

# INSIDE

FINANCIAL SERVICES

number

07

2021

THE BREWING STORM OF BUY NOW PAY LATER

exton  
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STRATEGY &  
MANAGEMENT

# EDITORIAL

Retail Banking has in many ways been a traditional, rather slow-moving industry where product innovation – if at all – has happened in small and incremental steps. Mortgages continue to work like they did for decades, deposits remain simple savings accounts and cards continue to be a primary vehicle to withdraw cash or pay for online or offline transactions. Disruption has happened mainly in the process and customer experience space, where old school products are sold in a more seamless, often digital way.

The Buy Now Pay Later hype visible in many European countries today may actually be different and create real product disruption, potentially shifting consumer lending volumes from traditional products to this new product category, and at the same time move revenues from the classic lending closer to the merchants and POS.

Our current newsletter is focusing on this brewing storm and analyzes the status quo, trends and potential impact that Buy Now Pay Later may have on the industry. In order to assess its potential, we have taken also a deeper look at Australia, one of the pioneer markets in that field, and share some predictions on the size of the opportunity, using Germany as an example.

Enjoy your reading.

*The Team*

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For more information  
[contactgermany@extonconsulting.com](mailto:contactgermany@extonconsulting.com)

# BUY NOW PAY LATER IS DISRUPTING CONSUMER FINANCE, AIDED BY THE 'PERFECT STORM'



**CHRISTOPH STEGMEIER**  
Managing Partner



**OYVIND OANES**  
Partner



**ERICA LIAO**  
Manager



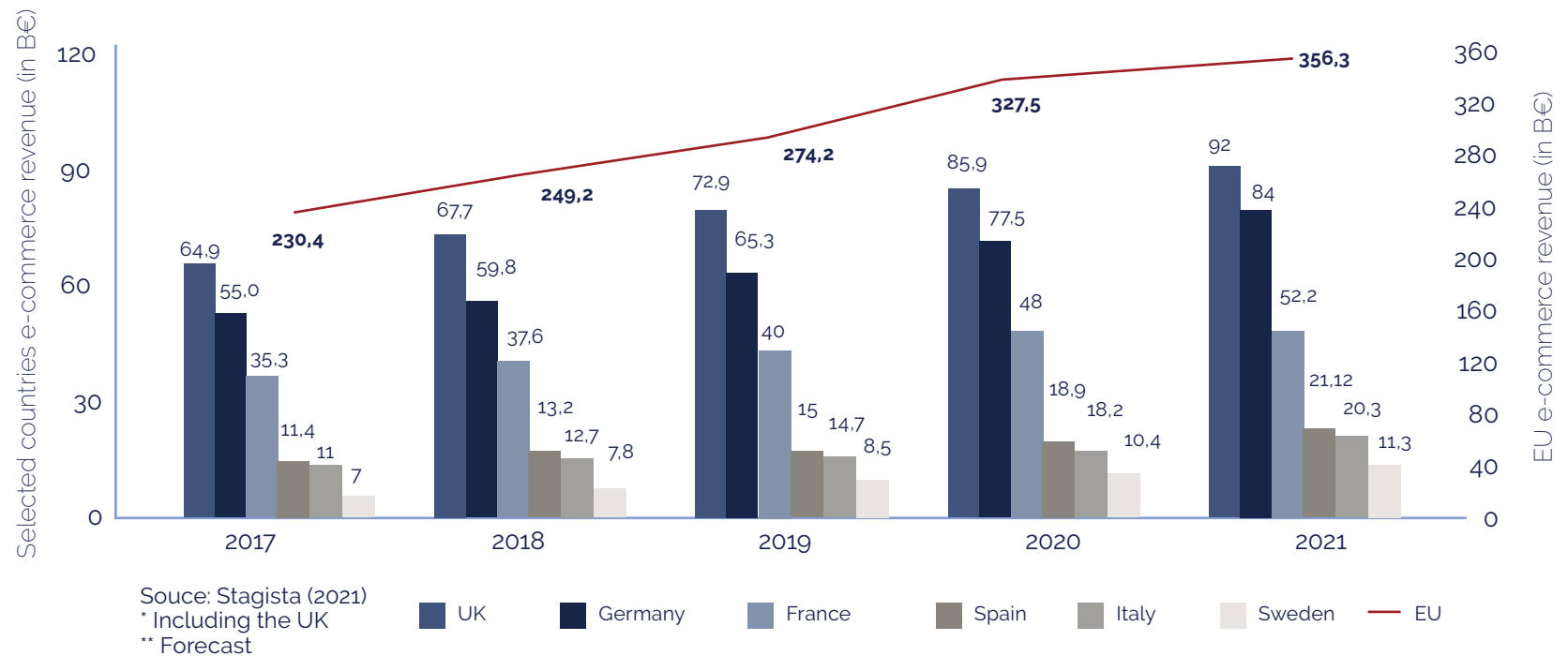
For the last decades, consumer finance markets in Europe have been anything but dynamic. Core product offerings and main providers have largely remained unchanged during that period – with card-based offers dominating in some countries while others have and still are focusing on instalment loans. But now it appears that disruption is – finally – around the corner. A trend, widely known as 'Buy Now, Pay Later' (BNPL) has emerged in retail markets across Europe, offered by quickly growing Fintechs such as Klarna or Afterpay. In this paper, Exton deep dives into this growing trend and the related business models of BNPL across Germany, France, Spain, Italy, Sweden, and the UK. We then forecast the growth and opportunity of the BNPL market, using Germany as an

example. We finally look at one of the most developed markets, Australia, and derive insights recommendations for European players aiming to benefit from the hype.

The reasons for the sudden hype around BNPL are various and are undoubtedly tied to the rapid growth of online shopping (e- and m-commerce) which has been growing at more than 12% annually across the EU since 2017, and by 26% in 2020 alone<sup>1</sup>. Furthermore, the increased acceptance of consumers to use mobile banking solutions and the growing awareness of BNPL as a payment alternative has paved the way for an extended offering in that area. Finally, the COVID-19 pandemic has made this a 'perfect storm' shifting more business to online, increasing

## RETAIL E-COMMERCE SALES ACROSS EU AND SELECTED EUROPEAN COUNTRIES

In B€, 2017 – 2021

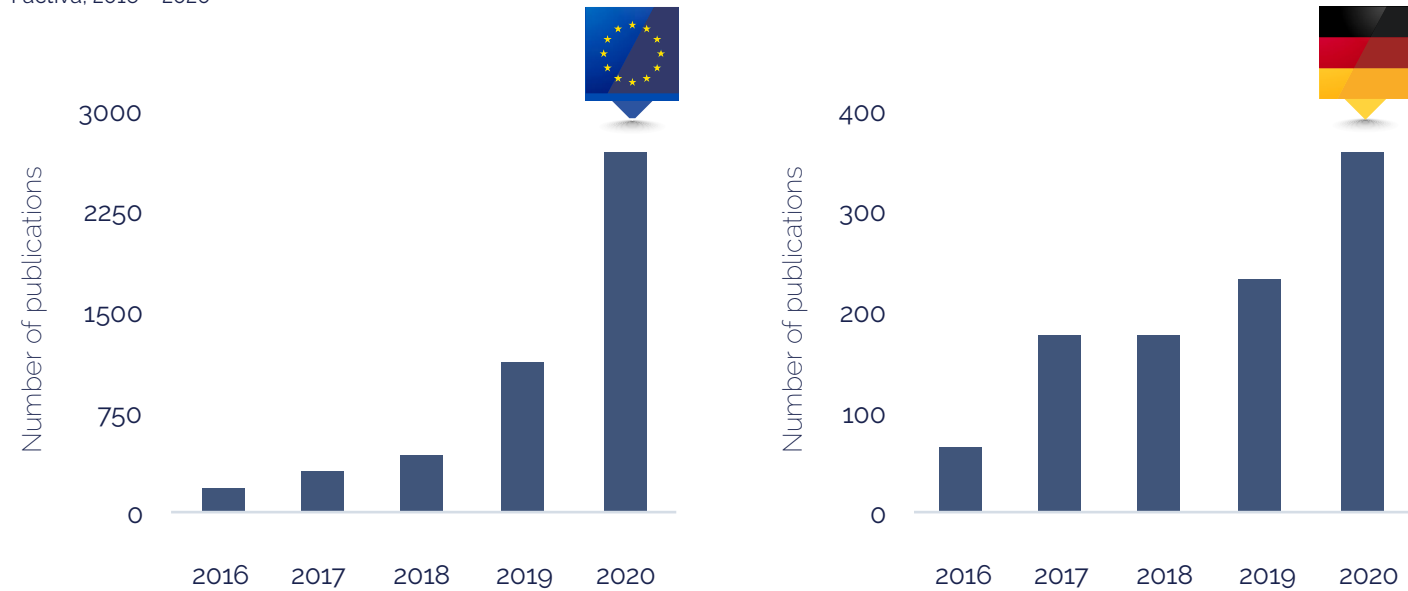


<sup>1</sup>Western Europe Retail Trends 2021 Report (2021), retrieved from <https://www.emarketer.com/content/western-europe-retail-trends-2021>.

consumer confidence in shopping online and increasing the need for managing personal cash-flows at least for a part of consumers. The market and the press across the EU and Germany have also responded, with significant growth of 'BNPL' mentions across publications, web news and blogs in 2020, adding to the emerging hype.

**"BUY NOW PAY LATER" PRESS AND PUBLICATION MENTIONS IN THE EU AND GERMANY**

Factiva, 2016 – 2020



BNPL is in essence not a completely new concept but can be seen as a new spin on the traditional point-of-sale (POS) lending, where merchants offered consumers the option (initially offline, then also more and more online) to pay for larger ticket items over a period in instalments. For the purpose of this publication, we define BNPL as all instalment payment options in e-commerce, irrespective of whether they are financed by the merchant or consumer. In fact, today's BNPL options are often highly flexible financing options, predominantly mobile-based, and increasingly merchant-agnostic, with enhanced benefits for both merchants and consumers. For consumers, BNPL offers a flexible credit option, seamless processes and an instant liquidity buffer.

For merchants, BNPL is a proven way to broaden their customer base, increase customer spending with higher average order amounts, increase conversion rates and improve the customer experience and perception. For BNPL providers the business promises a quick entrance to the consumer finance business, where they generate revenues through charging end customers interest or late payment fees (and in some cases account fees) or receiving merchants commission fees on the purchase value.

















# MATURITY OF BUY NOW PAY LATER IN EUROPE

## A COMPARISON OF BNPL MARKETS

Having developed quickest in the US and Australian markets, Europe now seems ripe for BNPL services. Although POS lending has existed and been a relevant financing option for several decades, there has been little change and innovation in the e-commerce payments space. New players, coupled with innovative payment services and younger, tech-savvy generations, have now created the foundation of disruption, with a different starting point in different countries. To illustrate this: as of 2020, BNPL share of e-commerce payments spanned broadly from just 1-2% in several Western European markets to over 20% in the Nordics, particularly in Sweden<sup>2</sup>. With Swedes carrying less cash than almost any other country, the acceptance and penetration of digital forms of payment (including BNPL) are significantly higher than in other European countries. In Germany, there are several signs of a rapidly evolving BNPL market, including several new providers and product launches in recent months. According to a survey conducted by IFH in 2020, BNPL has also become the third most preferred payment method for online transactions above €500, being more popular than credit cards<sup>3</sup>. Barclaycard, for example, launched a card in Germany end of 2020 that allows users to convert their purchases into instalments, diversifying from its 'core' credit products. Such BNPL led strategy could pay off if the growth and economics of it turn out to be more resilient than 'traditional' instalment loans, keeping in mind that Germany has a large outstanding consumer credit volume of more than €230 billion, of which much has been characterized by low margins.

### MATURITY OF BNPL MARKET IN MAJOR EUROPEAN COUNTRIES

Exton analysis, 2021

	E-commerce market CAGR (2017 - 2020)	Share of e-commerce users of total population 2021*	BNPL market share in e-commerce payments 2020 (2019)**	BNPL market maturity
	12%	77%	2% (1%)	
	12%	80%	23% (25%)	
	10%	82%	5% (3%)	
	11%	72%	4% (2%)	
	18%	63%	2% (1%)	
	18%	59%	2% (1%)	

Source: Exton expertise based on Statista's eCommerce Report 2020 and Worldpay's Global Payment Report 2020-21

\*Exton expertise and estimation based on Eurostat and Statista data

\*\*Based on Worldpay data incl. invoice payments; Share for Germany adjusted based on Exton estimation excl. invoice payments;

Assumption of marginal share of invoice payments for remaining countries

2. Numbers based on internal Exton analysis and FIS Worldpay Global Payment Report 2021.

3. "How does the Corona crisis affect the topic of payment?" Blog article original in German by IFH Köln (2020), retrieved from <https://www.ifhkoeln.de/buy-now-pay-later-corona-und-der-ratenkauf/>. Kabbage: an innovative source of short-term business loans. Nov. 2018 - [https://www.researchgate.net/publication/329258478\\_Kabbage\\_an\\_innovative\\_source\\_of\\_short-term\\_business\\_loans](https://www.researchgate.net/publication/329258478_Kabbage_an_innovative_source_of_short-term_business_loans)

The UK has the largest share of e-commerce users and according to a study performed in 2020, almost four in ten (37%) users claimed they have used a BNPL service<sup>4</sup>. French consumers are also relatively more willing to adopt BNPL services. This is the result of well-established local consumer credit Fintechs who have launched their own BNPL products helping to increase user adoption. Alma, a Fintech launched in 2017, built strong relationships with renowned French retailers and merchants and has since become an important player in the market, with a 6-fold total payment volume increase in 2020 and intentions to expand to other European countries. Spain and Italy are also experiencing rapid BNPL growth, but starting from a lower point, triggered by fast-growing local players like Aplazame (Spain) or Scalapay (Italy).

## KEY PLAYERS IN THE BNPL SPACE AND THEIR BUSINESS MODELS

For the time being, the BNPL market is mostly a playing field for new entrants and Fintechs, while being at least initially neglected by most incumbent banks. As a result, funding has poured into the BNPL start-up space, led by Klarna valued at more than €25 billion at the time of writing this report<sup>5</sup>, but also including others like Czech's Twisto or UK-based Divido. The total funding size of the BNPL market in Europe was estimated at more than €1 billion raised in 2020 (+118% YoY) and already over €930 million in the first quarter of 2021<sup>6</sup>. Unsurprisingly, the increased public awareness has caused incumbents to rethink, and some have started to offer BNPL services through credit card solutions (e.g. Commerzbank's '3-Raten-Service') or partnering with Fintechs like Raiffeisen Bank International (RBI) with Credi2 to launch Cashpresso, a simple and consumer-friendly BNPL service in Austria. We expect such partnerships from incumbents along with industry consolidation will take place, considering the competitiveness and comparative strength of pioneers such

4. Analysis conducted by Finder.com/uk (2021), retrieved from <https://www.finder.com/uk/buy-now-pay-later-statistics>.

5. "How 'Buy Now Pay Later' Companies are Reinventing Consumer Credit" news published by Nasdaq (2021), retrieved from <https://www.nasdaq.com/articles/how-buy-now-pay-later-companies-are-reinventing-consumer-credit-2021-03-05>.

6. LinkedIn Pulse (2021), retrieved from <https://www.linkedin.com/pulse/deep-dive-europes-fast-growing-bnpl-market-bart-visser/>.

as Klarna, and the number of start-up Fintechs such as Alma entering and saturating the market. We have also mapped BNPL specialists (providers which often embed merchants into their platforms and offer customers the possibility to spread payments when they make purchases online) and their respective business models across the UK, Sweden, France, Germany, Italy, and Spain. In terms of economics, BNPL providers generally pursue three different strategies - the 'merchant', 'end customer', and 'hybrid' model.

■ In the case of the merchant model, BNPL providers generate most of their revenues from the merchants, where those are charged fees between 2% to 8% on the purchase transaction value, or in rarer cases, a flat fee in return for managing the

payment. Scalapay is an example of a player who has adopted this approach in Germany.

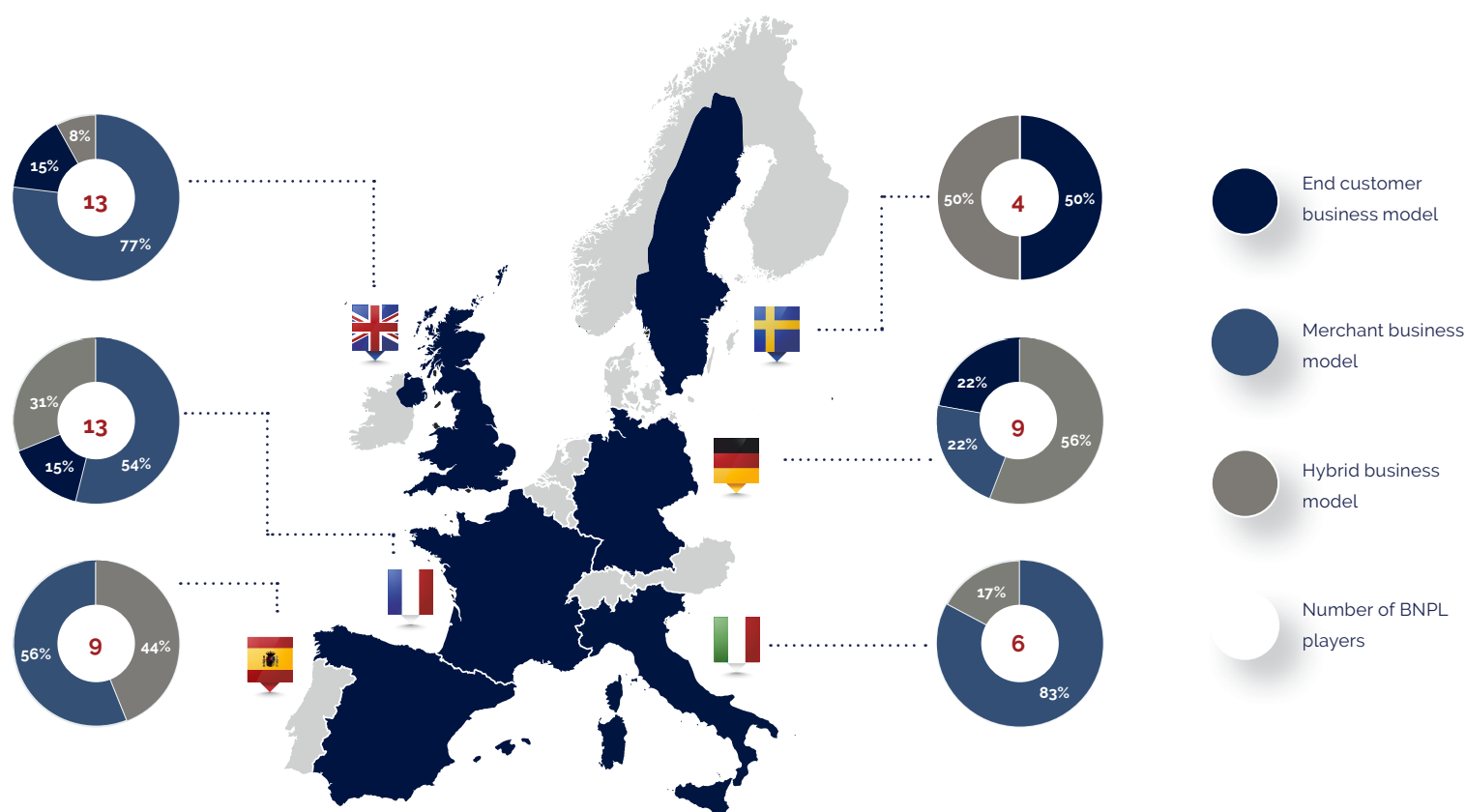
■ In the end customer model, consumers are charged directly interests on the 'loan' amount, usually based on the transactional value and the repayment duration.

■ The hybrid model combines both revenue streams, charging merchants in some cases and consumers in others.

In all three approaches, most BNPL providers will still charge the end customer late payment fees for missing instalment payments. Three options but where is the market going? We expect more and more providers to move towards the hybrid model maximizing flexibility to react to market changes.

## NUMBER OF BNPL SPECIALISTS AND THEIR RESPECTIVE BUSINESS MODELS IN EUROPE

Exton BNPL database, 2021



## JUST A HYPE OR A SUBSTANTIAL OPPORTUNITY?

### ASSESSING THE MARKET POTENTIAL IN GERMANY

Much has been written about the trending BNPL product, but few predictions are available as to how big an opportunity banks are dealing with. Being still at an early stage of development and with few reliable data points available, estimates for the future development of BNPL can best be guided by the speed of adoption in more advanced international markets. To forecast the development in Germany – serving us as a sample market – we have calculated three different, potential scenarios until 2024.

■ **Scenario 1 - 'The Australian Scenario'**: This scenario is built based on the growth rates of the Australian BNPL market, which represents one of the most mature BNPL markets worldwide with historical rapid growth since 2014, further accelerated by the COVID-19 pandemic. Applying the hypothesis that Germany will reach the same maturity in three to four years, the BNPL market volume will exceed €11 billion in 2024, translating to a sky-high CAGR of 46% p.a.

■ **Scenario 2 - 'The UK Scenario'**: This scenario mimics the growth rates of the UK market. Our assumptions include a one-year lag of Germany vs. the UK, and that EU wide regulation will be introduced e.g. consumer credit checks. In this scenario, we predict that the BNPL share of e-commerce payments in Germany will more than triple from 2020 to 2024 while BNPL volumes will increase fourfold. This scenario translates to a CAGR of 32% p.a.

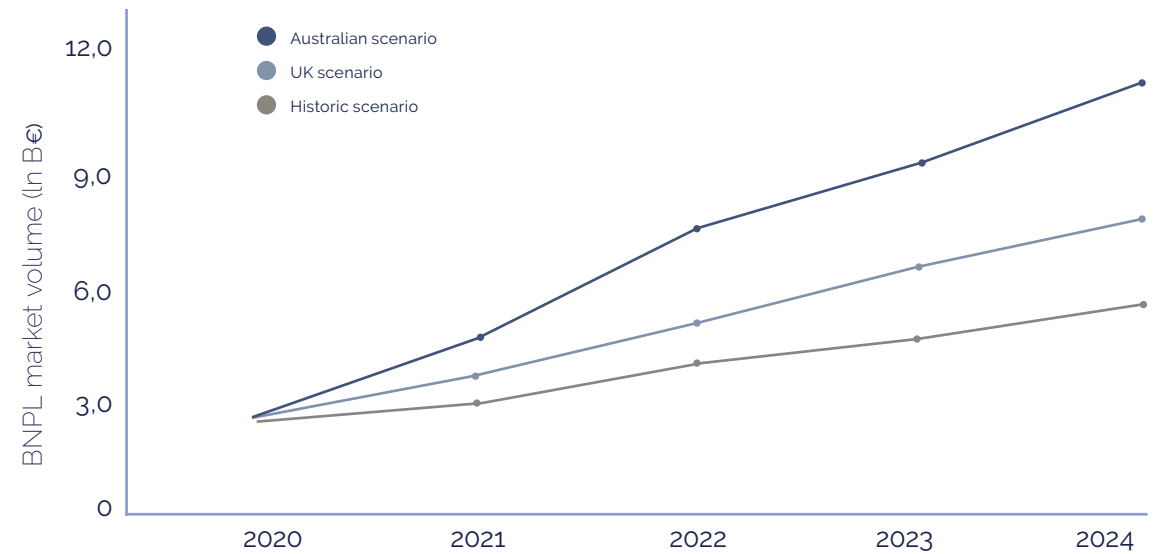
■ **Scenario 3 - 'Historic Scenario'**: Our most conservative scenario assumes the existing momentum of the BNPL trend, with a static growth p.a. without acceleration, considering that invoice payment will remain stronger in Germany compared to the other two models given its existing popularity in the market. With this growth, BNPL will amount to a total BNPL market volume of €5.6 billion in 2024. The scenario translates to a CAGR of 22% p.a.

It is worth mentioning that while BNPL frequently refers to all post-purchase payments, the terminology 'BNPL market volume' in this publication includes payments that are conducted online via the afore-mentioned specialist providers, excluding invoice payments or deferred credit card expenditures. The 'BNPL e-commerce share' is described as the BNPL share of total online POS transaction volumes.



## BNPL GROWTH EXPECTATIONS FOR THE GERMAN MARKET

In B€, Exton forecast, 2020 – 2024





# LESSONS LEARNED FROM AUSTRALIA'S BUY NOW PAY LATER BOOM



Considered by many a BNPL role model country and the homeland of major providers such as Afterpay and Zip Co, Australia is exemplary of a market that offers constructive takeaways for countries where BNPL is emerging. Understanding the drivers behind the growth “down under” and the impact it had on the industry, we can derive six key insights and lessons learned to keep in mind as European markets develop.

## 1. A BOOMING INDUSTRY THREATENING TRADITIONAL MEANS OF CONSUMER FINANCE

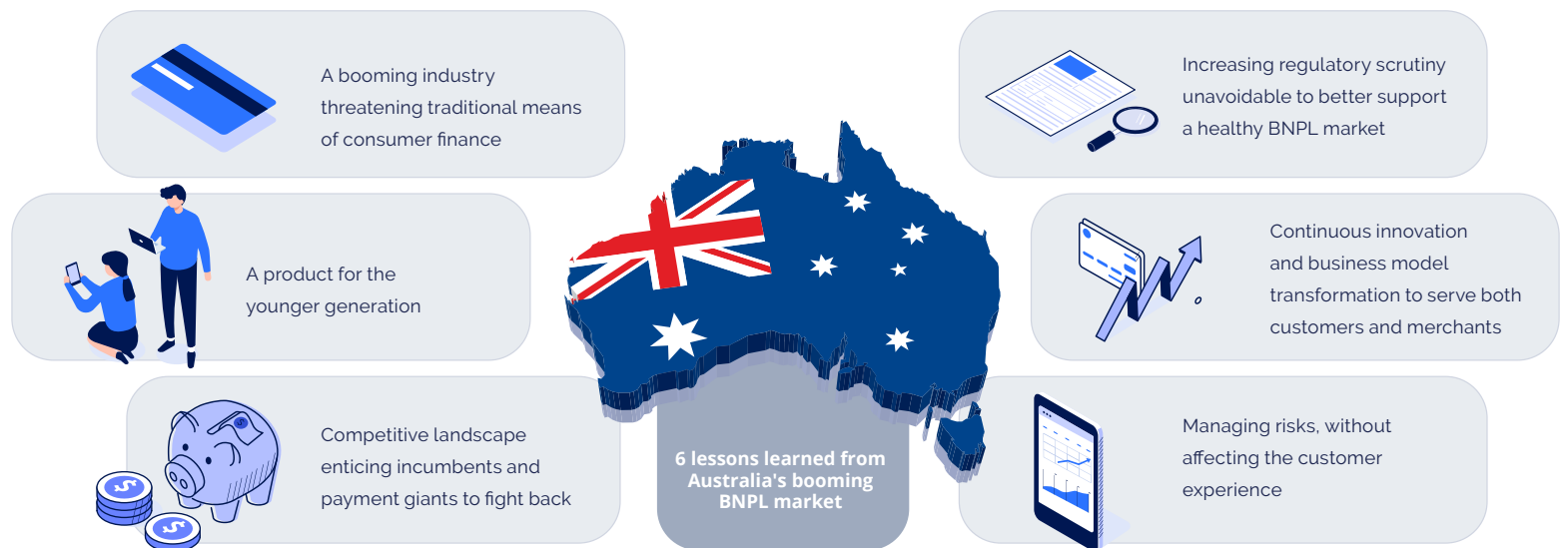
Driven by changing consumer behaviour, the Australian BNPL development (+79% in the total value of transactions between the fiscal year 2018-19 and +43% between 2019-20<sup>7</sup>) has happened in parallel to a decline in the traditional credit card market (-8% credit cards issued YoY<sup>8</sup> between 2018-2020). Consumers are apparently actively replacing traditional credit cards with BNPL likely due to the simple, digital nature of the product and fewer (or no) fees or lower interest rates involved.

In Europe, we expect a similar trend with BNPL threatening to cannibalize other means of consumer finance, be it cards in some or instalment loans in other countries. The order of magnitude of the shrinking card market in Australia may give an idea of the level of disruption to be expected.

## 2. A PRODUCT FOR THE YOUNGER GENERATION

In Australia, although most BNPL users are Millennials, Gen Z is rapidly penetrating the market as they do not have access to or have proactively decided against traditional payment vehicles such as debit and credit cards. “30-39-year-olds” were the segment with the by far highest penetration of the product, with more than 30% claiming they had used the product over the last 12 months, while that number went down to below 10% for the 50+ generation<sup>9</sup>. We are also observing a similar trend in the German e-commerce and m-commerce market with Millennials and Gen Z accounting for a large and increasing share of BNPL customers.

## 6 LESSONS LEARNED FROM AUSTRALIA'S BOOMING BNPL MARKET



7. Australian fiscal year runs from July 1 to June 30 of the following year.

8. Exton calculation based on data of the Reserve Bank of Australia (2021).

9. “Developments in the Buy Now, Pay Later Market” Bulletin – March Quarter 2021, RBA, retrieved from <https://www.rba.gov.au/publications/bulletin/2021/mar/developments-in-the-buy-now-pay-later-market.html>.



### 3. COMPETITIVE LANDSCAPE ENTICING INCUMBENTS AND PAYMENT GIANTS TO FIGHT BACK

Since the inception of the present-day BNPL, ~95% of the Australian BNPL market has been dominated by Fintechs. However, triggered by the rapid growth in interest from consumers and merchants, established credit providers including the big four incumbent banks CBA, ANZ, NAB and Westpac and payment giants such as PayPal have started offering BNPL options or alternatives, leveraging their brand and ability to take on higher risk costs whilst offering solutions that undercut existing BNPL providers in merchant and consumer fees.

### 4. INCREASING REGULATORY SCRUTINY UNAVOIDABLE TO BETTER SUPPORT A HEALTHY BNPL MARKET

BNPL providers in Australia are generally considered not to be regulated under the country's financial authorities. However, it is expected that regulations for the design and distribution of BNPL arrangements will be applied from October 2021. In the interim, self-regulatory obligations such as the BNPL Code of Practice (CoP) announced by the Australian Finance Industry Association have been set up to increase consumer protection, with broad industry support and commitment. Regulation within Germany and Europe is still pending but the European Commission plans to adopt an update on the current consumer credit agreement in the second quarter of 2021 to include BNPL service providers which will be setting new guidelines for the competition to move forward.

### 5. CONTINUOUS INNOVATION AND BUSINESS MODEL TRANSFORMATION TO SERVE BOTH CUSTOMERS AND MERCHANTS

In Australia, the majority and most popular BNPL providers offer consumers interest-free BNPL payment methods for low transaction purchases (e.g. Afterpay average purchase amount is \$147) over a relatively short period (6 to 8 weeks). For merchants, offering a BNPL payment solution to their clients is essential to increase the number and retention of clients whilst boosting conversion rates and average order values. Specialist BNPL providers in Australia capitalise on this reality and generate most of their revenues through charging merchant fees, e.g. Afterpay charges merchants ~4% of the purchase amount. However, traditional banks in Australia are now betting on late payment fees (missed payments by customers are increasing drastically) and on client conversion towards other traditional financial products (e.g. loans, credit cards, etc.). It's unclear which of these models will ultimately prevail but ongoing adjustments to product strategies are crucial in a market still shaping itself. That said, different countries might end up in a different balance of merchants vs. consumers paying the bill for the BNPL service and so copy-pasting from international peers could backfire.

### 6. MANAGING RISKS, WITHOUT AFFECTING THE CUSTOMER EXPERIENCE

In Australia, some BNPL providers have coped well with the financial risk of non-payment and bad debts during the COVID-19 pandemic thanks to consumer credit checks and streamlining of the loan

underwriting process. However, consumers are also worried about the product affecting their credit scores since many BNPL providers reserve the right to report actions such as defaulting on payments to credit reporting agencies. Australian BNPL companies have, in turn, internally adjusted the minimum credit scores required (along with following the best practices set out in the BNPL CoP) to protect themselves from bad debts and customers from increased debts and financial hardship. We expect that in Germany, regulations and debt aversion will also force providers into conducting credit checks. However, players on the market must do so without adding friction to the checkout process.

#### AFTERPAY CASE STUDY

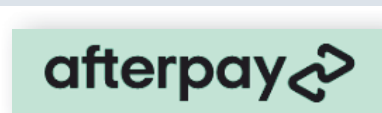
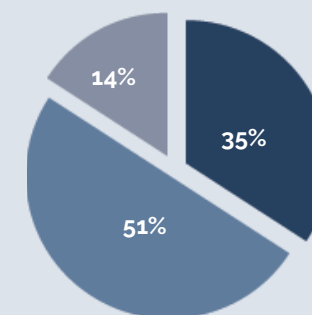
**AFTERPAY SNAPSHOT.** Founded in 2015 in Sydney, Australia, Afterpay is today one of the biggest BNPL providers worldwide with more than 13.1M active customers and over 75,000 active merchants. Afterpay users can convert their purchases into 4 interest-free instalments (the first instalment occurs during checkout) spread over 6 weeks. The company allows customers to shop directly through their website and mobile application or on merchant websites with an Afterpay card. The company charges merchants when customers select their BNPL payment solution at checkout (Merchant Discount Rate) and charges customers when an instalment is not paid on time (late payment fee)

**BUSINESS MODEL AND CUSTOMER SEGMENTATION (ANZ REGION).** In 2020, Afterpay generated a revenue of AUD\$404.1M (+59.4% YoY) thanks to its 3.3M active customers (+18% YoY). Their income source was split between merchant fees (85%) and customers fees or missed payment fees (15%). As of June 2021, Afterpay charges merchants an average of 4% of the purchase amount. The maximum purchase limit is AUD\$2,000 and the average transaction value through Afterpay is AUD\$147. Millennials account for the majority of Afterpay customers in 2020 (over half of the total active users), however, Gen Z is the fastest-growing customer group (+55% YoY).

#### AFTERPAY CUSTOMER SPLIT

In B€, Exton forecast, 2020 – 2024

- Millennials
- Gen X and other
- Gen Z



# WHAT CAN BE DONE TO BENEFIT FROM THE BUY NOW PAY LATER HYPE?



Unquestionably, incumbent banks and players not yet active in the BNPL market must assess their opportunities concerning this trending topic. Perhaps not all banks and PSPs need to react, but none should allow the opportunity to pass by blindsided. Card issuers for example were one of the first to react. Mastercard, Visa, and American Express have all already entered the BNPL market and released their own BNPL products, by partnering with or acquiring existing players. Others will need to follow suit and evaluate three strategic alternatives:

■ **Build Your Own” Product** – it’s not too late, but the window of opportunity is closing fast. Incumbents have an advan-

## EXTON RECOMMENDATIONS TO BENEFIT FROM THE BNPL HYPE

Exton study, 2021



“BUILD YOUR OWN” PRODUCT



PARTNER WITH A FINTECH OR BNPL SPECIALIST



PARTNER WITH OTHER BANKS

tage in that they can adjust existing products and leverage their numerous customer relationships to scale new offers quickly. Banking-as-a-Service (BaaS) options now readily available in many markets may simplify the path to get there and accelerate product development for banks otherwise struggling with their complex legacy structures. Large credit card players and incumbents in more developed markets may be good role models showcasing examples of new BNPL offers. American Express, for example, expanded its BNPL offer in the US, and now allows customers to spread their travel bookings on the Amex Travel portal into monthly instalments by paying a fixed fee. Commonwealth Bank of Australia recently announced its BNPL offering “StepPay”, an in-house built BNPL service that allows customers to split purchases above \$100AUD into 4 instalments with no interest. The service is being made available wherever Mastercard is accepted.

■ **Partner with a Fintech or BNPL Specialist** – incumbents should leverage their strategic assets that Fintechs do not have (funding, trust, existing customer base and data points) and marry that with new customer-centric tools offered by such partners. Australian Big Four incumbent bank Westpac recognised the need to adapt its business model to suit changing customer needs. Consequently, the bank introduced a BaaS platform and partnered with Fintech Afterpay, offering an E2E service and digital banking services. Afterpay will also gain Westpac accounts for its customers as well as money management tools.

■ **Partner with other Banks** – being late to the party, incumbents will likely find others in the same situation. Through partnership, two or more established entities can develop a common solution that would have better chances to convince merchants and clients than each of them on their own – particularly considering the multitude of new offerings being brought to market. Such partnerships could be guided by the experiences – both positive and negative – of similar efforts in the payments space (such as Bizum, Blik or Paydirekt, to name some examples with varying outcomes) where groups of banks developed integrated and common solutions and were at least in some cases able to dominate the market.

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