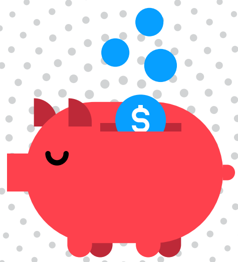
The Next Wave of Buy Now, Pay Later: BNPL 2.0



Point-of-sale (POS) finance offerings have grown significantly, especially with the COVID-19 pandemic accelerating digital growth across industries. With these new retail market trends impacting consumer behaviors, many key players have targeted checkout finance, by providing credit products such as "Buy Now, Pay Later" (BNPL).

Though there is a surge of rapid growth for BNPL particularly in the e-commerce space, providers face a variety of challenges related to risk and compliance in this unregulated space—one of the largest being potential consumer detriment by being unaware of debt risk. Plans to strengthen rules and impose proportionate regulatory control in this sector will need to address key areas such as:

1. Making affordability checks a mandatory requirement will be necessary for creditworthiness assessments.
2. Retailers should obtain authorization from providers to ensure that their promotions are fair and free from misleading information.
3. The information provided about the product, its features, and terms should be sufficient to minimize the risk of consumers misunderstanding what they are signing up for.
4. Consumers should be protected from inadvertently accumulating substantial debt.
5. To limit its impact on the broader credit market, BNPL debt should be included in credit files to make it visible.
6. Establishing mechanisms that guarantee fair treatment for customers facing financial difficulties is essential.

A transition to BNPL 2.0 will offer a safer, more integrated experience that will begin to tackle these challenges head-on. This piece will examine BNPL's current state, challenges and our vision for the future with the introduction of BNPL 2.0.

Sources: GOV.UK - Regulation of Buy-Now Pay-Later: consultation, Publicis Sapient Analysis

BNPL's transitioning state

Buy Now, Pay Later (BNPL) has grown rapidly in the U.K., especially since 2018.

Consumer behaviors have shaped the popularity of this product and will continue to favor BNPL's growth in the market—from 2019 to 2021, worldwide BNPL loans grew by 970% (from £13.2 million to £142 million). In 2023, the global BNPL market size will be valued at £243 billion and is expected to grow at a compound annual growth rate of 25.5% to reach £445 billion by 2026. This offers an excellent route for expediting customer acquisition, and banks that seek long-term growth should explore market entry.

First-generation BNPL product characteristics are known for their short repayment period (pay in three or four installments), 0% interest offers and no credit checks or may use soft credit checks with no footprint on the credit file.

Benefits for merchants and providers include the ability to expedite customer acquisition, increase checkout conversion rate for sales and scale growth. Merchant adoption in the U.K. is on the rise with over 20,000 merchants already offering a BNPL checkout option.

Sources: Global Data, Buy Now Pay Later (BNPL) Market Size, Share, Trends, Analysis and Forecasts by Spend Category (Clothing & Footwear, Furniture, Travel & Accommodation, Sports & Entertainment) and By Region and Segment Forecast - 2023-2026, Consumer Financial Protection Bureau, Buy Now, Pay Later: Market trends and consumer impacts - September 2022, Citywire - Buy now, pay later: What's next, and how should it be regulated?, GlobeNewsWire - Buy Now Pay Later Market Size, Share, Trends, Analysis and Forecast By Region, Channel, Business Model, Spend Category and Segment - 2021-2026, Publicis Sapient Analysis

£142M
The amount of global BNPL loans that has grown between 2019 and 2021, a total of 970%

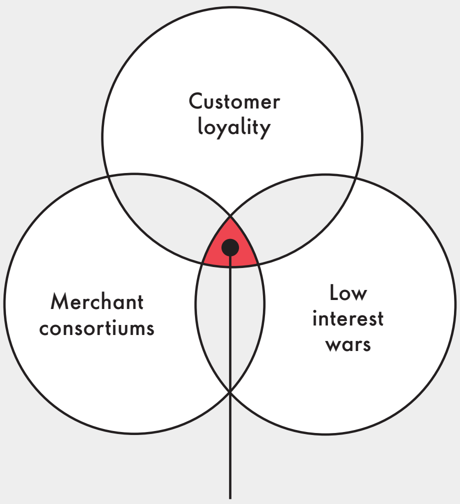
£243B
The global BNPL market size value in 2023

25.5%
Expected global annual growth rate

20,000
U.K. merchants offering BNPL at checkout

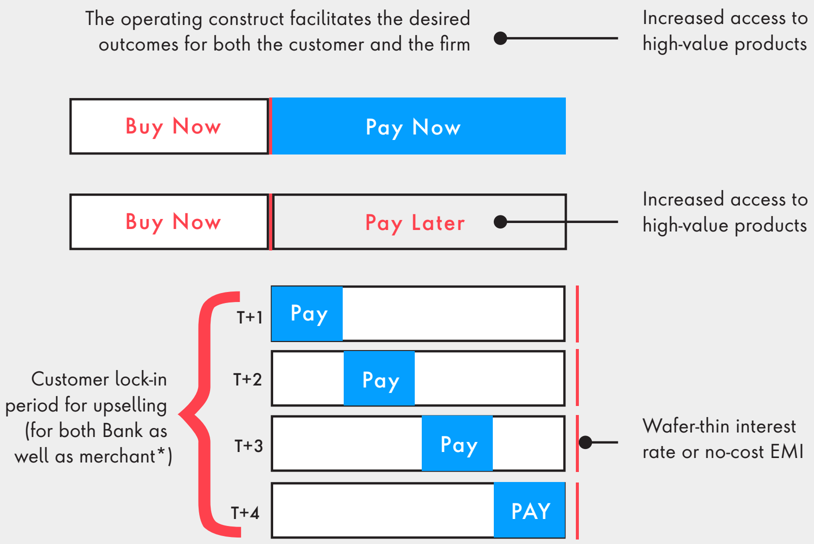
Benefits for merchants

The offering is a response to muiltiple forces to market



Intersect at the Point-Of-Sale:
(a) low-cost customer acquisition channel
(b) enhance merchant tie-ups
(c) increase customer stickiness
(d) upsell higher margin propositions

First-gen BNPL product characteristics



Sources: Publicis Sapient Analysis

While many consumers still prefer to pay via credit card, BNPL is beginning to gain traction.

BNPL adoption is growing exponentially

32% Buy now, pay later

13% Personal loans

69% Credit cards

The rapid growth of BNPL is currently driving unsecured lending. As a strong challenger to traditional lending and credit options, this payment method has emerged as a popular choice among Gen Z and millennial consumers—who are shaping the future of shopping. Its appeal lies in its structure of interest-free credit, simple approval processes and ease of set payments that make it a preferred alternative to credit cards.

Sources: Publicis Sapient Analysis, HSBC - Buy now pay later – what you need to know

An opportunity for scaling growth

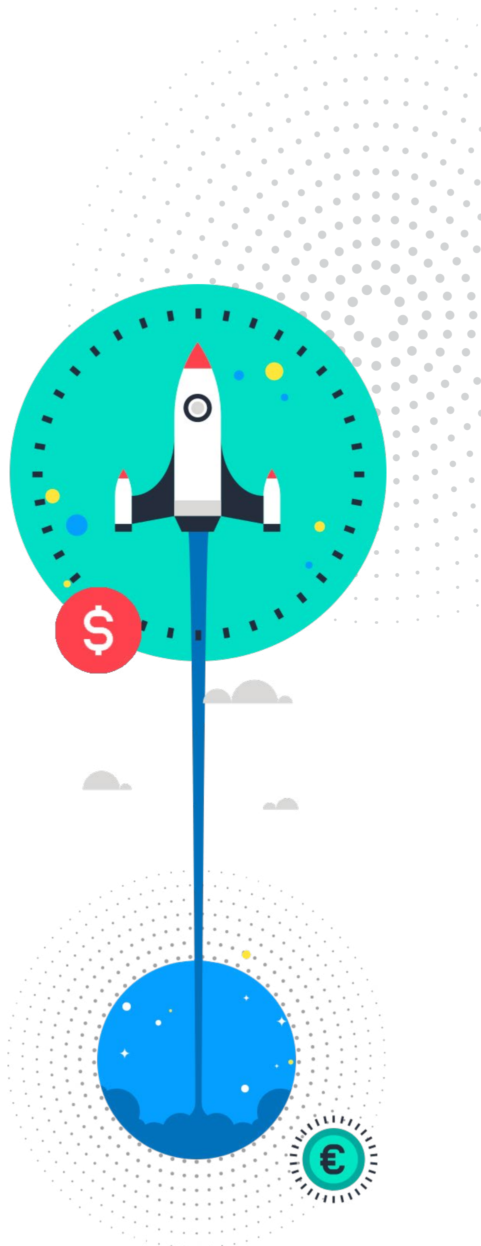
With 44% of consumers choosing to use BNPL for its ease and convenience, this affords a great opportunity for financial institutions to invest in long-term relationships with Gen Z and millennial consumers.

Moreover, as the BNPL model continues to evolve, it becomes more plausible to unbundle the traditional credit card model. The most dominant offerings and preferred choice for new market entrants in the U.K. in an attempt to unlock value quickly, appear to be card-linked installments. Providing customers with something that looks like BNPL but runs on the Visa or Mastercard rails that banks already use for their card businesses. On the flip side, such a business model doesn't support developing new customer acquisition and will inevitably cannibalize banks' existing credit card business at lower margins.

Although incumbents and challenger banks in the U.K. are entering the market and fighting for a slice of the pie, Klarna remains the most popular pure-play BNPL app with the highest number of active users. As we start to witness the transition of BNPL 1.0 to 2.0, we should begin to see a new wave of growth as new business models shift over time. Ultimately, the true benefit potential of scale and new revenue streams lies in embedded installments at checkout where partnerships with merchants and online marketplaces can be leveraged.

BNPL is in the vanguard of embedded finance—a loan product embedded in the customer journey of a partner company that makes the finance provider invisible to the customer but provides finance at the moment when it is most useful. Embedding financial products in this way lowers friction and improves the customer experience, increases loyalty, lowers customer acquisition costs and delivers greater lifetime value.

But merchants will have BNPL relationships with only one or two BNPL providers, and once established, these relationships are sticky. So, 'embedded' BNPL entails a land-grab and banks that want to play in this market need to move quickly.



Sources: Buy now pay later (BNPL) statistics UK - finder.com, Publicis Sapient Analysis

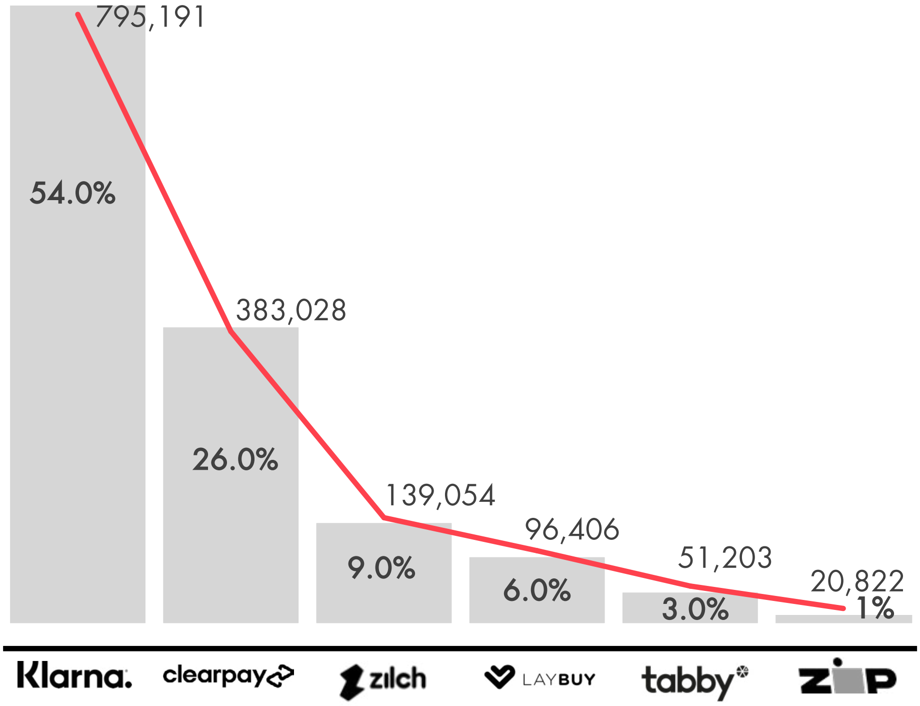
Buy-Now-Pay-Later U.K. tech pioneers are being squeezed as banks muscle in for a slice of the pie

The fight for market share

The top 6 pure-play BNPL apps in the U.K. by number of downloads based on 2022 rankings, where these services are now growing at 20% year-on-year.

The BNPL total value of gross lending estimated for 2022 is

£6.4BN



Recent selected examples of challengers and high street banks offering/ launching BNPL schemes.

BARCLAYS	BNPL 2.0 with digital revolving credit, embedded at checkout
NatWest	BNPL Virtual Card, stored within a digital wallet
monzo	BNPL Virtual Card, stored within a digital wallet
Virgin money	BNPL Virtual Card, stored within a digital wallet
HSBC	Pay upfront with a credit card, convert later to BNPL installment plan
PayPal	BNPL Virtual Card, stored within a digital wallet

Sources: Sensor Tower – European adoption of BNPL apps, Statista - Biggest buy now, pay later (BNPL) apps in the United Kingdom (UK) from 1st quarter of 2015 up until 1st quarter of 2023 by number of downloads, Statista - Estimated transaction value of buy now, pay later (BNPL) in the United Kingdom (UK) in 2022, with forecasts for 2023 and 2028, Credit Strategy – BNPL is booming, Publicis Sapient Analysis

'Embedded' BNPL entails a land–grab, and banks that want to play in this market need to move quickly.

Driving financial inclusion while ensuring responsible lending through smarter decisioning

What customers expect

While many consumers still prefer to pay via credit card, the convenient digital nature of BNPL checkout options is gaining adoption fast through the improved customer experience that boosts satisfaction and loyalty. From our research, we're also seeing that the dominant reason why customers switch to BNPL is to avoid paying high credit card interest, with the most popular purchasing category being casual wear.

Responsible lending

Most customers have never missed a payment, and, out of those that have, did not do so more than once. However, regulatory scrutiny has raised the need for significantly better protections to de-risk consumer detriment that make the current BNPL 1.0 unsustainable.

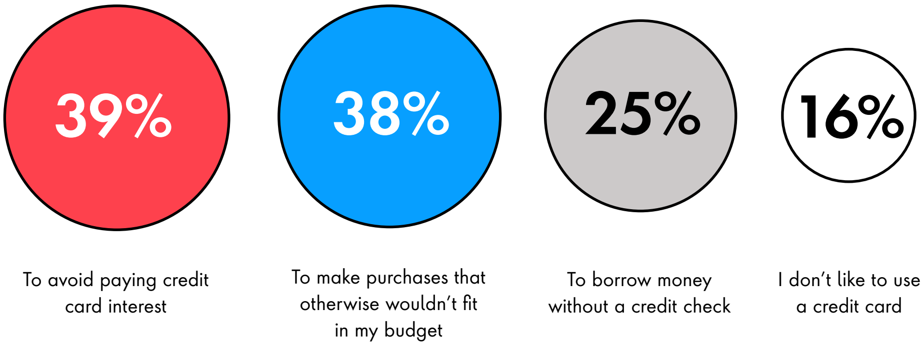
The current indications of potential scale of harm within this currently unregulated market, particularly where customers are vulnerable, has created a need to strengthen controls. Many existing providers are not financial institutions and, unlike banks, offering BNPL products does not require them to be FCA authorized as required by other regulated sectors.

To strike the balance between 'affordability' and 'availability' of loans, stronger safeguards are needed to protect consumers by assessing creditworthiness; and appropriate steps in the checkout process to ensure that customers understand that they are borrowing money when using BNPL. Even merchants distributing BNPL of a third party, will need to be licensed to comply with conduct rules as 'credit brokers.'

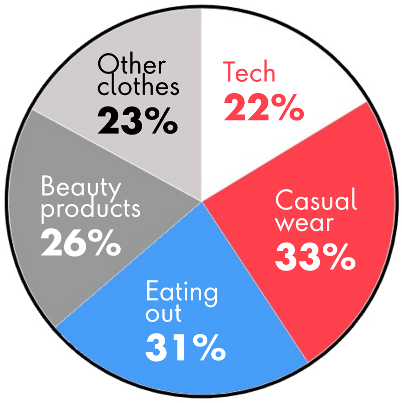
To support a more seamless transition to fully-regulated BNPL 2.0 products, Experian has launched the first BNPL 'specialty' bureau—as a ring-fenced approach to affordability checks by storing BNPL data separately from the core credit file. This will aim to protect consumer credit scores from immediate negative impact and may be an option that providers may prefer to adopt.

Other identified improvements within the scope of the government's plans for regulation is the need for consumer promotions not to be misleading, consistency in how those in financial difficulty are treated, provide the ability for BNPL shoppers to complain to the Financial Ombudsman Service and for their transactions to be covered by Consumer Credit Protection Act.

Why do shoppers use BNPL?

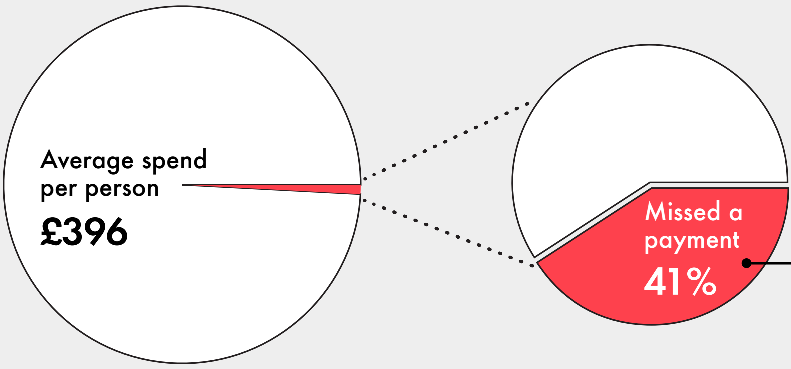


What products do BNPL consumers buy?



Most BNPL consumers have never missed a payment

In the last 12 months, 4 in 10 of those who've used BNPL are struggling to repay



Most customers have never missed a payment and those that have did not do so more than once.

Affordability vs. Availability

It's about whether consumers can afford the purchase in the first place. Stronger safeguards to protect consumers are needed, including steps in the checkout process to ensure people understand they are borrowing money when using BNPL.

!

Only **half** of those that missed a payment have done so **more than once** and out of those, less than half was for affordability reasons

The first BNPL 'specialty' bureau and a ring-fenced approach

Lenders can now protect consumer credit scores, better assess risk and support responsible and inclusive lending with real-time insights

Detailed information related to each BNPL transaction will initally be stored separately from Experian's core credit bureau data

Real-time, FCRA-compliant analytics enable instant decisioning so lenders can move faster with more confidence

Sources: Insider Intelligence – BNPL Market trends in ecommerce financing, Statista Share of BNPL by product category 2021, Credit Strategy – Missed BNPL repayments up 30%, Experian - BNPL Business Solutions

Today's BNPL 1.0 is a rocky landscape

Three focus areas of industry challenges for BNPL providers:

1 Cost pressures and a squeeze in margins

- Continuously rising cost-income ratio
- Rising interest rates and cost of funds are squeezing provider margins
- Smaller credit portfolios bear higher run costs associated with the tech estate

2 Regulation is essential to promote responsible lending

- Customers are not informed how they may be impacted if payments are missed
- Lack of affordability checks may lead to customers accumulating more credit than they can afford
- Credit reporting and credit checks are not mandatory
- Merchants offering BNPL do not undergo any vetting and are also not required to be an authorized credit representative of the BNPL provider

3 Escalating competition and an increasingly saturated market

- Rapid pace of entry of new players includes big tech companies and incumbent banks, creates profitability challenges for smaller and specialized providers
- The fight for market share will likely lead to more consolidation through acquisitions
- Opportunity to scale customer acquisition is only profitable if BNPL providers can cross-sell/upsell a wide array of products
- The underlying assumptions of BNPL will need to be revised and the model evolved, given that it's not proving viable as a standalone business

> *The underlying assumptions of BNPL will need to be revised and the model evolved, given that it's not proving viable as a standalone business.*

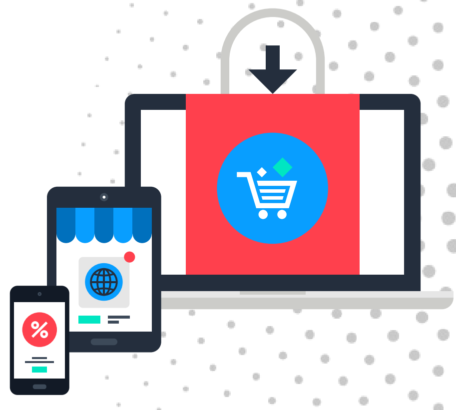
Sources: Publicis Sapient Analysis, Visa consulting & analytics 2022 – Buy Now Pay Later: A threat or an opportunity

Our vision for the future: Digital Revolving Credit & BNPL 2.0

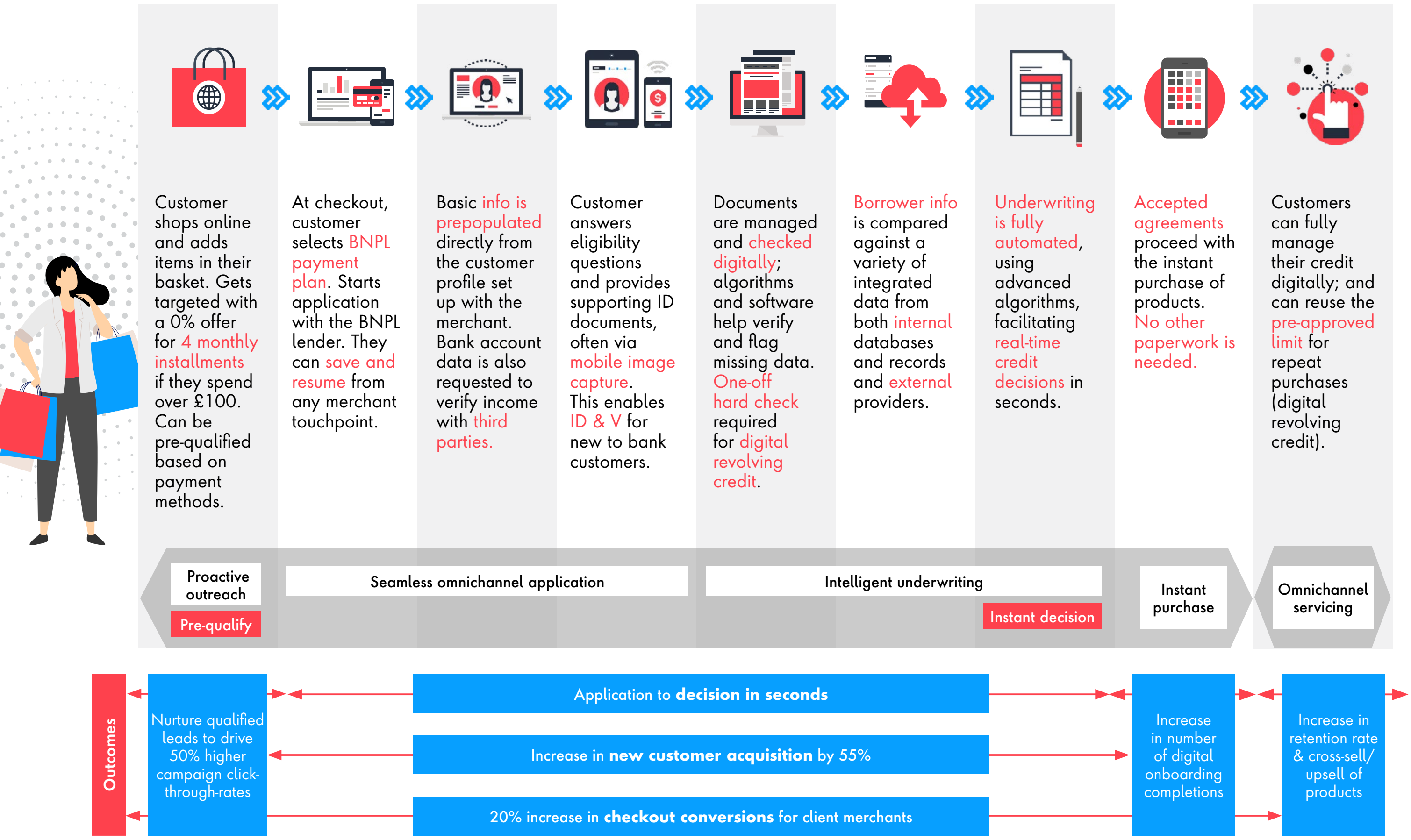
BNPL 2.0 is a safer and fully regulated option that will make lending more responsible. By creating an embedded, personalized checkout experience, merchants can achieve impactful growth through higher conversion rates and low-cost customer acquisition.

In parallel, BNPL providers can leverage enablers such as AI technology, to support how merchants can 'prequalify' eligible customers and power up 'intelligent underwriting' for fully automated credit decisioning to increase instant accept rates for revolving credit limits. Our envisioned journey includes a hard credit check to give the lender an accurate picture of affordability and an instant credit decision in seconds. Approved customers can then make repeat purchases without needing to reapply by using their credit limit that is added to their wallet. The BNPL provider also grants access to their app that enables the customer to fully manage their loan product.

Partnerships with Big Tech firms that act as embedders maximize benefits since BNPL providers can distribute at scale with a single integration.



BNPL 2.0 Customer Journey: An embedded, personalized checkout experience



Sources: Publicis Sapient Analysis

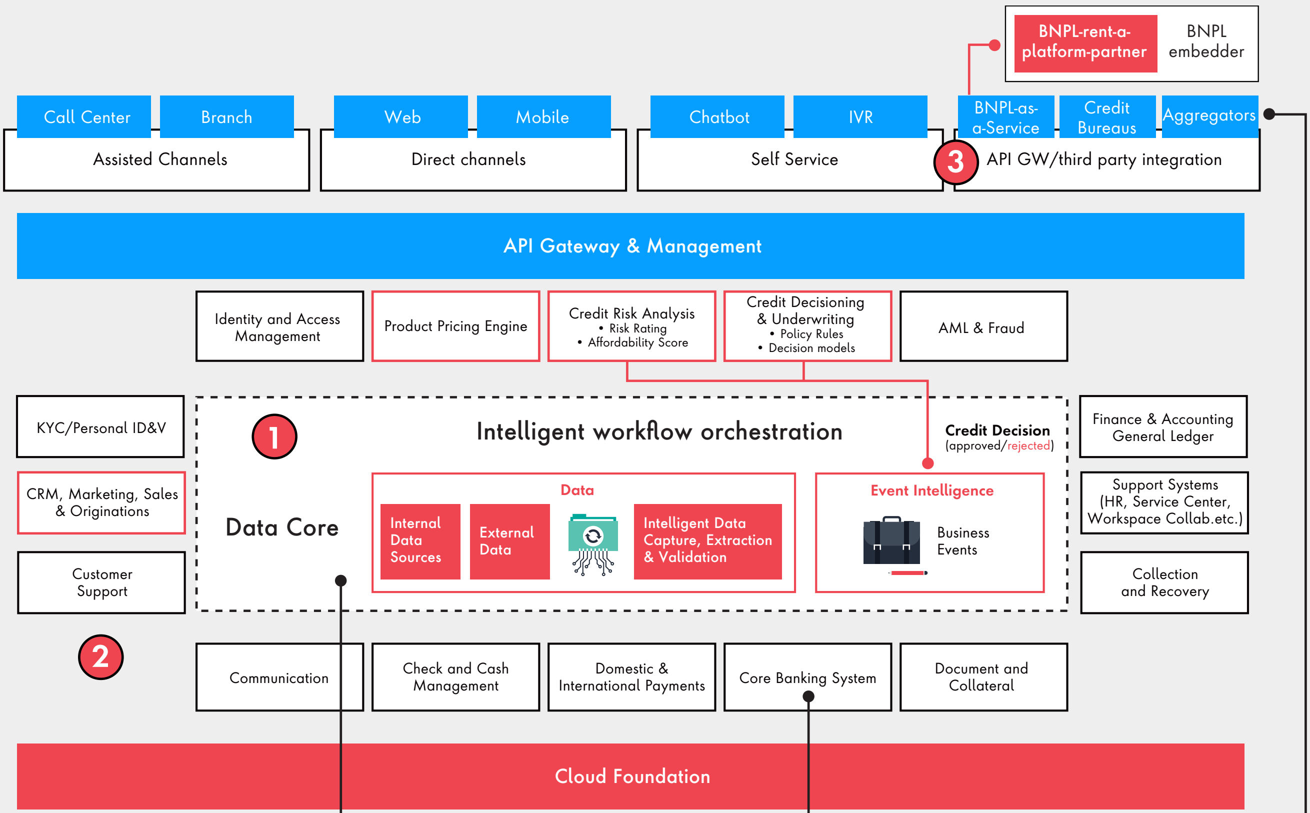
Coreless & BNPL-as-a-Service: Architect your value chain through modular technology

The foundation of modernization is coreless. A "coreless" banking system reorients the bank around the composition of digital fintech services. But incumbent banks often trust monolithic core banking systems, which can be costly to scale, difficult to innovate and incompatible with modern software platforms. When looking toward digital transformation, these legacy systems make it challenging for traditional financial institutions to innovate.

Coreless banks are ditching the monolith for a composable network of fintech products. Not only are coreless systems trusted by modern technologists, but they are also built for agility, elastic scale and modern cloud architecture.

Modernizing the core helps to achieve business agility, operational and technological efficiency. New, scalable tools can accelerate delivery times and cut costs. Intelligent workflows, AI and automated data reduce manual processes and risk. Powerful decisioning and business process management capabilities enhance the originations process through no-code/low-code solutions. The outcome is higher loan velocity through workflow automation for data-driven originations.

Ultimately, banks can leverage modular technology to define their value chain ownership and role within an embedded finance capability stack.



1 **Coreless Bank**
the target state is a coreless bank centered around data with APIs and Cloud as its back-bone. Every function is a replaceable module including core banking systems.

2 **Fintech Partner Ecosystems**
weave together solutions from fintech innovators to address capability gaps and create an engineering architecture for continuous improvement.

3 **External Partner Integrations**
integrate with third parties to scale your BNPL business. Speed up merchant onboarding times, scale merchant acquisition and improve the overall distribution partner experience.

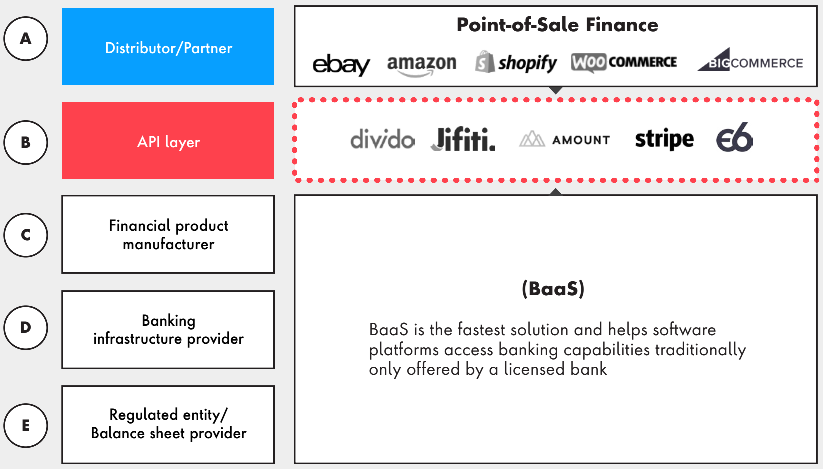
Sources: Publicis Sapient Analysis

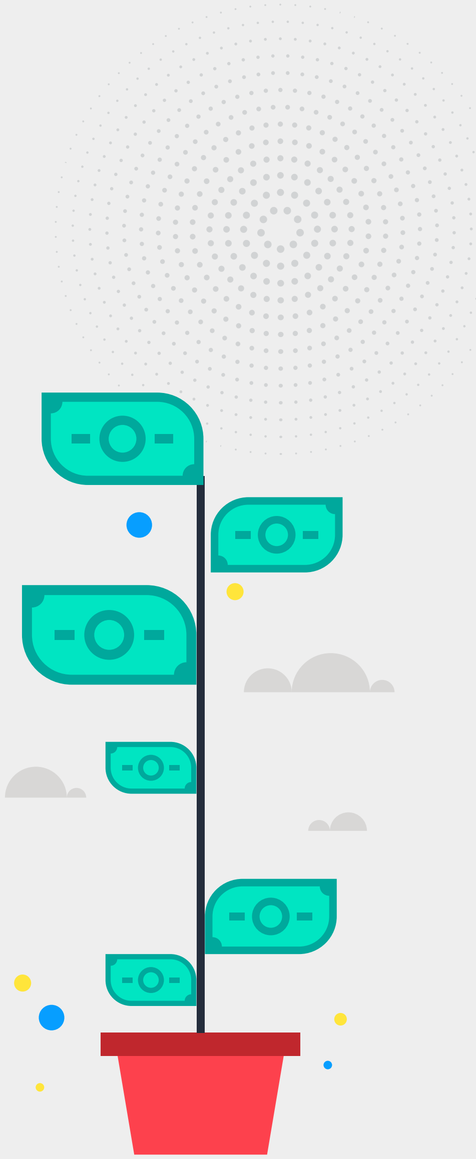
BNPL-as-a-Service: Considerations to accelerate market entry and supercharge sales growth

As the BNPL space continues to grow—with new issuers, acquirers and fintechs joining the conversation—these providers need to determine how to best offer BNPL solutions to consumers. Lenders can leverage an investment in next-gen credit solutions to provide banking-as-a-service (BaaS) and outsource BNPL 2.0 to specialist partners.

Partnerships are helping shape a better future for the BNPL industry. A rent-a-platform go-to-market model, will enable BNPL 2.0 providers to leverage a single integration to only strike partnerships with vetted online marketplaces, big tech firms and thousands of retailers who are already on these enabler platforms and act as the embedders; and distribute loan programs through them at lower risk. Such relationships will provide broad access to the e-commerce market, create opportunities to deliver significant revenue uplift by scaling merchant acquisition cost-effectively; and at the same time meet the increasing demands for responsible lending from regulators. This makes the 'land grab' easier to deal with.

BNPL rent-a-platform partnership





Value

Providers

Adapt to online & in-store touchpoints | Scale merchant acquisition cost-effectively | Single integration

- Ability to hand-pick distributors and offer a fully white-labelled business financing solution
- A single integration to offer online financing to eligible merchants at scale
- Zero overhead to maintain or add a merchant to a financing program
- Fully-branded flow for both the provider and the distributor

Merchants

Instant access to multiple loan programs | Zero integration required with e-commerce platforms | Plug & Play connection to any lender

- Zero integration with lenders' systems
- Short and simple onboarding
- Maximize revenue by selling large-ticket items with suitable financing

Sources: Publicis Sapient Analysis

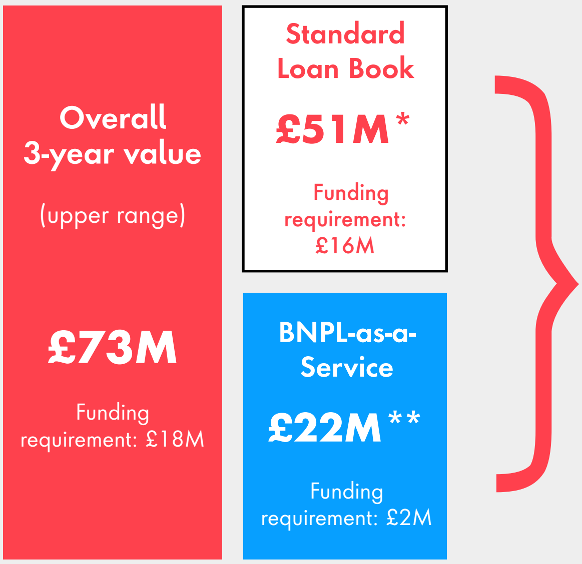
Quantifying the impact of BNPL-as-a-Service
(illustrative example)

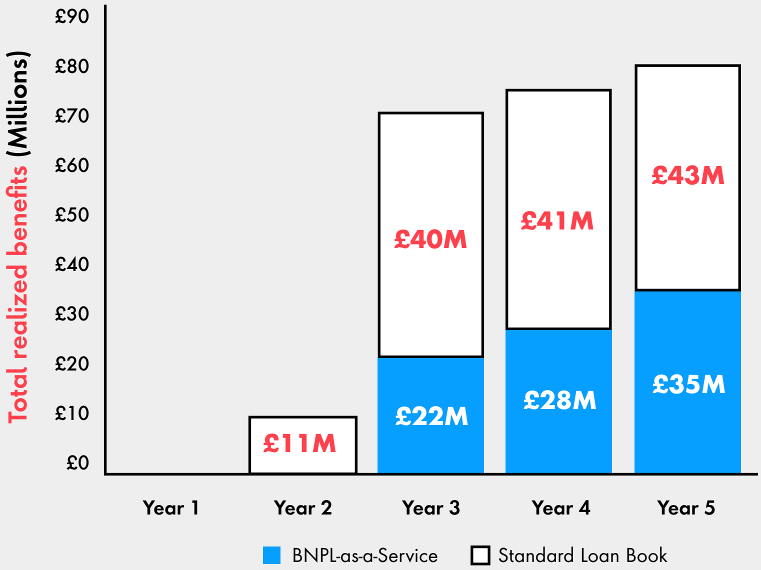
A strategic investment in the range of £8 million to £18 million could see an estimated potential total benefit of £52M+

This illustrative example clearly demonstrates the benefit potential that BNPL-as-a-Service can realize in its 1st year of launch (targeted for year 3 of the plan); and is being compared against the Standard Loan Book where the timeframe for benefit realization spans across the full 3-year period.

The forecasted realized benefits from year 3 include 'switching on' BNPL-as-a-Service to deliver exponential growth without incurring the costs of end-to-end distribution vs. the linear model of a standard loan book.

Investing for impact





* Standard Loan Book: timeframe for benefit realization is based on a full 3-year period
** BNPL-as-a-Service: assumed benefit realization is targeted for year 3 of the plan; and is illustrated based on a 1-year period

Sources: Publicis Sapient Analysis

The value of BNPL-as-a-Service

- Changes distribution, from horizontal (where direct customer acquisition has become increasingly expensive) to vertical—where lending is offered by SaaS and e-commerce with near zero marginal distribution cost
- Embedded consumer lending leads to speedier/more successful loan applications for customers
- Achieve exponential credit portfolio growth and significant increase in market share in a short timeframe and at low acquisition cost
- A bigger credit portfolio will bear lower run costs associated with the tech estate
- Leverage a foundational investment in modernizing core tech and next-gen credit solutions to offer BNPL-as-a-service and maximize benefits
- Monetize customer acquisition at scale by cross-selling/upselling a wide array of products through a One-Stop-Shop
- Provide a seamless and integrated customer experience through partner distributors, such as online marketplaces and big tech companies with the best CX track records.

> *BNPL-as-a-Service can deliver significant revenue uplift by reaching massive pools of customers to create exponential growth.*

Open Finance & Amazon-ification: How to build an unsecured lending One-Stop-Shop (illustrative example)

BNPL, as a standalone business, is not proving viable and poses even greater challenges for smaller, specialized providers. With Big Tech firms as new market entrants, such as Apple, the model will inevitably evolve into a One-Stop-Shop experience to include embedded loyalty solutions that may soon unleash the power of Open Data.

A super wallet proposition can be the first step towards such a strategy, that can later transition into a super app to cover the entire lifestyle of a customer base. An ecosystem business model would leverage the wide array of products and services that a provider can cross-sell/upsell to monetize customer acquisition.

We have developed an illustrative 3-year digital-first strategy to deliver an unsecured lending One-Stop-Shop that demonstrates how to best put this into practice for a future implementation:

Year 1 Modernize the core

Tech cost efficiencies · Ops efficiency and automation · Instant decisions engine · 360 Customer view

Proof of concept · Credit data aggregation · Legacy platform decommissioning · Open APIs & partner integrations

Journey-led progressive modernization

Reinvent customer journeys and business logic iteratively, as modular microservices are selectively "hollowed out" from legacy systems

- Coreless banking
- Scalable distributed architecture
- Orchestration of omnichannel CX

Robust risk and control framework

Realize a best-in-class credit risk strategy with data-driven automated credit decisioning models

Year 2 Develop new revenue streams

Get quote (eligibility checker) · Fast personal loan · Borrow more (Top-up loan) · Digital servicing (personal loan, BNPL, cards) · Buy Now, Pay Later virtual card

Mobile-first personal loans, credit cards, BNPL + **Credit coach** + **Digital wallet** = **Mobile Super wallet**

Digitize at scale

Launch enhanced propositions for a holistic experience by providing fast, true omnichannel lending with a mobile-first approach. Partner with technology innovators to enable new customer benefits

- 50% cases STF
- Increase digital sales by 10%
- Widen range of key touchpoints (including embedded)

Automate

Streamline loan processes end-to-end to simplify, build capacity and focus on continuous value release

Year 3+ Unlock customer engagement

Data-driven personalization and MarTech · AI chat bot for digital assistance · Pay: Integration with e-commerce payment gateways · Financial wellness/ track spending/ budgeting · BNPL 2.0 embedded at merchant checkout

Drive customer lifetime value

Deepen customer relationships via pro-active outreach and smart personalized experiences. Be at the right place, at the right time during the customer buying process.

- Drive conversions and long-term growth
- Nurture customer loyalty
- Deliver hyper-personalized interactions
- Scale customer acquisition through BaaS

Sources: Publicis Sapient Analysis

Driving Impact

Consumer Lending Business

£47M Average revenue uplift	**20%** Uplift in Completions
£11M Average cost reduction	**65%** Digital Adoption
70 NPS score	**80%** Digital Share of Voice for lending journeys

Strategic investment:
£8M to £18M+

The proposal

Publicis Sapient can develop a BNPL solution to diversify your consumer lending portfolio and accelerate value realization.

1 Define your value chain ownership

Define your value chain ownership to determine the business model. Explore the roles that you can take on, along a set of archetypes within the embedded finance modular capability stack.

2 Shape a unique value proposition

Develop your unique value proposition tailored to your specific needs. Identify the key value drivers that will guide the benefit potential of the business case.

3 Target strategic roadmap

Create a strategic roadmap with an incremental approach to capture the shared understanding of the vision and sequenced building blocks of the holistic value proposition.

4 Conceptual target architecture

Provide a target architecture aligned with the strategic direction. Facilitate unbiased vendor assessments to deliver a successful proof of concept (PoC).

Measuring return on investment for a 3-year period (illustrative)

Total benefit:
£31M – £73M

Revenue uplift:
£25M – £59M

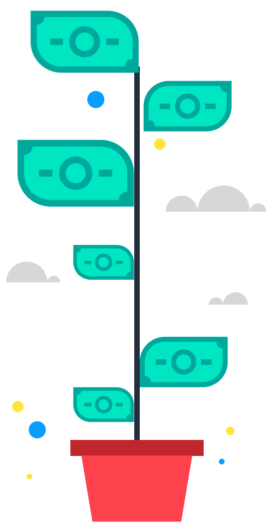
Cost savings:
£6M – £14M

Strategic investment:
£8M to £18M+

Investment payback within 3 years

Next steps: The first engagement

Publicis Sapient recommends an initial 12-week engagement to develop the essential components of a digital vision that will link in with a progressive technology modernization strategy and launch you into the coreless era.



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Want to learn more?

Talk to us.

To find out more about how we can help your
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