

CAPCO

THE ERA OF BUY NOW PAY LATER



INTRODUCTION

Buy Now Pay Later (BNPL) is changing the way consumers think about credit, but what does this mean for banks and the wider credit industry, and what should they be doing about it? In this paper, we share our perspective on this exciting new trend in payments.

Capco view:

1. BNPL will be a force for change in the consumer credit market
2. Banks need to take action to defend their credit business by enhancing the customer experience.
3. BNPL will come under closer scrutiny from the regulator and banks need to play their part to ensure BNPL is not another way of consumers getting into debt, or the next retail banking scandal.

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WHAT IS BNPL?

Buy Now Pay Later (BNPL) has quickly risen to prominence in the UK in the last decade, with Swedish challenger bank Klarna, which arrived in the UK in 2014¹, spearheading this exciting new form of credit. BNPL providers partner with retailers to give consumers the option of upfront credit which can be paid at a later date, either via a deferred payment in full or by splitting the payment across multiple fixed instalments with any interest agreed upfront and built into the repayment plan. The rise in BNPL services has predominantly come around thanks to a

series of fintechs coming to the table as payment platforms and partnering with leading e-commerce retailers to offer interest-free credit at checkout.

According to a 2020 Worldpay report, BNPL fintechs are growing at a rate of 39 percent annually in the UK, with expectation that they will double their ecommerce market share by 2023.²

1. <https://www.klarna.com/uk/about-us/>

2. <https://worldpay.globalpaymentsreport.com/#/en>

MAJOR PLAYERS:

The UK's main BNPL players are currently Klarna, Laybuy, ClearPay (part of the AfterPay family) and PayPal Credit. Below, we provide a snapshot of each of these providers.

BNPL Provider	Klarna	Laybuy	ClearPay	Paypal Credit
Company Info	Swedish-based company launched in the UK in 2014. Their services are available in 17 countries	New Zealand-based company launched in the UK in 2019. Their services are also available in Australia	Australia-based company launched in the UK in 2019. Their services are also available in New Zealand and the US	Singapore International Headquartered. EU Headquarters are in Luxembourg. Started BNPL service in UK in 2014 and operates in UK, USA, and Germany
Customers	Almost 10 million UK customers, growing by 95,000 each week. Globally, it has 85 million customers ³	269K+ UK customers, a 916% increase over the past year ⁴	1 million active UK shoppers ⁵	Exact number unknown, but there are 320 million active Paypal accounts globally ⁶
Retailers	190K+ retailers in 17 countries including ASOS, H&M, TopShop, Michael Kors & Samsung	800+ retailers including JD Sports & WH Smith	Over 1,100 brands including ASOS, M&S and Urban Outfitters ⁷	"Thousands of online stores" including Blacks, Chain Reaction Cycles, Dyson, Millets and Samsung ⁸
Products	0% interest when you 'Pay Later' (30 days)	0% interest, pay in 6 instalments	0% interest when you pay in 4 instalments within 6 weeks ⁹	0% for 4 months when you spend £99 each time. 19.9% APR ¹⁰
	0% interest when you 'Split it in 3'			Coming soon ¹¹
	0% interest with 'Klarna Financing' over 6 – 36 months ¹²			

Other global rising stars include Affirm, AfterPay, Sezzle, Zip, V12, and Sabadell.

3. <https://www.theguardian.com/money/2020/oct/03/klarna-debt-buy-now-pay-later-fees-interest>

4. https://www.altfi.com/article/7188_sales-soar-at-klarna-rival-laybuy-as-buy-now-pay-later-sector-hots-up

5. <https://www.prnewswire.com/news-releases/clearpay-reaches-one-million-active-customers-in-first-year-301081483.html>

6. <https://www.livewiremarkets.com/wires/is-paypal-a-threat-to-australia-s-bnpl-sector>

7. <https://www.prnewswire.com/news-releases/clearpay-reaches-one-million-active-customers-in-first-year-301081483.html>

8. <https://www.paypal.com/uk/webapps/mpp/paypal-virtual-credit>

9. <https://www.clearpay.co.uk/en-GB/how-it-works>

10. <https://www.paypal.com/uk/webapps/mpp/paypal-virtual-credit>

11. <https://www.cnbc.com/2020/10/13/paypal-takes-aim-at-klarna-with-pay-in-3-service-for-uk-shoppers-.html>

12. <https://www.klarna.com/uk/business/products/financing/>

KLARNA

Klarna has built a strong brand in Europe as the market leader of BNPL, paving the way for other providers across the continent as well as further afield. Their customer base is almost 10 million users in the UK which is growing daily¹³. Its expansion into new verticals, from initially fast fashion to more premium finance offerings for higher-ticket offerings (from Peloton bikes to Loaf sofas) are no doubt helping to propel its success.¹⁴

Each lending decision is made by an automated algorithm, and their customer offer is simple, enabling consumers flexibility of their spending through three key products: Pay Later (deferred payment in 30 days), Pay Later in 3 (instalments offering to split cost across three payments), Klarna Finance (6 – 36 months) and the

Klarna card. The Klarna card is currently only available in Sweden and Germany, enabling customers to use their Klarna card at any merchant, both online or at point of sale with the payment method aligning to the customer's default settings (either Pay Later, Pay Later in 3 or Pay Now).

Klarna's app provides a tailored user experience with personal spending reports, exclusive deals, and notifications of new product 'drops' from brands all over the world. Similar to millennial favorite, Pinterest, the Klarna app also allows users to 'pin' prospective purchases and create wishlists and has direct links to brands which offer its BNPL service. Is it any wonder that the average age of Klarna user today is 33 years old?¹⁵

WHERE DOES BNPL FIT IN THE WIDER CONSUMER CREDIT INDUSTRY?

BNPL is a 'during purchase' payment option which is predominantly present in ecommerce, although there have been products launched for face-to-face point of sale (PoS) transactions, such as Klarna In-store (by QR code), Klarna Card and Laybuy. Other consumer credit options include PoS finance, and revolving credit cards. PoS finance is typically initiated in-store when purchasing electronics and household goods, and such solutions have historically had socioeconomic status around them. The revolving credit card is perhaps most under threat from BNPL, although our Capco research shows that credit cards are here to stay for the time being.

However, they must stay on top of emerging payments options; the majority of the BNPL users we surveyed said that they preferred BNPL to the credit card, store cards, and other forms of credit¹⁶.

An increasing number of instalment repayments are moving away from card transactions and are being set up as direct debit repayments, which will impact consumer issuing banks due to the loss of interchange revenue. Face-to-face BNPL PoS transactions, will additionally appear as ecommerce transactions, meaning there is an even greater impetus for banks to protect their market share.

13. <https://www.klarna.com/uk/csr/openness/>

14. <https://securecdn.pymnts.com/wp-content/uploads/2020/01/PYMNTS-Buy-Now-Pay-Later-January-2020-Tracker.pdf>

15. <https://www.thisismoney.co.uk/money/cardsloans/article-7966159/Could-buy-pay-later-Klarna-kill-credit-card.html>

16. <https://www.capco.com/BNPLsurvey>

THE BNPL CUSTOMER

WHAT IS THE CUSTOMER NEED?

The growth of digital wallets and mobile commerce will be at the forefront of future BNPL adoption, given the younger demographic focus and personalized user experience already available on BNPL apps. During the 2019 holiday season in Australia, Afterpay reportedly saw 80 percent of all their customer base using their mobile phones to BNPL, proving that convenience is still king.¹⁷

We wanted to know whether consumers wanted a series of different BNPL providers available at checkout, varying merchant to merchant, or for their banks to join the BNPL party (giving consumers the flexibility to manage their money as their trusted financial partner). Our consumer research on BNPL found that the majority of respondents, who had not used this form of credit before do not want a service like this from their bank at this point. However, the majority of BNPL users were open to having BNPL integrated into the credit card or current account¹⁸.

WHO IS BNPL FOR?

Buy Now Pay Later has been stereotyped as a solution for people who live paycheck to paycheck, however, a series of consumer research carried out by multiple different sources has identified that it is in fact simply a great solution for the budget conscious and more 'credit averse' consumers. Indeed, our consumer research survey on BNPL found that almost 30 percent of BNPL users were well above the average UK individual annual income¹⁹.

Furthermore, our consumer research indicated that consumers like the concept of BNPL as it gives them the flexibility to manage their finances, regardless of income level. For the majority of those who have used BNPL before, they even prefer it to other forms of credit, like credit cards or store cards²⁰.

At present, BNPL purchases are clustered around typically cheaper retail items but there is a clear appetite to pay for more expensive items using BNPL too.

17. <https://securecdn.pymnts.com/wp-content/uploads/2020/01/PYMNTS-Buy-Now-Pay-Later-January-2020-Tracker.pdf>

18. <https://www.capco.com/BNPLsurvey>

19. <https://www.capco.com/BNPLsurvey>

20. <https://www.capco.com/BNPLsurvey>

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%
Smartphones	28%	38%
Jewellery	28%	38%

Items being bought on BNPL over traditional credit, according to February 2020 ThisisMoney.co.uk consumer research survey.²¹

We believe BNPL adoption will increase as more stores (on the high street and online) start to offer BNPL at point of sale. Despite the rapid rise of BNPL, most of our survey respondents (30 percent) only use it a few times a year²². However, BNPL is not an available payment method for many of life's purchases. For example, high-street fashion is a huge vertical for BNPL, but usage may remain fairly low as it is driven by how often

consumers shop with these providers and merchants. As BNPL providers expand into more verticals, BNPL usage should increase. Last year, we saw the emergence of the UK's first BNPL supermarket, Flava.²³ While there's no option to 'try now and pay later' on perishable goods, who's to say whether supermarkets and the food & drinks industry won't soon get onboard with the BNPL and instalments trend too?

21. <https://www.thisismoney.co.uk/money/cardsloans/article-7966159/Could-buy-pay-later-Klarna-kill-credit-card.html>

22. <https://www.capco.com/BNPLsurvey>

23. <https://www.which.co.uk/news/2020/10/flava-the-buy-now-pay-later-supermarket-that-lets-you-spread-the-cost-of-groceries-what-are-the-risks/>

TRUST & LOYALTY

To date, how a consumer selects a BNPL option has been driven by the merchants they shop with. Strong partnerships with a broad range of merchants enable Klarna, ClearPay, LayBuy and PayPal Credit to shape the UK's BNPL and consumer credit markets.

The branding of these BNPLs are also very much present on social media channels, and even Transport for London advertising spaces, such as on the tube and on sides of London buses. This begs the question, does the same amount of thought go into selecting a BNPL provider as you would with choosing a new bank?

Loyalty plays a big role in consumer behaviors, but whether the BNPL era is driving loyalty amongst consumers remains to be seen. After that first purchase with a BNPL provider, does the consumer become more attached and loyal to that brand, or would they 'cheat on them' for their next BNPL transaction? We don't know the answer to this exactly, but we do know that one of the biggest issues online retailers face is the dreaded shopping basket paralysis. In fact, a Smart Insights report

found that global mobile conversion averages less than two percent for online shopping.²⁴ Such realities put the pressure on BNPL providers to make the onboarding and payment process as simple and stress-free as possible, but they also present an opportunity. Flexible payments could, in theory, be able to reduce shopping cart abandonment at checkout by lessening the significance of making a purchase (and thus driving value and sales conversions for merchants).

Continuing this theme, we were keen to see how the sign-up process and making a BNPL payment varies per provider, so we did some testing. We found that the user journeys between BNPL provider to be very similar, with the mean number of clicks to the final payment screen being just five. In Australia, an even more streamlined BNPL payment process is possible with Zip, which has launched a 'tap and go' feature with Visa, allowing the BNPL service to be used 'at every checkout' (well, in theory).²⁵ Whilst most BNPL providers in the UK partner directly with merchants, Zip are showing how partnering with payments players (schemes, acquirers) can accelerate distribution. Your move, UK.

A CHANGING ATTITUDE TOWARDS CREDIT

The presence of BNPL providers is playing a key role in changing the buying behaviors and general outlook on traditional methods of credit. Our research shows, contrary to the youthful marketing image of BNPL, the biggest users of BNPL are in fact 35 – 44-year-olds (Gen Y and X demographics), followed by the over 65s (Boomers) according to our research²⁶, which suggests more mature demographics are not averse to trying new types of credit; and as aforementioned, BNPL is the most preferable form of credit for those who have used it to make a payment before.

By providing a manageable way for consumers to borrow and repay with the interest (where applicable) built into the repayment plan with fixed-end date, BNPL providers are giving consumers more assurance that they can repay without falling into a revolving credit repayment.

The entrance of these new BNPL players and their innovative solutions is putting under threat the future of unsecured credit, which begs the question what banks and other credit card issuers are doing about it?

24. <https://www.smartinsights.com/ecommerce/ecommerce-analytics/ecommerce-conversion-rates>

25. <https://www.businessinsider.com.au/zip-tap-go-visa-australia-stores-credit-2020-10>

26. <https://www.capco.com/BNPLsurvey>

WHAT NEXT?

IMPLICATIONS FOR BANKS AND CREDIT CARD ISSUERS

The rise of BNPL services demonstrates the need for banks and credit card issuers to act quickly in response to this demand for change. Unsecured credit is transforming, and credit card issuers need to consider new ways of offering credit to consumers; furthermore, with the cost of credit reportedly rising²⁷, customers may be driven towards alternative lending solutions sooner rather than later.

Banks have been considered a trusted source of lending, so it seems like a no-brainer to give customers the choice to pay by instalments. This would additionally give customers a tool within their existing safe and trusted banking space to manage their finances, avoiding taking on additional apps and new lenders. Almost half of our surveyed BNPL users would like this service (45 percent) from their bank or credit card provider²⁸.

We believe banks should be making a defensive 'play' in this space to maintain their existing market share by:

1. Looking at investing in instalments solutions
2. Creating their own standalone BNPL products
3. Partnering with a BNPL provider to provide either of the above.

With consumers adopting new alternative ways of accessing credit, there is a need to diversify credit card offerings for future sustainability and profitability. The move to in-checkout origination is part the ongoing trend of financial services moving closer and closer to the customer's specific point of need. The way forward for lenders is twofold: continuing to offer and build on traditional consumer credit such as credit cards but enhancing the accessibility and options available; and importantly designing new products that respond to consumer needs giving them instant access to short-term payment plans with capped interest built into the repayment, which maintaining transparency.

Transparency is key, as it gives consumers peace of mind. Banks and other credit card issuers should be feeling the pressure and growing threat of the new entrants, currently shaking up the consumer credit market. The starting point for banks and other credit card issuers is to consider why people choose credit, when they initiate it, how they initiate it and what their preferred of trusted source of credit is. Banks have the benefit of being they trusted companion for consumers when it comes to credit, and if they choose to act now and launch new and enhance their existing credit offering, will most definitely reap the benefits in years to come as the market continues to evolve.

27. <https://www.theguardian.com/money/2020/oct/15/uk-banks-plan-to-hike-cost-of-credit-card-borrowing>

28. <https://www.capco.com/BNPLsurvey>

BNPL AND ETHICAL LENDING

The regulator is hot on the heels of new entrants to the consumer credit market, and as a nation we need our banks to join the party to drive the increasing requirements for responsible lending. The main challenge with BNPL is the rate at which it is growing and the limited requirements for credit checking consumers before they are approved for taking on BNPL plans. This concern has been raised by the Financial Conduct Authority (FCA), as part of a larger review into how regulation can better support a healthy unsecured lending market. Recommendations from the FCA are expected in early 2021.²⁹

Is BNPL the next big red flag for spiraling debt and revolving credit? Unless financial regulators step in and ensure BNPL

providers are lending responsibly to consumers and limit the acceptance of credit eligible customers to those who have the ability to pay back their credit plan within the specified timeframes, this unfortunately could be the reality.

In a world where consumers desire simplicity and immediacy in their buying, BNPL is merely responding to this evolving consumer need. It is up to the consumer credit providers however to lend responsibly and avoid the vicious circle of enticing consumers into revolving credit debt. This further underlines the opportunity for traditional lenders, who have a proven capability to operate within the bounds set by the regulator.

HOW CAN CAPCO HELP?

Whether you are deciding if you should enter the BNPL market, have made the decision and want to design your proposition, or are looking to accelerate the launch of your BNPL product into the market, Capco can help.

We combine industry expertise in banking and payments with strategy, proposition design, product development, and delivery capabilities to help clients make better decisions, and execute them more effectively.

We aim to make it simple for you to partner with us to deliver new products to market, utilizing our significant expertise in delivering projects across the payments value chain.

29. <https://www.ftadviser.com/regulation/2020/09/16/chris-woolard-to-leave-fca/>

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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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