



Disrupting The \$8T Payment Card Business:

The Outlook On 'Buy Now, Pay Later'

2021

Today, “buy now, pay later” accounts for only a small portion of overall card spending. But amid the pandemic-fueled e-commerce boom, this alternative model may be poised to disrupt the \$8T US payment card industry.

As online shopping surges amid the pandemic, “buy now, pay later” (BNPL) companies have dominated headlines – attracting online, money-conscious shoppers with seamless delayed payment alternatives that bypass the usual fees.

With e-commerce volumes jumping forward an estimated 4-6 years due to worldwide lockdowns, consumers and merchants have increasingly looked to buy now, pay later solutions to alleviate financial pressure and to meet online shopping demand, respectively. BNPL players like Klarna, Afterpay, and Affirm are well on their way to becoming household names, with new user growth and transaction volume exploding.

Today, BNPL reflects a small portion of the overall spending on payment cards (including credit, debit, and prepaid cards), an industry that sees roughly \$8T in annual spend volume in the US. However, there is growing evidence that BNPL is at an inflection point.

By 2025, the global BNPL industry is expected to grow 10-15x its current volume, topping \$1T in annual gross merchandise volume by some estimates. This growth trajectory has incumbents paying close attention and increasing their efforts to improve the digital user experience.

While the BNPL industry is still in the early innings, competition is quickly mounting. Several key questions remain – especially around how incumbents will respond to the emerging threat, and whether BNPL players really can offer a better alternative to credit cards without harming consumers.

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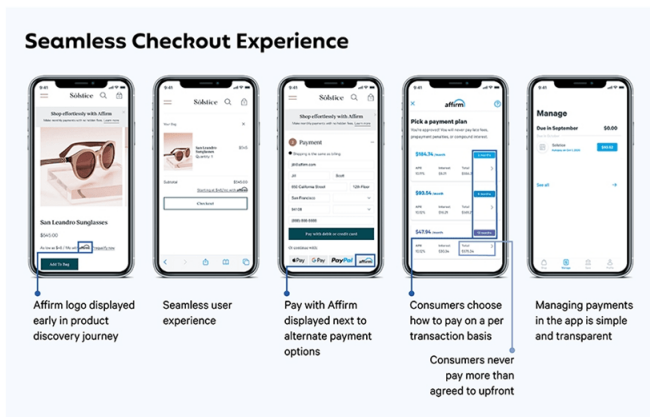
What is buy now, pay later?

Buy now, pay later payment models have a dual mandate.

The first is to provide consumers with a seamless purchasing experience, characterized by convenience, transparency, and flexibility.

The second is to help merchants increase online sales conversions and order values, while lowering user acquisition costs.

BNPL checkout experiences are digitally native and designed to drive sales conversion



Source: Company filings

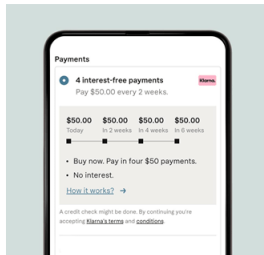
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FLEXIBLE PAYMENT OPTIONS FOR ONLINE CONSUMERS

BNPL providers allow consumers to purchase items online through flexible installments (typically in 4 payments) with no interest or penalties if paid on time, or through fixed-rate interest-bearing loans at the point-of-sale where fees are known upfront.

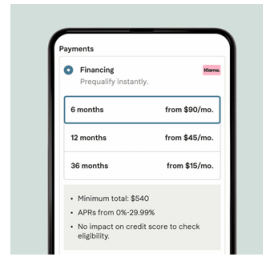
BNPL options come in two major variations

Installments



- Split purchase cost typically over 4 interest-free payments, paid automatically every 2 weeks
- No interest or credit check, but late fees and returned payment fees apply

Online POS Financing



- Point-of-sale lending with traditional interest
- Loan terms vary by provider, but 6-36 months terms are common

Source: cbinsights.com, Klarna

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BNPL can be used for smaller purchases – for instance, Klarna offers the service for purchases as low as \$10 – without requiring hard credit checks or traditional underwriting. Additionally, these transactions typically don't get reported to credit bureaus, which can appeal to some subprime users.

Typically, the first payment is made at checkout, and subsequent payments are deducted automatically to avoid late fees. Some examples of leading pure-play installment providers include Australia-based [Afterpay](#) and US-based [Quadpay](#) and [Sezzle](#). Sweden-based [Klarna](#), another major BNPL player, offers other payment variations, including 3-36 month financing and a Pay in 30 option, but its revenues are predominantly driven by merchant fees as opposed to interest income.

Point-of-sale (POS) financing is also increasingly common among BNPL players as a way to diversify revenue streams. US-based [Affirm](#) and Klarna both offer POS financing, where users are subject to soft credit inquiries and risk-adjusted interest rates. But unlike the 0% APR installments, missing payments on POS loans has the potential to impact credit scores.

Users often opt in for credit products from BNPL providers because they may have a better chance of getting approved. For example, Affirm's proprietary credit underwriting model approves 20% more customers on average than comparable competitor products.

Affirm's unsecured loans are typically originated through partnerships with chartered industrial banks like Cross River Bank and Celtic Bank.

ENABLING MERCHANTS TO DRIVE ONLINE SALES

While the BNPL payment option has become popular among millennials and Gen Z shoppers, it has also gained increased attention from merchants.

A crucial value proposition of the BNPL model is that it helps merchants boost average order values (AOVs) and purchase rates – both key revenue drivers. Moreover, BNPL checkout options are seamlessly incorporated into merchant web and mobile sites via APIs that don't require developer resources.

BNPL solutions directly integrate with e-commerce platforms via APIs



Seamless Integration with your store

Afterpay integrates with your e-commerce platform seamlessly or manually. Plus, our tech support team is with you every step of the way.

Logos for: auyen, shopify, COMMERCE, Magento, Magento 2, COMMERCE, WIX, spree, ACADICA, LLC, workarea, Ecwid



Effortless integration. Plug-in ready.

Getting up and running with Klarna is hassle-free. We're staffed and skilled to quickly integrate with your store and payment partners. With quick API integrations from our partner platforms, you'll be up and running with Klarna in no time.



Direct API integration

Integrate Affirm on web, on mobile, or in your stores.

Get started

Source: Company websites



In exchange for higher merchant fees that are nearly 2-3x what Visa and Mastercard typically charge, BNPL companies aim to drive increased sales conversions and repeat purchases while lowering user acquisition costs.

Both Afterpay and [PayPal](#), which launched its own BNPL feature in 2020, claim to raise average order values by up to 20%. Affirm, which covers a larger range of transaction sizes, reported increasing AOVs for merchants by 85% in 2019 and 92% in 2018 compared to other payment methods.

Why is BNPL accelerating now?

Buy now, pay later isn't a new phenomenon. The concept of layaway – where a retailer reserves an item until the customer has paid it off – has existed in offline contexts for decades. And some of the largest players in the BNPL space were founded as early as 2005 (Klarna).

But the sector is certainly gaining momentum. In 2020, corporate executives mentioned BNPL-related terms on earnings calls a record number of times, according to [CB Insights' Earnings Call Mentions tool](#).

Corporate executives' focus on BNPL skyrockets in 2020



Note: Earnings Calls Mentions based on search terms Buy Now Pay Later OR BNPL OR POS lending OR point of sale lending OR installment lending OR point of sale financing

Source: [cbinsights.com](https://www.cbinsights.com)

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Against the backdrop of the pandemic forcing shoppers online, there are two significant reasons why BNPL is having its moment now: merchants are aiming to capture a greater share of online sales, while millennial and Gen Z shoppers are attracted to BNPL as a way to defer payments, interest-free.

COVID-19 FUELED MERCHANTS' DEMAND FOR ONLINE SALES CONVERSION

The coronavirus pandemic has supercharged e-commerce penetration. Retailers that historically neglected the checkout experience suddenly needed to find ways to attract and retain customers online. And unlike brick-and-mortar, the universe of potential online customers is virtually limitless.

In March 2020, practically overnight, US in-store shopping traffic essentially fell to zero as shelter-in-place mandates went into effect. This exacerbated an already challenging environment for merchants and retailers facing intense competition from online e-commerce players. Many major retailers [filed for bankruptcy amid the lockdowns](#), including JCPenney, J. Crew, and Neiman Marcus.

Increased e-commerce adoption has presented a new – and competitive – opportunity. With in-store shopping at reduced capacity, merchants need ways to quickly capture omnichannel shopping activity in a hyper-competitive environment.

Unlike essential shopping categories such as groceries and household supplies, which have seen a 15-30% increase in online purchases during the pandemic, discretionary spending on apparel, footwear, furnishings, and other categories has seen significant decreases in shopper intent, according to a McKinsey survey.

Consumers' decreased non-essential spending drives competition for online retail sales

Expected spending per category over the next 2 weeks compared to usual¹
Net intent by annual household income



Non-essential purchase intent sunk as much as 46% amid the pandemic's peak

Retailers will need to accelerate use of advanced analytics in assortment to anticipate changes in consumer trends. CPG players will need to enhance speed to market/product development, with a focus on essential and value offerings.

Source: McKinsey & Company

Note: Net intent is calculated by subtracting the % of respondents who expected to decrease spending from the % of those who expected to increase spending.

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BNPL solutions have increasingly come into focus as a way to provide a better user experience, capture younger demographics, and drive sales conversion.

Foot Locker, a major sneaker retailer, partnered with both Klarna (in North America) and Afterpay (in Australia) following a revamp of its payment platform in Q2'20. In Q4'20, Foot Locker's chief executive Dick Johnson commented that Klarna had already become one of its top 3 payment options, driving over 2,000 orders a day.

MILLENNIALS AND GEN Z ARE MORE LIKELY TO PAY WITH CREDIT CARD ALTERNATIVES

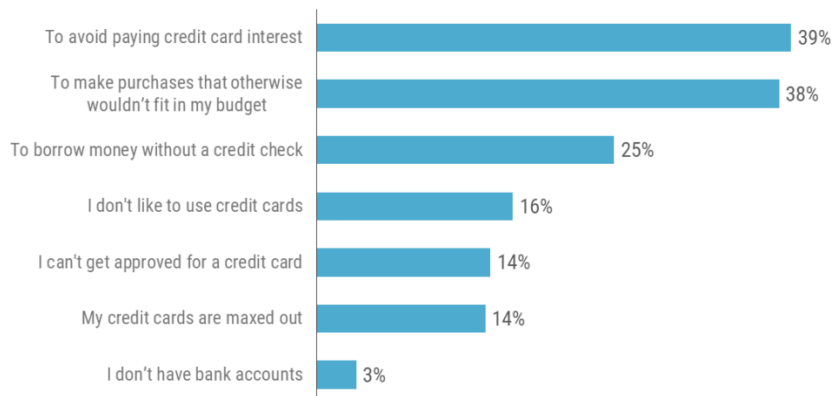
Millennials and Gen Zers represent a disproportionate percentage of users bolstering BNPL companies, with the average customer for Afterpay, Klarna, and Australia-based Zip in their early 30s. Nearly 70% of Afterpay's user base falls into the 18-34 range.

While over 70% of millennials and roughly half of Gen Z across established and emerging credit markets have credit cards, BNPL is increasingly coming into focus as an attractive alternative to paying with credit.

In a survey of over 1,800 people, two of the most commonly cited reasons for using BNPL were the ability to avoid paying credit card interest and to make purchases that wouldn't fit in a budget.

BNPL offers payment term flexibility that cards can't

Reasons shoppers use buy now, pay later



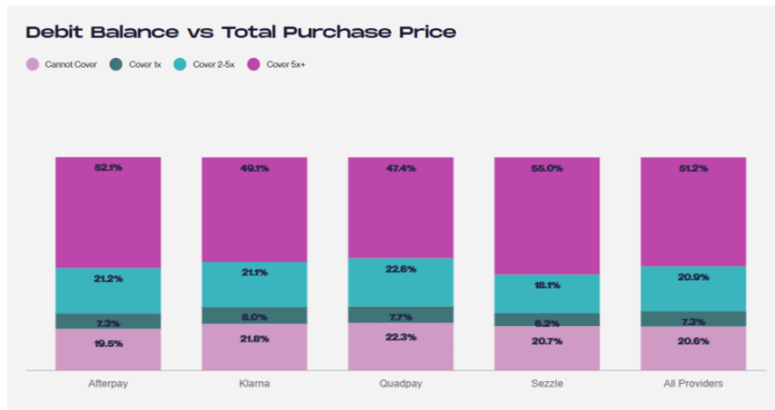
Source: The Ascent Survey

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While there is concern that BNPL will lead to irresponsible spending, some studies suggest that this generally isn't the case.

One analysis found that, for many shoppers, BNPL is their sole source of deferred payments, with many users appearing not to have a credit card at all. In addition, of those paying with a debit card, roughly 80% had enough money in the bank to cover at least 1x the purchase price, and over half of users could cover 5x+ the purchase price.

80% of debit-linked users have enough funds to cover at least 1x purchase amount



Source: Cardify.ai

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Where the opportunity lies

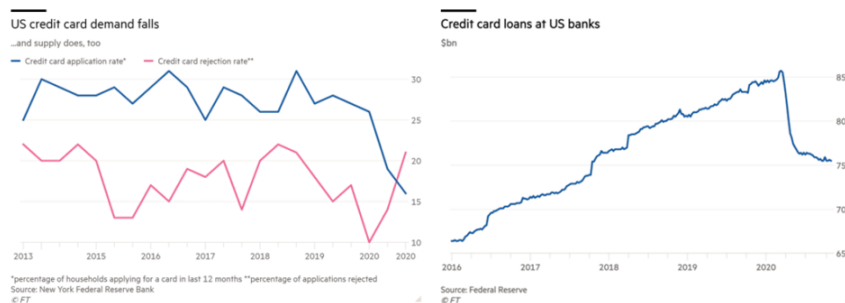
The BNPL market opportunity is roughly pegged to the size of the e-commerce and online payments market – meaning the revenue opportunity is massive and growing exponentially. Americans made an estimated \$20-25B worth of BNPL purchases in 2020.

The global buy now, pay later revenue opportunity is valued at \$680M today, with the potential to be a \$1.1B market by 2025, according to [CB Insights' Marking Sizing tool](#).

NEAR-TERM CHALLENGES FOR CREDIT CARDS LEAVE OPENINGS FOR BNPL

Millennial and Gen Z shoppers aren't the only ones eschewing credit card spending. In the past year, US consumer spending and new credit card accounts have fallen sharply as consumers pay down credit card debt at a faster rate amid income uncertainty. The number of new US credit card accounts fell by nearly 50% in Q3'20 compared to the year before, while US banks held \$755B in card loans in October 2020 – a \$100B decline from the start of the pandemic.

Opportunities open for BNPL as consumer and bank appetite for credit shrinks in the US

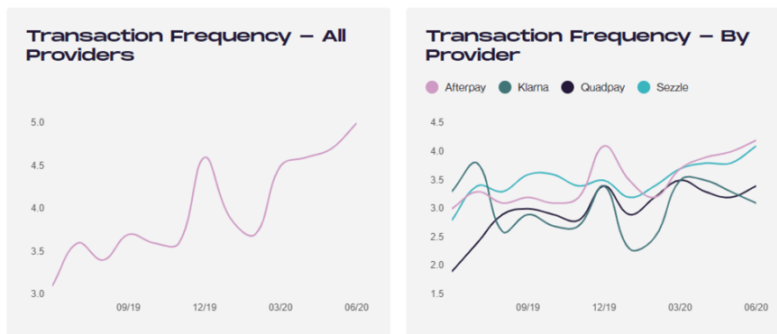


Meanwhile, as consumers are using credit cards less often, they're increasing their BNPL usage.

For players like Afterpay, Klarna, Quadpay and Sezzle, BNPL purchase frequency is on the rise, according to a Cardify analysis. From those 4 BNPL providers, consumers on average made 3 purchases per month in June 2019, which grew 67% to an average of 5 purchases per month during the same time in 2020. The growing payment frequency suggests that BNPL products may capture a significant share of bigger-ticket purchases traditionally made with credit cards.

BNPL users' purchase frequency is trending up

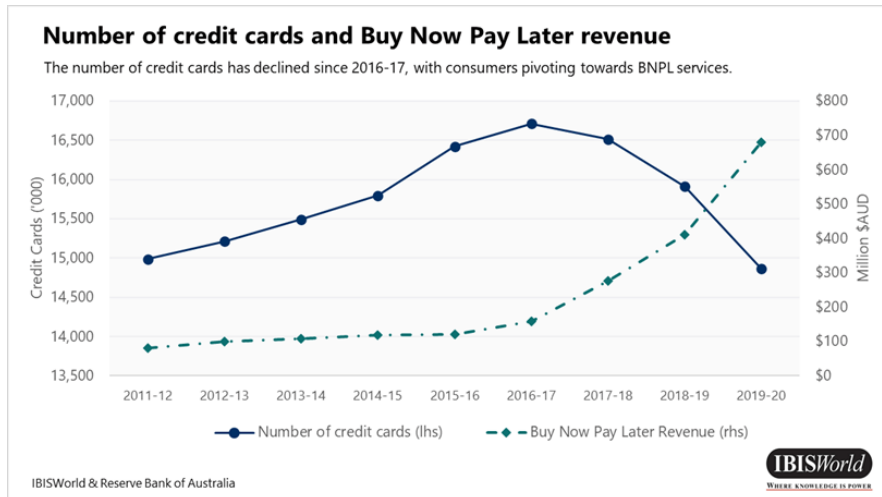
Users' average monthly BNPL transactions, June 2019 - June 2020



Source: Cardify.ai

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In Australia, where BNPL has been particularly popular, the acceleration of BNPL revenue has coincided with a decline in the number of credit cards.



PARTNERSHIPS OPEN UP NEW AVENUES FOR EXPANSION

Thus far, BNPL firms have only partnered with a small portion of merchants and retailers globally. Players such as [Splitit](#) and [Four](#) have opted to partner with major payment networks including [Visa](#) and [Mastercard](#) as a way to take advantage of extensive relationships with merchants and retailers, while Affirm has struck exclusive deals with e-commerce platform [Shopify](#) and exercise company [Peloton](#).

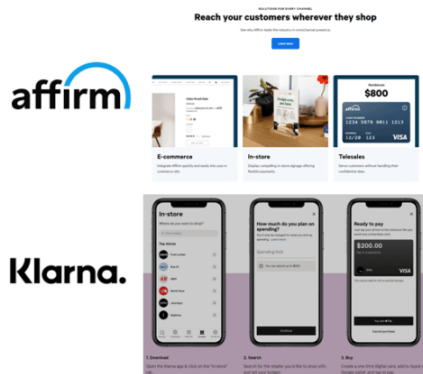
Banking and personal finance products will be key areas to watch as BNPL players look to build out new product offerings to retain customers.

For example, Affirm has launched a savings account feature through a partnership with [Cross River Bank](#) that allows customers to generate up to 0.65% APY (13x the national average). Meanwhile, Klarna's rewards program, Vibe, allows customers to rack up loyalty points and discounts by using Klarna's BNPL offering.

Although BNPL companies have benefited from growing e-commerce and online penetration, the offline market opportunity will still be attractive in a post-Covid world. The top 4 BNPL players (Affirm, Klarna, Afterpay, and Quadpay) have built in-store payment solutions to enable a better omnichannel experience in anticipation of a post-pandemic in-person shopping surge.

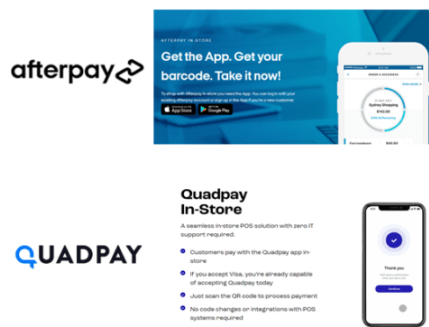
BNPL providers are planning for a post-pandemic in-person shopping surge

POS financing-enabled



Source: Company websites

Pure-play installments



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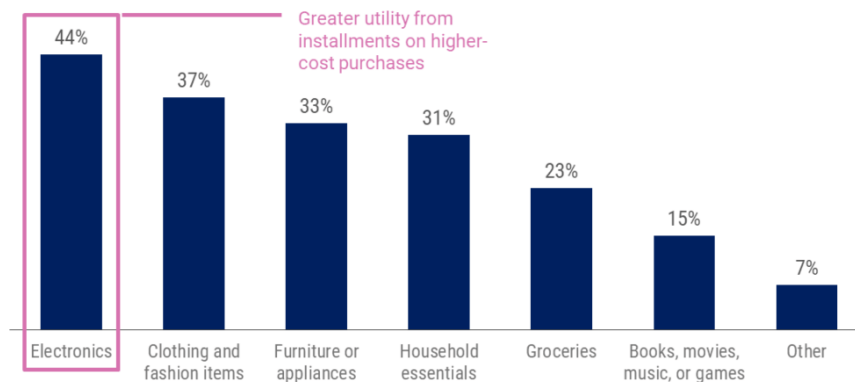
EXPANSION AREAS TO WATCH

The BNPL market will likely grow in 3 areas.

1. New commerce categories. The market has been successful so far with consumer purchases in apparel, beauty, electronics, and homeware. Beyond that, it has the potential to expand into markets including healthcare (dental, optical), travel, and entertainment and events.

For example, US-based [Uplift](#) offers a BNPL option for travel purchases like flights by partnering with well-known travel brands such as [United Airlines](#) and [Lufthansa](#).

Higher-cost electronics are the most common category of purchases for BNPL users



Source: The Ascent Survey

Note: Respondents able to select more than one category

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2. New geographic markets. The BNPL market is already saturated in e-commerce-heavy regions like Europe, Australia, and the US — but there is an opportunity for new BNPL players to emerge across geographies like Asia, the Middle East, Africa, and Latin America.

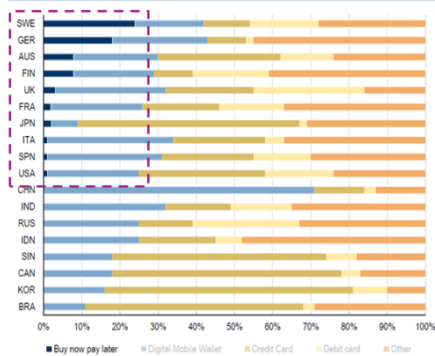
Within the last year, a handful of BNPL startups, including UAE-based [Tabby](#) and Egypt-based [Shahry](#), have emerged, bolstered by the rise of e-commerce.

3. Increasing BNPL penetration rates among e-commerce transactions. BNPL penetration rates represent less than 25% of global e-commerce markets today, and tend to be highest in Europe, per Worldpay's Global Payments Report 2020. While the UK and US have relatively low BNPL penetration rates (3% and 1% of the e-commerce market, respectively), Sweden has a rate of 24%,

largely due to Klarna's massive presence there. Widespread use in this early adopter country suggests there could be similar growth opportunities for other adopters.

BNPL share of e-commerce penetration led by early adopters suggests growth potential in the category

Exhibit 5: 2019 eCommerce mix by payment method



In Sweden, the home of early pioneer Klarna, BNPL has an estimated 24% penetration in e-commerce transactions.

The UK and US have room to grow with BNPL penetration at just 3% and 1%, respectively.

Source: Global Payments Report 2020, Worldpay, Bank of America

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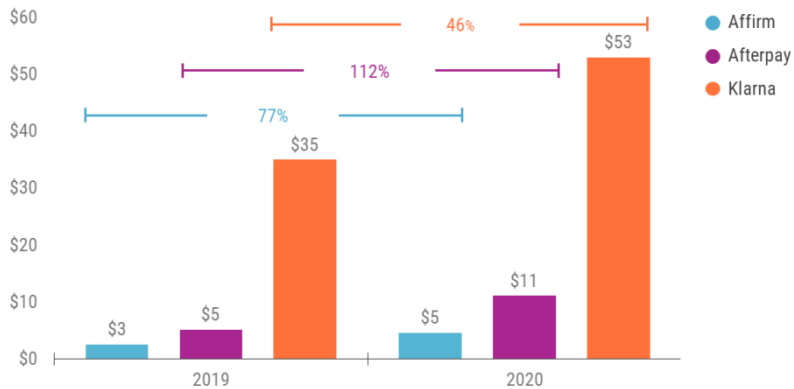
BNPL POWERS MERCHANT REVENUE GROWTH AND DEMAND

Top BNPL players have reported large increases in gross merchandise value (GMV), a measure of total merchant sales.

Klarna leads in total GMV, growing its \$35B GMV in 2019 by 46% to \$53B in 2020. However, Afterpay has experienced the most accelerated growth after reporting a 112% increase in GMV year-over-year (YoY).

BNPL players provide merchants with increased GMV

Gross Merchandise Value (GMV) in \$B and growth rate (%), 2019-2020



Source: Company filings

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This growing figure is a good indication of BNPL's effectiveness in driving e-commerce sales on behalf of merchants.

In addition, BNPL providers have a unique relationship with shoppers that can increase merchant demand.

Through their mobile apps and seamless checkout experiences, the platforms are aiming to become a shopping destination where consumers can discover new products from the same merchant.

In doing so, BNPL companies aggregate customer demand and increase retailers' cross-sell opportunities.

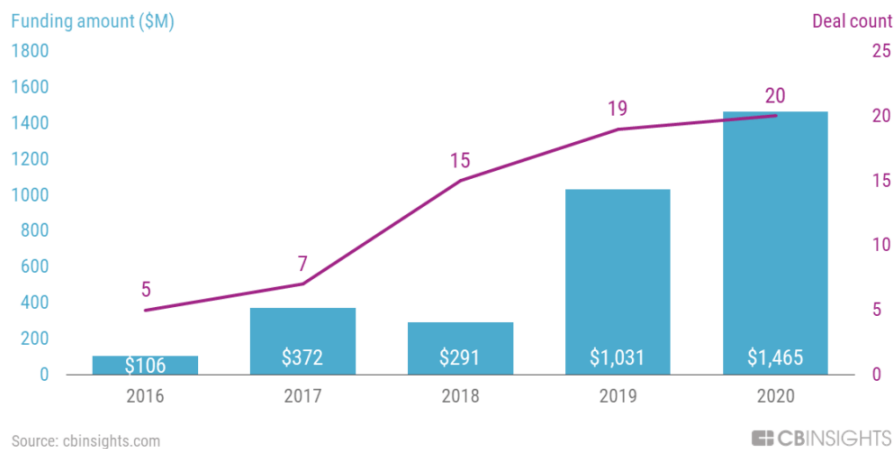
What the BNPL market looks like today

Despite the dominance of banks and credit card issuers in the consumer lending market, BNPL players are presenting themselves as a viable alternative. They have acquired customers and merchants over the past few years by prioritizing changing customer preferences, flexible financing options, and cheaper fees or interest – areas where traditional banks, credit card issuers, and lenders fall short.

Recent funding trends show that BNPL players are gaining momentum, raising a record \$1.5B in 2020 – a 42% increase from 2019 – across 20 deals. The pandemic has bolstered the BNPL market, as economic uncertainty shifts consumers away from credit cards and toward short-term payment plans.

Since 2016, BNPL funding has grown at 93% CAGR

Disclosed deals & equity funding (\$M), 2016 – 2020



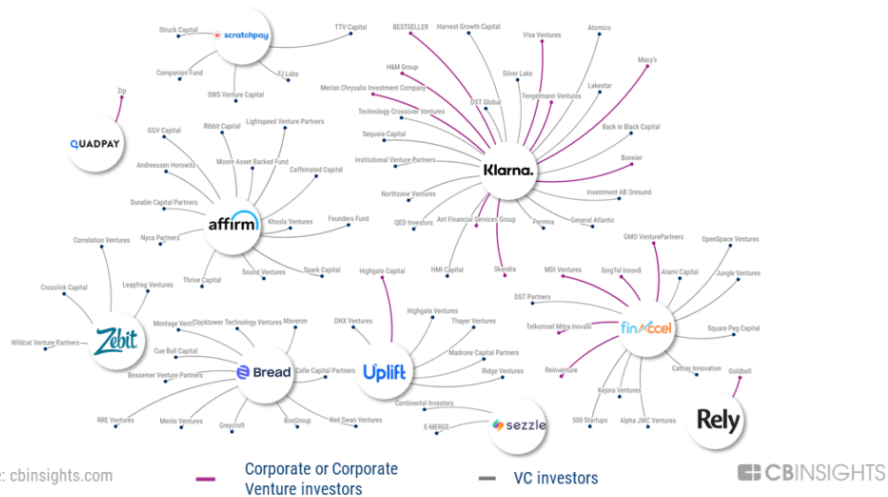
STRATEGIC INVESTORS ARE PAYING ATTENTION

Corporates and corporate venture investors have shown significant interest in the BNPL market.

Of the top-funded BNPL players, Klarna has attracted the largest share of corporate and CVC investment, from institutions including Ant Financial, Macy's, H&M Group, and Visa Ventures. Meanwhile, Affirm has raised funds from fintech Smart Money VCs like Ribbit Capital, Khosla Ventures, and Thrive Capital.

Corporates make strategic investments in BNPL

Select BNPL providers and their investors, 2010 – 2020



THE BIG FOUR DOMINATE THE US BNPL LANDSCAPE

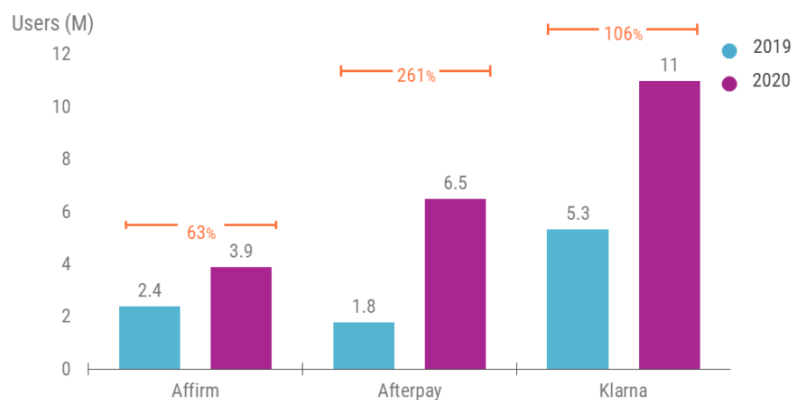
According to a Cardify analysis, four key players dominate the US BNPL space: Afterpay, Klarna, Sezzle, and Quadpay. Afterpay holds the largest share of total BNPL transactions (70%), followed by Klarna (12%), Sezzle (10%), and Quadpay (9%). (Affirm was excluded from the analysis because, unlike the 4 leading installment players listed, Affirm's primary offering is POS lending.)

Meanwhile, Klarna leads in US user volume, reporting 11M US customers as of November 2020, a 106% increase from 2019.

Afterpay reported 6.5M active US accounts as of November 2020, a 261% increase from 1.8M in FY2019. Affirm, which focuses on higher-value transactions, has just under 4M US users.

Klarna leads in total number of US users

Number of US users (M) and growth rate (%), 2019 – 2020



Note: Affirm 2020 figures as of Sept 2020; Afterpay as of Nov 2020; Klarna as of Oct 2020

Source: The Wall Street Journal, company filings, and press releases

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INCREASED PARTNERSHIP ACTIVITY DRIVES MERCHANT ADOPTION

Going forward, strong partnerships with merchants and integrations across e-commerce platforms will be important for long-term success in the BNPL space. Thus far, the BNPL go-to-market playbook has focused on prominent retailer sign-ups, technology integrations, and platform partnerships.

Adding large retailers and well-known brands as customers can drive low-cost customer acquisition. To this end, Affirm has brought on [Walmart](#) (in the US) and [Peloton](#) as customers, Klarna added [Macy's](#) and [Lululemon](#), and [Afterpay](#) signed up [Gap](#).

To acquire more merchant customers, BNPL players offer native integrations into merchants' shopping carts by partnering with e-commerce platform plug-ins like [Magento](#), [Oracle Commerce](#), and [Salesforce Commerce Cloud](#).

Other key partnerships have been instrumental to attracting more merchants. For example, Affirm partnered with Shopify to exclusively power its US BNPL product. Meanwhile Afterpay has teamed up with Google Pay and Apple Pay, both of which use their own terminals and require no additional technical integration.

Big retailers and e-commerce giants partner with financial services firms for installment lending



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COMPETITION COMES FROM VARIOUS ANGLES

Competitors in the space include not only traditional lenders, banks, and card issuers, but also white-label BNPL platforms and other players in the payments space.

White-label BNPL platforms enable banks to make their own BNPL products to diversify their loan portfolios. For example, [GreenSky](#) provides a white-label BNPL offering to partners like [Fifth Third Bank](#) and [Synovus Bank](#).

In addition, major banks and card issuers including [Citigroup](#), [JPMorgan Chase](#), [Goldman Sachs](#) (via its Marcus app), and [American Express](#) have all introduced their own versions of BNPL. Even [Lunar](#), a Sweden-based digital bank that doesn't have a credit card offering, has launched a BNPL product following a similar model to the incumbents.

Citigroup's Citi Flex Pay, JPMorgan's My Chase Plan, and AmEx's Pay It Plan It all offer customers the ability to finance transactions in installment-style payments – but unlike newer BNPL models, the financing happens after a transaction. This means users must separately go to their accounts and select which qualifying transactions to finance.

While arguably less convenient, this retroactive option is intentionally structured to avoid eating into credit card revenues, but rather offer customers a different way to engage with credit products.

The outlook for buy now, pay later – and the challenges ahead

The outlook for BNPL is positive, as e-commerce penetration continues to rise and as consumers increasingly expect payment flexibility and transparency when they shop.

By 2025, the global BNPL industry is expected to grow 10-15x its current volume to \$1T in gross merchandise volume. With this growth, BNPL players face some formidable obstacles, as incumbent players including card issuers, payment networks, and digital wallets all ramp up efforts to jockey for real estate on merchant checkout pages.

Additionally, the BNPL industry, which has mostly been free of regulatory scrutiny relative to its credit card counterparts, is likely to see important rulings on how the business model should be regulated.

PAYMENT FACILITATORS ARE RAMPING UP EFFORTS TO COMPETE WITH BNPL

Incumbent payment facilitators (including payment networks, gateways, and digital wallets) and card issuers (including banks) see BNPL as a growing threat to existing businesses.

Visa and Mastercard – two of the most dominant payment networks – have both partnered with or acquired companies to grow their BNPL capabilities.

Major card networks strike BNPL deals to compete

VISA

Select Partnerships

- Commerce Bank – first US bank to offer installments on select Visa cards
- Invested in and partnered with ChargeAfter to offer Visa Installments

Product launch

- Developed Visa Installments, which enables issuers and merchants to offer installments via API integration

mastercard.

Select Partnerships

- Working with TSYS to create BNPL offerings for card issuers
- Leveraging Mastercard's partner network to scale Splitit's installment solution

Acquisition

- Acquired Vyze, a POS financing marketplace

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In Q4'20, Visa partnered with [Four](#), an alternative credit and BNPL platform, to provide customers worldwide with the ability to split payment options online and in stores. It has also partnered with [ChargeAfter](#), a POS financing platform.

Visa is also testing out its own installment program, Visa Installments, with select merchant partners. Merchants can experiment with the checkout option via APIs.

Meanwhile, Mastercard has partnered with [Spotii](#), FlexiGroup's Bundll, Splitit, and [TSYS](#) as it explores ways to stay abreast of the BNPL surge. To this end, Mastercard acquired [Vyze](#), a POS lending marketplace, in 2019.

It's worth noting that most of the major BNPL solutions are built on top of existing payment facilitators, such as Visa and Mastercard's networks. For every transaction that BNPL players facilitate, they forfeit a portion of fees to the incumbents for processing and clearing.

Although BNPL players are tethered to payment networks to some extent, the longer-term success of BNPL poses real competition around merchant fees and fees from payment volumes. In particular, many BNPL transactions are debit-based – for instance, 90% of Afterpay’s customers link accounts to debit cards. This matters to card networks as debit transactions command lower interchange fees compared to credit.

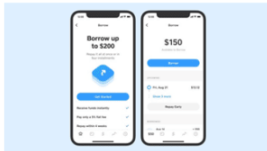
PAYMENT GATEWAYS AND DIGITAL WALLETS WILL ACCELERATE BNPL

Payments players like [Stripe](#) and [Square](#) and digital wallets like PayPal and [Grab](#) are worth watching as competitors in the BNPL space, with many of them starting to add the payment option directly or through partnerships.

Stripe, a developer-friendly payment facilitator, has partnered with a number of BNPL providers, including Klarna, Quadpay, and Four. Meanwhile, Square is piloting a program with its peer-to-peer Cash App offering short-term, 5% fixed-rate loans between \$20 and \$200 after launching its Square Installments product in 2018.

Grab, a leading digital wallet in Southeast Asia, has also embedded buy now, pay later capabilities within its super app.

Established fintechs launch lending products to capitalize on pandemic-boosted e-commerce



Q3'20 Developments: Square added a peer-to-peer service through its Cash App product that allows users to access short-term loans. Cash App will offer loans between \$20 and \$200, charging a 5% fixed rate with a payback period of 4 weeks.



Meet Pay in 4
A new buy now, pay later interest-free installment solution at no additional cost.



Q3'20 Developments: PayPal introduced an installment lending feature called "Pay in 4." The service offers customers the option to pay for purchases interest-free in 4 installments. They can do this over a 6-week period for purchases between \$30 and \$600.



Q3'20 Developments: The Southeast Asia-based on-demand transportation and mobile payments giant launched a buy now, pay later product. The service allows users to shop for products online and make payments in interest-free installments. Users can also defer payments until the next month or a future date.

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WITH ITS RECENT PAY IN 4 LAUNCH, PAYPAL IS A FORMIDABLE PLAYER

In PayPal's Q3'20 analyst call, CFO John Rainey acknowledged that BNPL solutions had a tangible impact on PayPal's share of checkout:

"...as we look across the marketplace today, one of the areas where we see our share of checkout diminish is when these Buy Now Pay Later type products are offered because it certainly appeals to certain individuals that they don't necessarily need to have a long-term [...] credit relationship with a financial institution."

— JOHN RAINEY, CFO AND EVP GLOBAL CUSTOMER OPERATIONS, PAYPAL

This has led PayPal to develop its own in-house solution to compete in the BNPL space, called Pay in 4.

The solution is a comparable offering to the standard 0% APR installment offering from pure-play BNPL providers like Afterpay and Klarna.

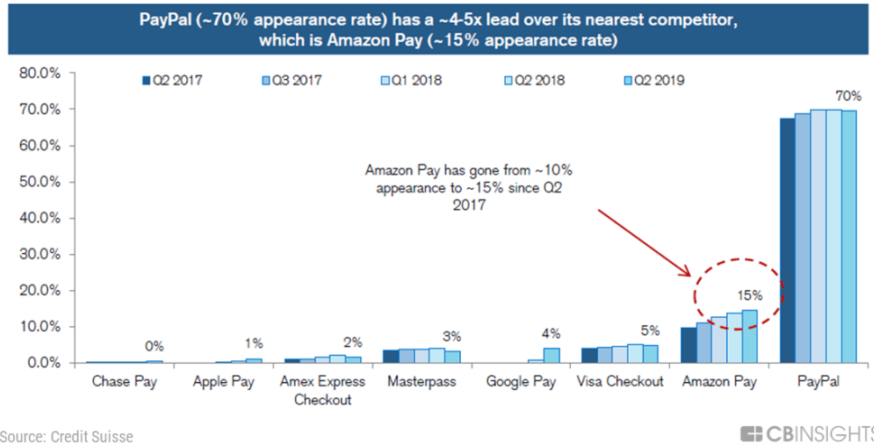
Following a successful Q2'20 launch in France, PayPal introduced the payment program in the US and UK, where the response has been “tremendous,” according to Dan Schulman, president and CEO.

The graphic is a promotional banner for PayPal's 'Pay in 4' service. On the left, a smartphone displays the PayPal checkout interface, showing a total of \$110.00 USD and the 'Pay in 4' option. On the right, a blue background contains the text 'Pay in 4: Easy as 1-2-3.' followed by three numbered steps: 1. Choose PayPal at checkout and select 'Pay Later' – you'll see 'Pay in 4' as a way to pay. 2. Get a decision in seconds and complete your purchase. 3. Make the down payment today, and pay the rest in 3 payments – one every two weeks. Payments are easy to manage through the PayPal app and on PayPal.com. Below this, a white section titled 'Enjoy the power to pay later.' features four icons and their corresponding benefits: a percentage sign with a red 'X' for 'It's interest free. Make interest-free payments with Pay in 4*'; a storefront icon for 'Use it at millions of online stores. Shop at your favorite brands and retailers, enjoy now and pay later'; a stopwatch icon for 'Get a decision in seconds. There's no impact to your credit score – you won't have to wait long to see if you are approved*'; and the PayPal logo for 'It's backed by PayPal. Get the same security and purchase protection you already enjoy from PayPal'.

Source: PayPal

Two major factors differentiate PayPal from competitors. The first is that it already has a massive base of 28M merchants – orders of magnitude larger than the top pure-play BNPL companies. In the US, 80 of the top 100 retailers already offer customers PayPal as a checkout option, and nearly 70% of US online buyers have a PayPal account.

PayPal's availability across merchants is the highest in its peer group



Second, because it has a massive, profitable network, PayPal can offer its Pay in 4 option for free to its merchants.

This pricing strategy is crucial to helping PayPal grow merchant adoption and subsequently drive volume and higher share of checkout over competitors. Additionally, because PayPal typically charges merchants 2.9% + \$0.30 per transaction, the fixed fee component actually helps drive higher take rates (the percentage of sales PayPal gets to keep as revenue), while simultaneously driving more incremental revenue for merchants.

AN UNCERTAIN REGULATORY LANDSCAPE

Compared to the credit card industry, a heavily regulated space, BNPL providers have operated with relatively limited scrutiny, as regulators deliberate on the implications of the model.

For example, should BNPL companies require a license to operate? While BNPL clearly benefits merchants by driving up average order values, does the model incentivize poor personal finance decisions for shoppers? And are late fees and monthly charges predatory toward vulnerable users?

Thus far, there have been a small number of brushes with regulators. In March 2020, Afterpay paid a roughly \$1M settlement with California's Department of Business Oversight, which found that the company structured products to "evade otherwise applicable consumer protections" and made loans to California residents without a valid license.

In a similar vein, in late 2020, Klarna was reprimanded by the UK's advertising regulator, Advertising Standards Authority, for commissioning influencer social media posts to encourage spending to improve moods.

Notably, Klarna has been a vocal proponent of regulating the industry, citing the importance of consumer protection and transparency. While it's formally regulated by the Swedish Financial Supervisory Authority, Klarna has been working actively with the Financial Conduct Authority (FCA), a UK regulatory body, in the FCA's review of the unsecured credit market – the results of which are expected by the end of 2021.

Though today many of the largest BNPL companies report merchant fees as a driver of overall revenues, loan loss rates and late fees will be key metrics to monitor in the months to come. Any significant increases in customer-borne fees will certainly draw attention from regulators.

Looking forward

The concepts of installment payments and point-of-sale financing are hardly new – but buy now, pay later providers are digitally native and primed for the direction the world is headed. Going forward, fair, flexible, and transparent payments will play an increasingly important role in creating a best-in-class customer journey and driving sales conversions.

As BNPL companies see rapid growth, the industry as a whole will continue to expand into deeper, more frequent relationships with customers. Affirm's savings and Klarna's rewards offerings are just a small taste of the larger ambitions of some BNPL companies, which aim to not only enable consumers to spend flexibly, but more prudently as well – an area regulators will be sure to monitor.

Incumbents' responses and future decisions will be key to watch as they continue to leverage existing advantages, in particular their entrenched merchant and customer bases. And they're seeing early success – for instance, PayPal's Pay in 4 was the fastest start to any product launch in the company's history, seeing \$750M in payment volume in its first full quarter.

Ultimately, buy now, pay later companies have set in motion a major checkout page land grab, in turn compelling incumbents to adapt to changing customer expectations.

Additional reading

This report was created with data from CB Insights' emerging technology insights platform, which offers clarity into emerging tech and new business strategies through tools like:

- [Earnings Transcripts Search Engine & Analytics](#) to get an information edge on competitors' and incumbents' strategies
- [Patent Analytics](#) to see where innovation is happening next
- [Company Mosaic Scores](#) to evaluate startup health, based on our National Science Foundation-backed algorithm
- [Business Relationships](#) to quickly see a company's competitors, partners, and more
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