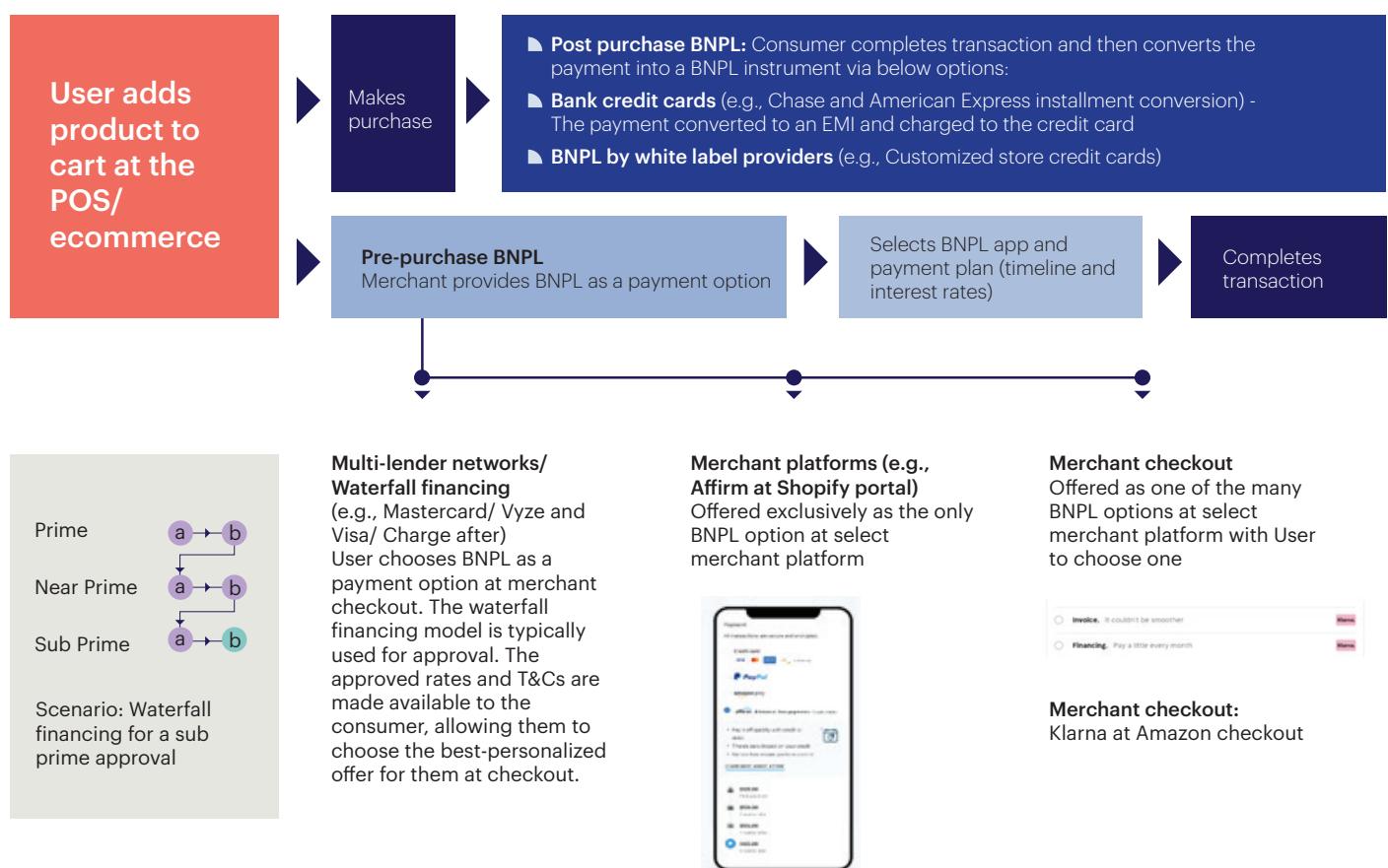
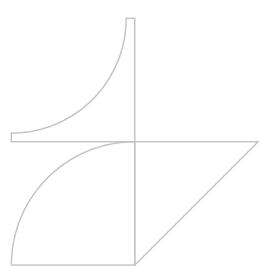
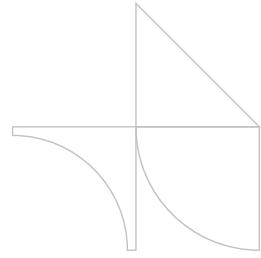


Figure 2: Distribution models



# BNPL payments: Methods and economics



**BNPL lenders offer different payment options for users including:**

- ▶ Split pay - Where the BNPL user splits the payment into installments
- ▶ Pay later - Where the user makes the complete invoice payment at a later date in one go
- ▶ Long-term financing at 0% Annual Percentage Rate (APR) - A version of split pay with longer tenure and higher number of installments
- ▶ Longer-term financing with subsidized interest or fee - The BNPL solution is converted to a general POS lending instrument, although at a low fee/APR

Figure 3 depicts how the various intermediaries monetize from buyers as well as sellers. The primary avenue is merchant discounting which gets distributed across the network. However, there are other revenue sources such as:

- ▶ Transaction fees / Platform usage fees
- ▶ Interest charges (if applicable)
- ▶ Late fees

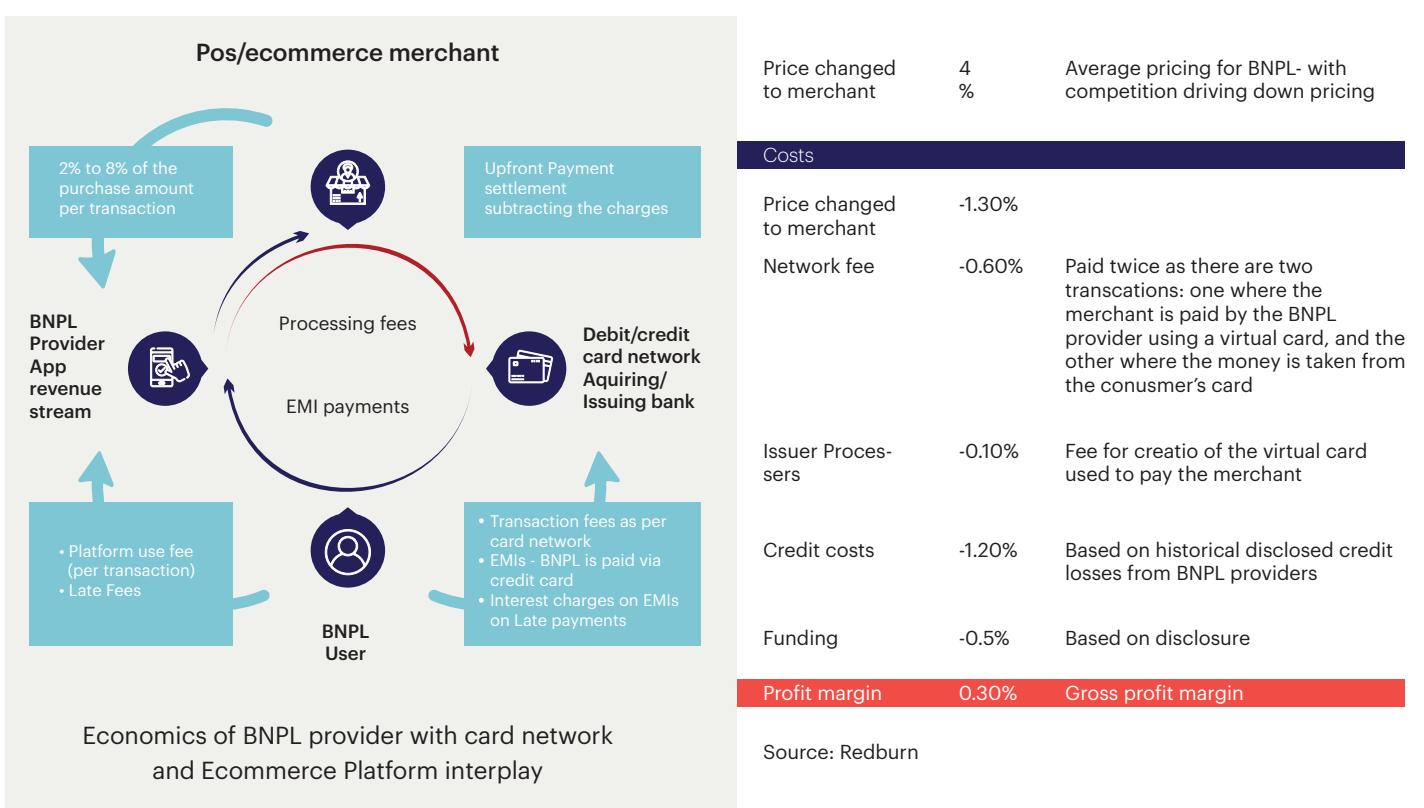


Figure 3: Monetization by intermediaries in the BNPL ecosystem

# BNPL: Industry consolidation and growth

The conundrum for the nascent startup space has always been - build or buy. In the BNPL space, where growth and rapid scale are key KPIs, 'buy' has always been the answer to defend margins at the cost of growth. As the BNPL space picks up pace globally, mergers and acquisitions (M&As) have seen an uptick across the BNPL value chain.

- ▶ Larger players like existing BNPL, payments players and banks that have the funding advantage and understanding of regulatory headwinds have been acquiring to scale up. E.g., Paypal acquired Bill Me Later and Paidy, Santander announced the launch of Zinia and Apple announced BNPL partnership with Goldman Sachs
- ▶ The other approach is to position B2C BNPL brands as strong consumer brands/super apps via M&As. These brands are moving away from being a payment only method towards offering a comprehensive shopping experience for consumers. E.g., Klarna offers a complete price comparison (PriceRunner), shopping (Spring) and BNPL value chain on one Klarna app to its customers. Figure 4 shows Klarna's acquisitions timeline along with core and peripheral acquisitions.

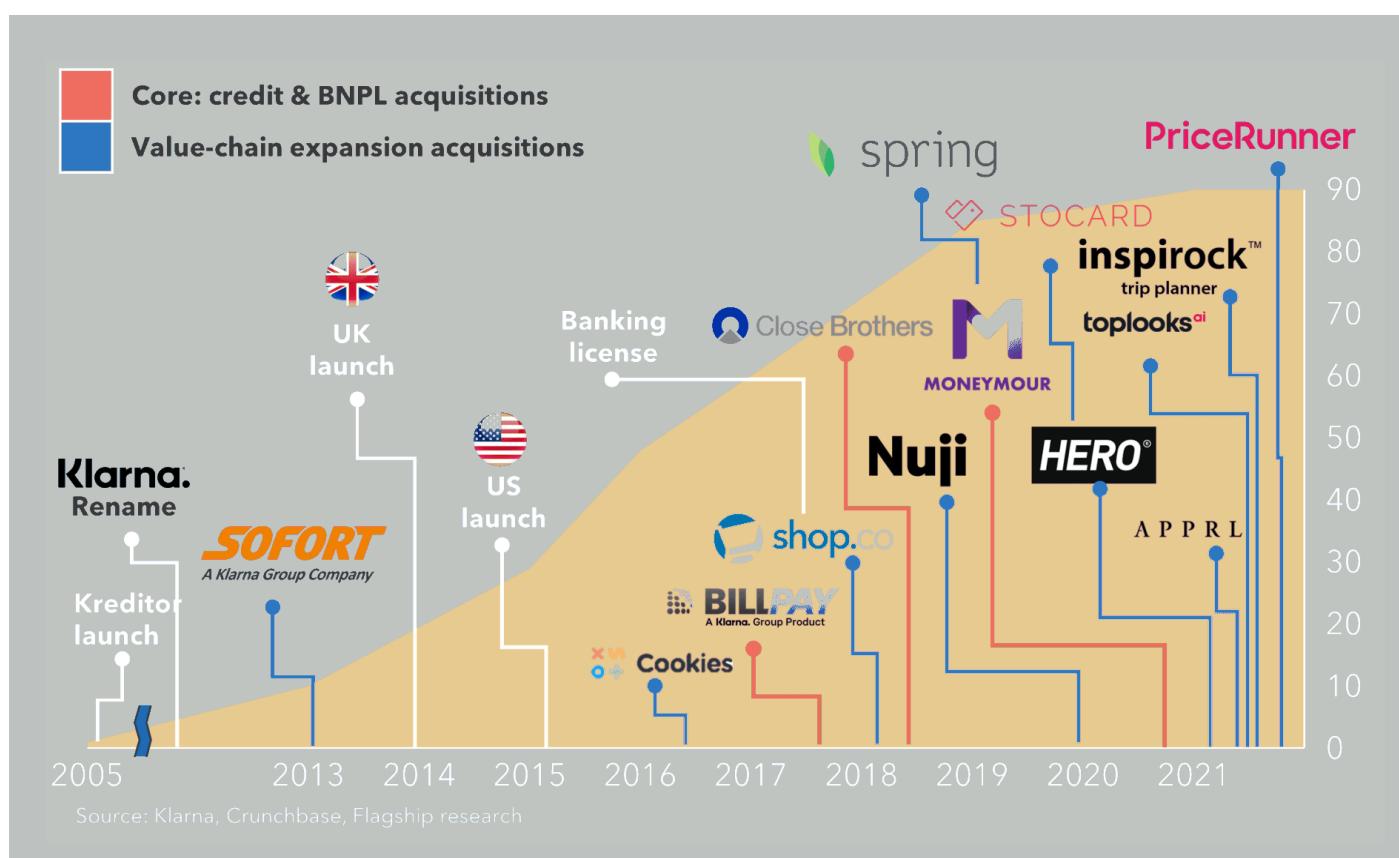


Figure 4: Klarna M&A Timeline, source - Klarna/Flagship advisory

# BNPL:

## Demand for an offline payment option

- 46% of online shoppers at department stores are highly interested in using an installment payment method such as BNPL
- 94% of consumers who have used BNPL options in the past month would use them again at a local retailer's physical store

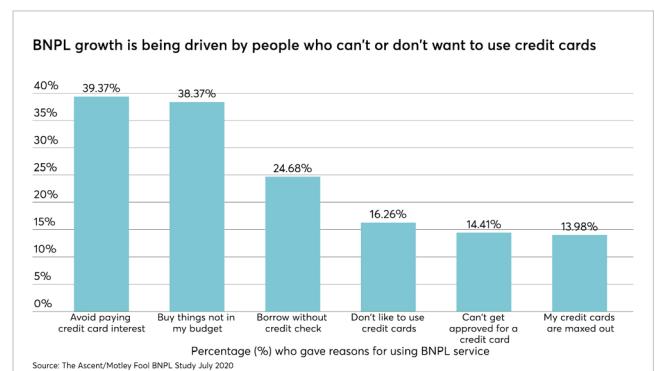
According to the Main Street Index, 25% of businesses plan to add BNPL as an embedded finance option in the next 12 months. However, the criticism, especially for offline BNPL options on food/alcohol/grocery has focused on providers preying on people's apprehensions or fear of missing out (FOMO) on attractive offers. BNPL for anything but larger purchases will increase personal debt for account holders, leading to a cycle of debt and credit defaults at some point.



# BNPL consumers: Key drivers and insights

## Inflation is a key driver for BNPL adoption

In a recent Experian Consumer Study, 75% of consumers said they were worried about the rate of inflation while 43% of consumers reported that they were moderating their spending. This inevitably implies slow retail spending through traditional payment methods.



Barring late fees and any other platform specific charges, BNPL offers the option of spreading out a payment into the future without any extra interest charges. Around 40% customers from a survey stated they would want to use BNPL to avoid additional interest payment.

## Financial flexibility regardless of wage

Although BNPL has often been stereotyped as a solution for people who live paycheck to paycheck (much like a payday loan), consumer research has revealed that it is, in fact, an excellent solution for frugal and credit averse customers.

Customers enjoy the idea of BNPL because it allows them the flexibility to manage their accounts regardless of their wage level. Around 25% surveyed customers did not want an additional credit check during a purchase, which is usually done in case of credit cards. They therefore preferred BNPL to other types of credit methods. Research also showed these consumers were keenly interested to use BNPL for high value purchases.

## Items being bought on buy now, pay later over traditional credit

Item(s) purchased	All credit types	Buy now, pay later methods (Paypal Credit, Klarna, Clearpay, Partial.ly)
Clothing and shoes	44%	46%
Health and beauty	39%	40%
Toys	40%	39%
Electrical items	35%	39%
High fashion	29%	39%
Smartphone	28%	38%
Jewellery	28%	38%

# BNPL: Challenges and regulatory concerns

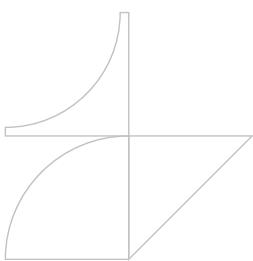
As BNPL proliferates, it creates the risk of consumer debt and defaults. Also, since the trend is largely driven by small fintechs (who may not be so well financed), there is a potential risk to these companies as well as the merchants. The challenges are further amplified due to continuously innovative BNPL products, exponential growth and lack of any overarching regulatory framework across the globe.

Recently, regulators have started taking note and are formulating regulations, although not with the required agility. However, with the entry of larger players like credit card networks (Visa, Mastercard) and large banks/FIs in collaboration with larger merchants/chains like Amazon, there is an opportunity for BNPL offerings to be more structured and customer friendly while continuing to be innovative. Here are some key callouts for market players and regulators:

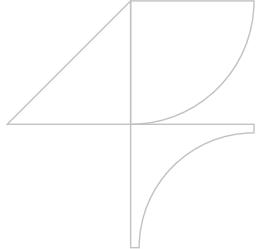
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 Credit/Affordability Checks	 Product Considerations	 Regulatory Oversight	 Regulation
<ul style="list-style-type: none"><li>▶ Today, providers like Afterpay unilaterally increase consumers' credit limits over time</li><li>▶ Regulators need to introduce mandatory end customer affordability checks for all BNPL offerings. This can be a simple mechanism of debt to income ratio checks and denials if it crosses a certain critical threshold</li></ul>	<ul style="list-style-type: none"><li>▶ Allow buyers a window to cancel / opt out of the BNPL offer for high value items, say within a week (with certain underlying asset usage conditions)</li><li>▶ Credit limit relaxations can be considered based on asset types like smart phones, which have resale value in case of defaults</li></ul>	<ul style="list-style-type: none"><li>▶ Regulatory oversight should be mandatory for all BNPL providers to ensure that there is no aggressive lending and subsequent coercive collections in case of defaults</li><li>▶ Ensure transparency into product, merchant and customer profiles</li><li>▶ Ensure protection of end customer data and compliance with laws like GDPR</li></ul>	<ul style="list-style-type: none"><li>▶ Regulations need to be quickly brought in place before BNPL becomes too big to manage</li><li>▶ USA has the inherent complexity of central, state &amp; county statutes and oversight</li><li>▶ EU regulators are still grappling with the correct setup, exploring the directive for credit cards and overdrafts. FCA in the UK is exploring applicability of the Consumer Credit Act to BNPL</li></ul>

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# Product innovations in a digital native space



The rapid advances in Digital payments ecosystem and especially BNPL is potentially going to become a key driver for Embedded Finance. BNPL players are exploring various Payments as a Service models across industries. Banks & FinTech players are adopting different business models



## Innovative business models by BNPL providers (Apps/Banks/Card Networks)

- ▶ Vertical-specific POS lending
- ▶ BNPL platform to onboard and serve small businesses that enable small merchants to offer BNPL
- ▶ Consumer data analytics, fraud, loyalty and marketing for merchants
- ▶ Debit card with built-in BNPL options
- ▶ Bundled customized personal finance for BNPL consumers



## BNPL for large ticket items Market/Merchant driven innovation

- ▶ Merchant banking:  
Meeting and maintaining trade margin using BNPL
- ▶ B2B/trade financing solution –  
E.g. Mastercard BNPL for SMBs in APAC
- ▶ BNPL for metaverse and in-game purchases – E.g., Metafi
- ▶ Tourism - Vacation financing/Vacation house purchase/Air ticket financing –  
E.g., Delta airlines offering Amex BNPL for air tickets
- ▶ Retail purchases - High Street fashion, collectibles and art purchases (powered by NFTs)
- ▶ Hospitality sector: Hospitalization expenses, healthcare products/services financing

Digital experience will be the key to quick customer acquisition, for any of these innovations to shape the space!

Customers are likely to abandon the payment midway if there are too many steps involved. The mean number of clicks to the final payment screen is typically five across any platforms. However, newer BNPL fintechs are looking to reduce these mean touch points using:

- ▶ Ease of signing up and even lesser steps at the POS
- ▶ or “touch and go” by partnering with schemes / acquirers

# Enabling technology for BNPL products and services

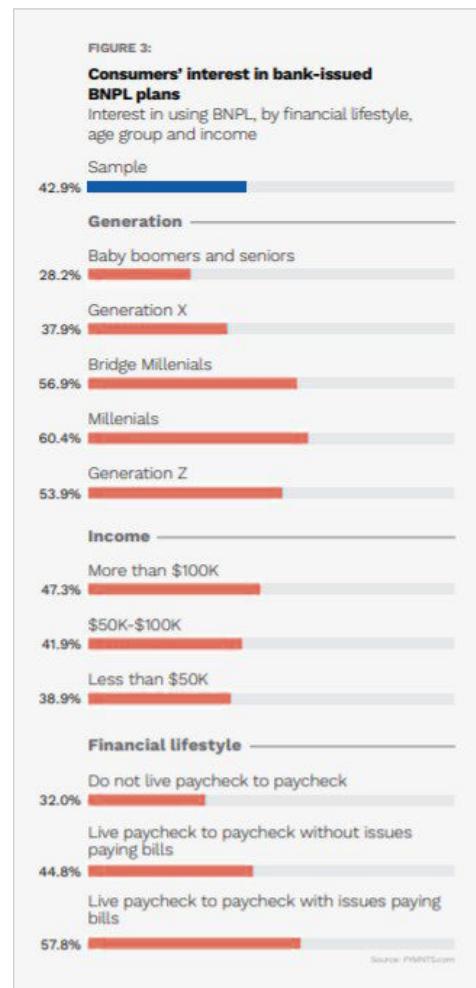
- BNPL platforms need to offer seamless customer experience along with transparency of terms and conditions
- BNPL platforms need to offer the ability to quickly launch new products in response to market needs and offer automated STP for quick approvals
- BNPL platforms need to offer an AI/ML enabled robust workflow and rules engine for fast but secure underwriting approvals
- BNPL platforms need to offer robust APIs and embedded payment gateways for easy integration to third party services like fraud checks, credit bureaus, and other entities in the ecosystem to enable smooth payments experience
- BNPL platforms need to have good data analytics capabilities – to offer customized bundled and extended products beyond being just a prepaid payment instrument
- BNPL platforms need to be able to quickly incorporate any regulatory guidelines and maintain due audit trail



# With many product innovations – what's next?

We envisage two key imperatives for the future that will impact the growth of the BNPL market: First, embedded finance will create opportunities for merchants - Around 75% of consumers\* who finance large-ticket purchases decide to do so early in the purchase journey, before the actual purchase. Integrating BNPL solutions offers an avenue to capture sales by increasing the conversion rate by 20% while also increasing average order value by 60%. Further, integrating financing offers throughout the consumer journey increases the conversion rate by 2-3X, relative to integration at checkout and improves stickiness for lenders.

Second, banks will be the chief catalysts in changing the BNPL landscape - Fintechs often lack the scale and expertise especially in loan servicing and collections, placing them at risk in case of any economic downturn or regulatory change. This is where banks and traditional lenders have the advantage given their legacy in the business. Banks have the requisite knowledge to underwrite and price credit, and have proper systems and guidelines in place for unsecured consumer lending. With this expertise and consumer trust, in addition to the large installed base of credit card customers, banks are poised to win and revolutionize the BNPL landscape. Further, research also indicates that a large number of consumers prefer bank-issued BNPL plans.



With BNPL gaining popularity, the market is likely to experience commoditization of BNPL products. The barriers to entry for established financial players in this segment is low. On the other hand, global players are likely to increase their presence in emerging markets through acquisitions and buyouts. Even as the players fight for a larger share of the market with offers, added discounts and insurance and related offerings, regulators are likely to tighten the compliance and regulatory guidance to ensure consumers don't succumb into a debt trap. Ultimately, securing consumer and merchant loyalty will be key to success.

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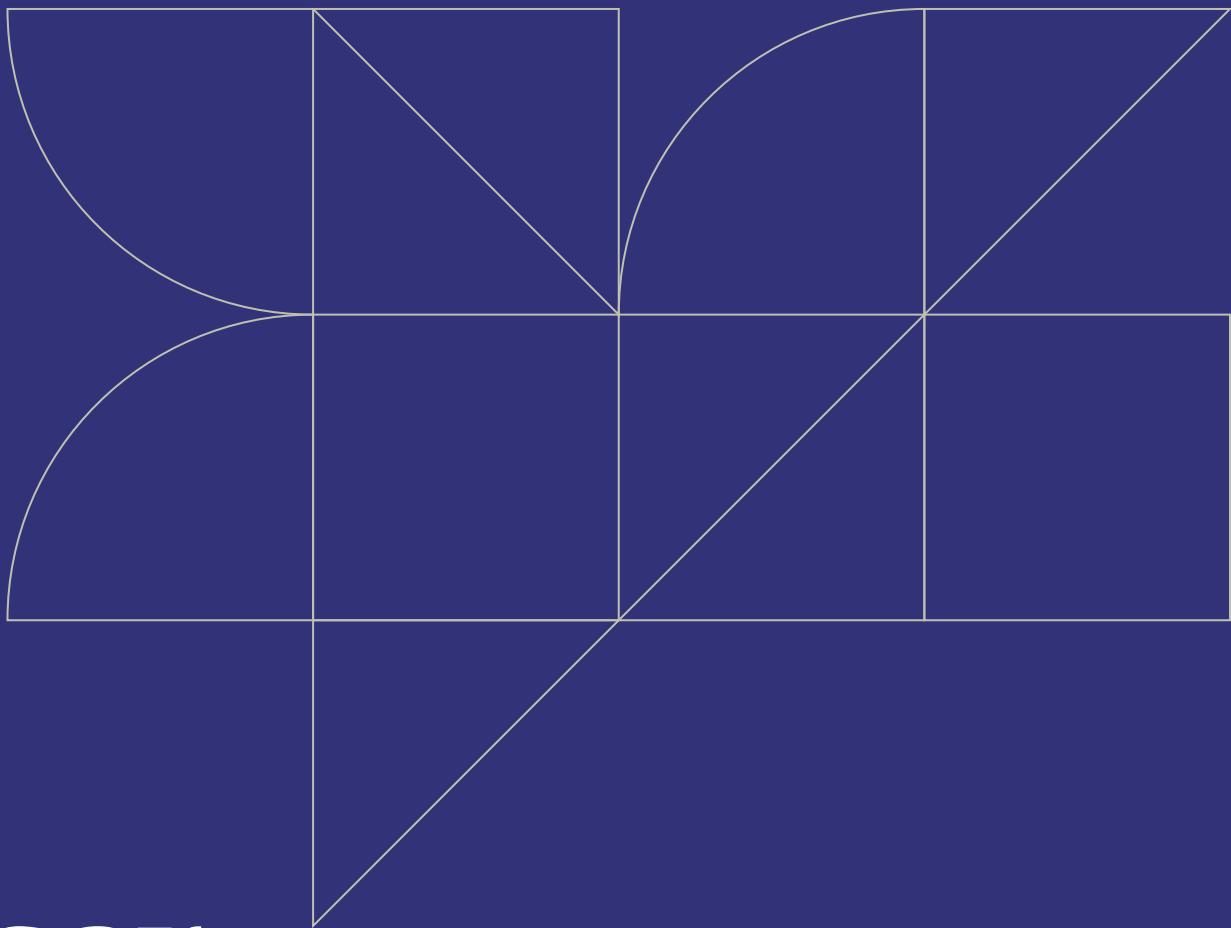
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