Buy Now, Pay Later in the UK

Consumers’ Delight, Regulators’ Challenge
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Buy now, pay later (BNPL) is one of the hottest trends in financial services and retail today, attracting resources and innovation in many countries.
Executive summary

On the Eve of Regulation, Five Insights from the UK Experience

Buy now, pay later (BNPL) is one of the hottest trends in financial services and retail today, attracting resources and innovation in many countries.

Significant capital is flowing into high-growth BNPL businesses, with Klarna’s $639 million funding round this year valuing the company at $45.6 billion and Square acquiring Afterpay for $29 billion.

Large technology and fintech businesses are extending their products further into BNPL. Apple recently announced it was adding a “pay later” feature to its mobile wallet, Affirm is partnering with Amazon to offer BNPL in the US, with Amazon likely to find a partner for the UK in the near future, and PayPal UK has introduced a “Pay in 3” feature to its growing array of payment options. Some of the biggest banks and card providers worldwide are moving into BNPL as well. Visa, for instance, will be offering BNPL application programming interfaces to its card-issuing partners to enable installment payment features for end users. Monzo and Revolut have also announced BNPL features in their digital banking apps.

In the wake of all this activity, demand, and growth, BNPL will soon become regulated in the UK as the Financial Conduct Authority (FCA) and UK government begin regulatory consultations. To help executives, regulators, and analysts better understand this fast-moving space, this report aims to define and estimate the size of the BNPL market, examine the benefits and challenges for consumers and merchants, and offer insight on how BNPL is likely to evolve. Much of the report’s data and analysis pertain to the UK, but the insights have relevance for markets in other countries.

While the report contains a wealth of detail, it can be distilled into five key insights:

• High demand spurring sustained growth. BNPL has evolved into embedded digital payment and lending products used by 25% of e-commerce shoppers and 20,000 merchants. Transaction value in the UK reached £6.4 billion, or 5% of the e-commerce market, reflecting 60% to 70% annual growth. We expect this growth trajectory to persist, as BNPL appeals to a mass consumer market and is expanding to be used across a wider range of products and use cases.

• Favorable consumer perception. For consumers, BNPL has quickly become a well-liked product, as evidenced by its Net Promoter ScoreSM of 30, compared with 6 for credit cards and –15 for over-drafts. The simplicity of payment at checkout and the ability to manage their cash flow better by deferring payments partly account for consumers’ favorable opinions. However, the interest-free nature of BNPL serves as the biggest draw for consumers. Over the course of 2020, we estimate, people using BNPL in the UK saved £103 million in credit card interest costs.
• **A key ingredient of merchants’ growth plan.** It’s not just consumer demand that spurs merchants to offer BNPL checkout options; merchants also benefit from improved checkout performance and new customer acquisition. Our new survey finds that 54% of merchants have their brand exposed to new customers through co-marketing activities, and 23% could track the direct referral of customers from their BNPL providers. When customers visited a store, 57% of merchants using BNPL reported an increase in basket conversion, and 46% experienced an increase in average order value. Compared to card payments, orders made through BNPL can be 20%–30% larger as consumers spread out the payments, and they like the convenience. Summing up these commercial benefits, 75% of surveyed merchants said BNPL will be a key part of their growth plan over the next year.

• **Upheaval in financial services.** There has been a rapid shift to digital over the past five years, creating big structural changes in the financial services industry. Consumer expectations have shifted away from traditional lending and payment products toward low-cost or free services with convenient, intelligent digital experiences. Among online shoppers aged 25–34 in the survey, 49% reported using BNPL and 51% used credit cards; the generational shift toward BNPL is even more pronounced among younger cohorts. Winners in this market will be companies that combine strong consumer and merchant relationships into a robust value proposition and business model. Another attractive option is to create embeddable, white-labeled solutions that enable brands to offer financial products to their existing customer base.

• **Imminent regulation and the need for industry-wide debt data.** BNPL will soon become a regulated product, and one key concern that needs to be addressed is the inadequate ability to share credit data between BNPL companies and other lenders. The current credit referencing systems and processes were not designed for higher frequency, low-value credit checks and reporting for each transaction. While debt levels currently are low among BNPL users, adequate consumer protection will require greater visibility as adoption continues to grow. Furthermore, the industry should build upon its promising start of improving education on responsible BNPL spending and creating the right environment to ensure that debts are repaid on time.

We look forward to continuing the conversation around how to expand a BNPL industry that’s healthy for all involved.
Buy Now, Pay Later Moves Center Stage with Consumers and Regulators
It’s a market in flux, with surging consumer demand and merchant appeal.

To understand what buy now, pay later (BNPL) is and is not, it’s important to explore the types of BNPL in the UK, along with differences from other forms of unsecured lending. Let’s start by defining the category in a global context.

The fast-moving evolution of BNPL

Whether one looks at transactions, users, or merchants, BNPL has been growing at a blistering pace. It represented 5% of e-commerce transaction volume in 2020, up from 3% in 2019, according to Worldpay. Based on data supplied by BNPL providers, we estimate annual BNPL transactions total approximately £6.4 billion, roughly a 60%–70% increase over the same period a year before.

When Bain & Company conducted a survey of more than 2,000 UK online shoppers in July 2021, we found widespread usage, reflecting long-term shifts in consumer behavior. Extrapolating from our customer survey and data from BNPL companies, we estimate that approximately 10.1 million people used BNPL in the previous year, showing roughly 70% to 80% annual growth.

In terms of merchant partners, data from BNPL providers points to roughly 20,000 merchants offering BNPL at checkout.

BNPL providers are indeed becoming more prominent in both online and offline shopping. They address a wide range of customers’ “Jobs to Be Done” (a theory proposed by Clayton Christensen as shorthand for what an individual seeks to accomplish in a given circumstance. The circumstances related to BNPL range from discovering personalized lifestyle products such as clothes and electronics to simplifying online purchases and deferring payment until they’ve received the products).

BNPL has long thrived in the UK in various forms, including point-of-sale (POS) finance and mail-order or catalog credit. Such services have traditionally focused on extending interest-bearing loans (sometimes with interest-free periods) to consumers at the point of sale. Historically, their aim was to make larger purchases affordable by financing them over relatively long durations. This was the original version we call BNPL 1.0.

This report, however, delves into BNPL 2.0, which has quickly gained popularity with consumers and retailers of all kinds. We define BNPL 2.0 as digital services that allow people to defer or stagger payment for a product at the time of purchase. Providers assess creditworthiness in real time for each transaction, then pay the merchant the purchase value and charge a service fee. Individuals repay the provider in interest-free installments (see Figure 1).
**Figure 1:** A sample customer journey using buy now, pay later

1. Customer shopping online, on BNPL app, or offline selects items.
2. Customer goes to checkout and chooses BNPL.
3. Total to pay: £60.00
   - Pay with:
     - Credit/debit card
     - Digital wallet
     - Buy now, pay later
4. Enter email: [ ]
   - Password: [ ]
5. Customer is approved for BNPL, is shown terms of purchase, and agrees to payment plan.
   - Pay in 3 £20 installments
   - Complete purchase
   - Note: This is a credit product and...
7. Customer is prompted to make repayments before each installment is due.
   - £20 payment due tomorrow
8. Customer makes repayments until purchase price fully repaid.

Source: Bain & Company interviews with BNPL providers
We define BNPL 2.0 as digital services that allow people to defer or stagger payment for a product at the time of purchase. Individuals repay the provider in interest-free installments.
In the UK today, Klarna is the best-known BNPL 2.0 brand, with 54% of our survey respondents having heard of it. PayPal has capitalized on its existing user base to introduce “Pay in 3,” while a few fintechs from Australia and New Zealand—Afterpay (known as Clearpay in the UK), Laybuy, Openpay, and Zip—have drawn on their home market expertise, where BNPL is more prominent, to launch services in the UK.

The UK financial services regulator, the Financial Conduct Authority (FCA), refers to such retail credit products as “deferred payment credit,” which are currently exempt from consumer credit regulation because of their short-term and interest-free nature. The rise of BNPL has excited both retailers and investors, and provoked debate about bringing deferred payment credit within the scope of FCA regulation.

Given the growth of the market, and the need for greater regulatory oversight, it’s useful to clearly define BNPL, how it evolved, and how it differs from other payments and credit products.

**All due credit to the precursors**

Offering loans at checkout isn’t new, and it might be hard to see how BNPL 2.0 differs from alternatives in the market. When it comes to the customer’s overall journey with a merchant, direct precedents are POS lending and mail-order/catalog credit (BNPL 1.0). In the UK, retailers that offer POS lending include John Lewis and dfs and historic catalog businesses, such as Very, Littlewoods, JD Williams, Argos, and Next.

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**5%**

BNPL’s share of e-commerce transaction volume in 2020

**60%–70%**

Annual increase in BNPL transactions for 2020
Before the Internet, shoppers would make their way through a store or a catalog, select items, and choose whether to pay upfront or take out a loan for the purchase. The main purpose of this service was to allow customers to spend more by offering them credit, and to give them the option of spreading payments in order to manage their cash flow. As the world moved online, so too did this process. The customer browses, selects items, and is presented with payment options, among them an installment loan for the purchase. Thus, BNPL 1.0 went digital.

However, the shift to online shopping spurred a further evolution and growth of BNPL 2.0, as distinct from digital BNPL 1.0. One immediate challenge for consumers was that they were forced to accept a lag between payment and delivery. When Klarna launched in 2005, it enabled consumers to pay for online purchases after (or closer to) time of delivery. Since it didn't charge interest, consumers could try products and attempt returns without out-of-pocket outlays, mitigating a key psychological barrier to purchasing online.

While BNPL 1.0 use cases have remained relatively unchanged, BNPL 2.0 has grown to fulfill more customer Jobs to Be Done, such as:

- convenient and safe payment methods;
- sources of credit that are cost-effective and easier to manage than alternatives (for example, through an app); and
- the ability to spread or delay payments, which helps to manage personal cash flow.

These benefits contribute to the relatively high levels of customer satisfaction with BNPL; with a Net Promoter ScoreSM of 30 (on a −100 to 100 scale), it fares well compared with many other payment and credit products.

The difference in use cases lies in fundamental differences in the design of BNPL 1.0 and BNPL 2.0 products. Most obvious is that BNPL 1.0 products normally bear interest. Some have interest-free periods and annual percentage rates (APRs) can vary from low to very high, but they’re fundamentally structured as interest-bearing products and regulated as such.

Another key difference lies in who owns the customer relationship. When an individual checks out in digital BNPL 1.0, the financing option is often branded under the merchant’s name, keeping the customer relationship under the retailer’s umbrella. With well-known BNPL 2.0 providers, the shopper can clearly see the independent nature of the finance provider. At checkout, customers need easy, low-risk payment methods. Shoppers might have confidence in the retailer-branded financing options at large, trusted names like John Lewis, Very, Littlewoods, Argos, QVC, and AO.com. But this often doesn’t translate to newer or specialty merchants that are still in the process of building their brand equity and trust with customers. A well-known BNPL solution at checkout lends credibility and makes shoppers more likely to trust smaller merchants online.
A well-known BNPL solution at checkout lends credibility and makes shoppers more likely to trust smaller merchants online.
More merchants now find themselves in this position because of how online shopping and product discovery has evolved. Digital advertising and social media enable brands to reach customers in targeted, low-cost ways. Platforms such as Shopify allow almost any merchant to set up an e-commerce website and sell directly to consumers. As always, they need to provide payment options that are ubiquitous and trustworthy. This is where independent, fintech-branded BNPL 2.0 options stand out. They democratize access to digital payments for large and small merchants alike, while also reaping the benefits of offering instant credit, such as larger basket sizes.

To compete, traditional POS lending and historic catalog businesses have moved into smaller average order value (AOV), digital BNPL 1.0 financing, which can often feel like BNPL 2.0 (see Figure 2). Among the retailers, Very now has “Take 3,” Next has “3Step,” and AO Finance has a BNPL option. These products include zero-interest installment loans (often interest-bearing, but with an interest-free grace period). On occasion, as is the case with Very, retailers finance their own BNPL product, which entails credit risk for them, but in turn helps subsidize sales. More common is for merchant-branded loans to be financed by third-party white-labeled solutions.

What we do not show in Figure 2 are the white-labeled solutions offered by Creation, NewDay, Barclays, V12, and others. The business model around white-labeling consumer finance products does not fit our definition of BNPL 1.0 or BNPL 2.0. Nevertheless, it offers an interesting embedded finance opportunity. Embedding financial products at the point of customer need—distributed via

**Figure 2:** Blurring the lines between consumer lending and payments

**Examples of buy now, pay later companies in the UK**

<table>
<thead>
<tr>
<th>Type of purchase</th>
<th>Digital BNPL 1.0</th>
<th>BNPL 2.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher frequency, lower value</td>
<td>Littlewoods*</td>
<td>Clearpay</td>
</tr>
<tr>
<td></td>
<td>Next Credit*</td>
<td>Klarna</td>
</tr>
<tr>
<td></td>
<td>Very*</td>
<td>Zip</td>
</tr>
<tr>
<td></td>
<td>DFS</td>
<td>Payl8r</td>
</tr>
<tr>
<td>Lower frequency, higher value</td>
<td>John Lewis*</td>
<td>Pay in 3</td>
</tr>
<tr>
<td></td>
<td>QVC</td>
<td>Pay After Delivery</td>
</tr>
</tbody>
</table>

*Interest accrues on overdue balance

Note: QVC is merchant branded but never charges interest on its Easy Pay product, which therefore is covered by the same FCA exemption as BNPL 2.0

Sources: BNPL merchants; Klarna; Clearpay; Laybuy; Openpay; Zip; PayPal Pay in 3; John Lewis; Littlewoods; Next; Very; Easy Pay; DFS; AO
brands, including retailers that customers have strong relationships with—is garnering a lot of interest. If banking providers can successfully execute white-labeled BNPL and other lending products, they may be able to significantly scale up distribution of their products.

Besides well-established white-labeled providers such as Barclays and NewDay, another notable provider is Divido, with a slightly different offering; it combines BNPL white-labeled solutions with a marketplace for lenders to provide financing to retailers at competitive rates. On occasion, these white-labeled providers do offer true BNPL 2.0 solutions—installment loans that are completely interest-free—but interest-bearing financing is more common. White-labeled, large retailer-branded financing works for a key customer segment: shoppers without strong direct relationships with independent brands. Here, these large retailers have maintained a key advantage in being the point through which shoppers discover and purchase items.

It comes as no surprise, then, that BNPL 2.0 providers are also encroaching on the realm of online retail. BNPL 2.0 apps are beginning to act as aggregators where customers search for and buy from different merchants simultaneously, thereby taking control of more of the customer journey. Clearpay, Klarna, Zip, and Laybuy have launched their own apps where users can search, discover, and finance purchases in one interface. Some BNPL 2.0 providers also offer interest-bearing products for high-ticket purchases, though the sequence of product releases varies.

For example, PayPal is rapidly extending its credit products within the e-commerce space. It has gone from being a digital wallet to offering Pay After Delivery (payment 14 days after the purchase date), followed by PayPal Credit (revolving credit with offers), followed by Pay in 3 (payment in three, zero-interest installments). On the other hand, some BNPL 2.0 providers have moved into longer-term, larger-ticket financing. These products accrue interest, so they’re already regulated and fall outside our definition of BNPL 2.0.

**Comparisons to cards and digital wallets**

These days, when shoppers go to check out, they often see the same options: pay with card, credit or debit; pay via a digital wallet, such as PayPal or Apple Pay; or pay with BNPL. These payment products are distinct, but increasingly overlap.

**Dissecting BNPL products in the UK**

With about £100 billion in sales in 2020, the UK ranks as the world’s third largest e-commerce market. Growing about 70% from 2019, BNPL contributed roughly 5% of this transaction volume, Worldpay estimates. This level of BNPL penetration within e-commerce exceeds that of younger markets, such as the US (at about 2%), but falls well below other Western European countries, including Sweden (23%) and Germany (19%), as well as Australia and New Zealand (10% each). At first glance, then, BNPL might seem like a fringe product in Britain.
The picture differs when looking at customer penetration, instead of transaction volume. Our survey found that about 25% of 18-to-74-year-olds paid with BNPL at least once in 2021. This is higher than the 20% usership reported by a March 2021 Capital Economics survey, but is consistent with what major providers reported in our interviews. Therefore, many people shop with BNPL, but much less frequently than with mobile wallets or cards, as validated by our survey data (see Figure 3 and Figure 4). This isn’t surprising for an emerging product and explains why total transaction values appear comparatively small.

What could this mean for e-commerce payment volumes over the next few years? Even if BNPL companies don’t attract any more customers, as they partner with more merchants, develop their aggregator apps, offer merchant-agnostic payment solutions (in which BNPL companies shift focus from the merchant to the end-customer relationship), and refine omnichannel services, purchase frequency could increase and the proportion of e-commerce transactions that are BNPL would follow in kind. As a result, that 5% of transaction volume could move closer to the 25% in penetration in the coming years.

**Embedded e-commerce checkout services at the core**

Given the size of the opportunity, the rush to participate and even lead in this market makes sense. Six companies make up the lion’s share of BNPL transactions in the UK. Most of them began with an embedded e-commerce checkout product that allows users to spread out payments. Their operating models, however, vary in omnichannel capabilities, credit approval processes, and application of late repayment fees (see Figure 5).

**Many companies enjoying growth**

Indicative of the health and growth potential of the market, BNPL providers are expanding beyond simply offering an embedded checkout button. Most, for instance, have introduced proprietary mobile applications that help customers search and discover products to buy. By aggregating e-commerce offerings in a single interface, these apps support more stages of an online purchase. Apps from Klarna, Zilch, and Laybuy go a step further, integrating a virtual prepaid card that links to the user’s account and works with any merchant online. This means that when BNPL providers cannot offer an embedded finance service, they are able to deploy a direct-to-consumer proposition instead.

In addition, with the Laybuy and Zilch virtual cards, consumers can delay payment on in-store purchases as well. Many of the BNPL providers are also finding ways to support merchants with in-person sales. Typically, they’ve integrated with the merchants’ in-store POS systems, allowing shoppers to pay using a QR code or bar code. One merchant we spoke with discussed reimagining the customers’ journey so that sales reps could convert a sale on the shop floor using BNPL on their phone or tablet. This would be a radical, but feasible, redesign of the in-store experience.
Figure 3: Buy now, pay later and credit cards in the UK vary on a number of dimensions

<table>
<thead>
<tr>
<th></th>
<th>BNPL</th>
<th>Credit card</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total transaction value</td>
<td>£6.4 billion</td>
<td>£153 billion</td>
</tr>
<tr>
<td>Annual growth in transaction value</td>
<td>60%–70%</td>
<td>5%</td>
</tr>
<tr>
<td>Percentage of e-commerce transaction volume</td>
<td>5%</td>
<td>21%</td>
</tr>
<tr>
<td>Total number of users</td>
<td>10 million</td>
<td>35 million</td>
</tr>
<tr>
<td>Average use</td>
<td>Less than once a month</td>
<td>2–3 times a month</td>
</tr>
<tr>
<td>Average transaction value</td>
<td>£75–£100; seldom used for very large or very small purchases</td>
<td>£50–£60; for a wider range of purchases including more expensive items</td>
</tr>
<tr>
<td>2020 default rate</td>
<td>&lt;1%–5%</td>
<td>~1%</td>
</tr>
</tbody>
</table>

Sources: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021; Mintel Unsecured Loans UK, January 2021; WorldPay Global Payments Report 2021; MoneyExpert.com; Capital Economics; Guardian; Financial Times; This is Money

Figure 4: Comparing buy now, pay later with other forms of unsecured lending

<table>
<thead>
<tr>
<th></th>
<th>BNPL 2.0</th>
<th>BNPL 1.0</th>
<th>Credit cards</th>
<th>Store cards</th>
<th>Overdraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>Typical purchase value</td>
<td>Lower value</td>
<td>Higher value</td>
<td>Lower value</td>
<td>Lower value</td>
<td>Lower value</td>
</tr>
<tr>
<td>Merchant coverage</td>
<td>Specific merchants</td>
<td>Specific merchants</td>
<td>All merchants</td>
<td>Specific merchants</td>
<td>All merchants</td>
</tr>
<tr>
<td>Credit decision</td>
<td>Before every purchase</td>
<td>One time</td>
<td>One time</td>
<td>One time</td>
<td>One time</td>
</tr>
<tr>
<td>Ability to revolve credit</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest charged</td>
<td>No</td>
<td>Only after repayment period</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Late fees</td>
<td>Provider dependent</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Main source of revenue for provider</td>
<td>Merchant service fee</td>
<td>Interest and fees</td>
<td>Interest</td>
<td>Interest</td>
<td>Interest and fees</td>
</tr>
<tr>
<td>Consumer-facing examples</td>
<td>Laybuy, Zip, Openpay, Clearpay, PayPal Pay in 3, PayPal Pay After Delivery, Klarna Pay in 3, Klarna Pay in 30 days, Zilch, Payl8er</td>
<td>DFS, Very BNPL, Littlewoods BNPL, Next 3Step, AO BNPL</td>
<td>Barclaycard, NatWest credit cards, Tymit, Curve</td>
<td>Topman Santander, Selfridges store card, Argos store card</td>
<td>Barclays, NatWest, Lloyds debit cards</td>
</tr>
</tbody>
</table>

Sources: BNPL providers; Bain & Company analysis; Money Helper; Fintech Business Weekly; Barclays POS Finance Survey; Cashasap
## Figure 5: Comparing the largest buy now, pay later providers in the UK and their services

<table>
<thead>
<tr>
<th></th>
<th>Klarna</th>
<th>Clearpay</th>
<th>LayBuy</th>
<th>Openpay</th>
<th>Zip</th>
<th>PayPal (Pay in 3 and Pay After Delivery)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales channel</strong></td>
<td><img src="checkmark" alt="Embedded online checkout" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
</tr>
<tr>
<td><strong>App to discover brands</strong></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="cross" alt="No" /></td>
</tr>
<tr>
<td><strong>In-app virtual card (use BNPL with any merchant online)</strong></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="cross" alt="No" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="cross" alt="No" /></td>
<td><img src="cross" alt="No" /></td>
<td><img src="cross" alt="No" /></td>
</tr>
<tr>
<td><strong>In-store checkout with partnered merchants</strong></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
<td><img src="checkmark" alt="Yes" /></td>
</tr>
<tr>
<td><strong>Credit</strong></td>
<td>Soft credit search and internal credit scoring system for all purchases</td>
<td>No external credit search and internal credit scoring system for all purchases</td>
<td>Hard credit search on first purchase, internal credit scoring system for all purchases</td>
<td>Hard credit search on first purchase, internal credit scoring system for all purchases</td>
<td>Soft credit search and internal credit scoring system for all purchases</td>
<td>Soft credit search and internal credit scoring system for all purchases</td>
</tr>
<tr>
<td><strong>Credit approval mechanism</strong></td>
<td>Pay in 30 days or 3 monthly installments (first one upfront)</td>
<td>4 fortnightly installments (first one upfront)</td>
<td>6 weekly installments (first one upfront)</td>
<td>2–6 monthly installments (first one upfront)</td>
<td>4 fortnightly installments (first one upfront)</td>
<td>Pay in 14 days or 3 monthly installments (first one upfront)</td>
</tr>
<tr>
<td><strong>Repayment options</strong></td>
<td>None</td>
<td>£6 late fee for orders &lt;£25; repeated £6 late fees for orders &gt;£25 (max. 25% of purchase)</td>
<td>£6 late fee can be charged twice on each installment (max. £24 per purchase)</td>
<td>£7.50 late fee can be charged twice on an installment (max. £15 per purchase)</td>
<td>£6 late fee per missed payment (max. £18 per purchase)</td>
<td>£6 late fee can be charged twice on each purchase (max. £24 per purchase)</td>
</tr>
<tr>
<td><strong>Late repayment fees</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Late repayments can affect credit score</strong></td>
<td>Clothing and shoes, home and garden</td>
<td>Clothing and shoes, health and beauty</td>
<td>Clothing and shoes, health and beauty</td>
<td>Home and garden, clothing and shoes</td>
<td>Clothing and shoes, hardware</td>
<td>-</td>
</tr>
<tr>
<td><strong>Large merchant partners</strong></td>
<td>H&amp;M, Nike, Expedia, Halfords</td>
<td>JD Group, Boohoo, ASOS, M&amp;S</td>
<td>JD Group, The Hut Group, Boohoo</td>
<td>JD Group, Snug, Monsoon, Bedsonline</td>
<td>ShopTo, Boinclo, hype, Never Fully Dressed</td>
<td>Most merchants that have the normal PayPal checkout option</td>
</tr>
</tbody>
</table>

Notes: UK information only, companies may have other policies in other countries; Clearpay in-store checkout soon to be released in the UK; Klarna does not share late repayments on its BNPL products, but it does for Klarna Financing; OpenPay plans to launch in-store checkout later in 2021. For PayPal, there are cases where a soft search is not necessary.
Sources: BNPL merchants; FAQs from Klarna, Clearpay, Laybuy, Openpay, Zip, and PayPal; Which.co.uk
“We’ll never not have a card option, we’ll never not have PayPal, we’ll never not have BNPL.”

—senior executive, fashion retailer
**Credit assessment and underwriting**

BNPL providers have also innovated to develop their own credit assessment process. Credit underwriting for BNPL companies balances two often opposing priorities. First, companies must build relationships with customers and strive to delight them. When we surveyed more than 600 people who had used BNPL in the previous six months, only 8% expressed a preference for a traditional alternative, such as a credit card. This marks a shift in perception and behavior brought about by reinventing how people shop, making credit accessible to more people and with much faster approval times.

The second priority involves the need to share information in a centralized way, in order to protect customers from debt spiraling across multiple providers. Existing data-sharing mechanisms and credit-scoring models provided by credit reference agencies (CRAs) were designed for traditional credit products. Participating lenders typically share static data monthly, and not all share the same borrower details. For example, default-only subscribers share information only on accounts in default, whereas full subscribers provide all of their borrowers’ data, including repayment history.

Such frameworks suit an up-front credit check toward a larger credit limit that’s underwritten only once and are designed for longer-term borrowing (typically more than a year). However, they don’t work for BNPL, where consumers take small amounts of credit for much shorter periods of time. CRAs are working with BNPL companies to find ways of ingesting these usage patterns and the associated credit information into their databases.

BNPL companies have worked around this challenge through several innovative underwriting approaches. Many invest in aggregating their own users’ data to build proprietary credit information and assessment models. This enables them to underwrite credit and assess spending limits in real time, reducing the need for a front-loaded approval process akin to credit cards.

Companies with more customer data can manage credit risk independently. By relying on their data sets, they can extend credit to new and underserved customers based on proprietary credit assessments. A certain level of defaults is factored into their customer acquisition costs, especially during earlier stages of adoption. A small upper limit for a first purchase is extended to all users, often with only a soft credit check, in order to start seeding these proprietary data sets. BNPL providers have succeeded in managing risk this way, with larger firms such as Klarna and Clearpay saying they see default rates of less than 1%, but smaller firms having rates that can reach to around 5%.

**The unresolved challenge of sharing credit data among providers**

One problem remains, though; namely, a lack of strong mechanisms for BNPL companies to share data with each other (and with traditional lenders). At the moment, BNPL companies are able to share data only on missed payments and defaults—events that occur too late in a user’s journey to effectively protect against misuse. They’re unable to piece together customers’ cumulative balances across providers.
Some companies mitigate this challenge by conducting credit checks using reports provided by CRAs. There are two types of credit checks. The first type, known as “soft” credit checks, doesn’t adversely affect the user’s credit score, and is common among BNPL providers. CRAs don’t mark such checks as a formal application for credit visible to other lenders, thereby minimizing any effect on the user’s future ability to borrow. The downside with soft checks is that the information isn’t made available to other providers.

The second type of credit check, called “hard” credit checks, does allow lenders to comprehensively share credit information with CRAs. However, these types of checks are unsuitable, even detrimental, for BNPL users, because each hard credit check leaves a credit application footprint on customers’ profiles that can adversely affect their credit score. Where users make smaller, less frequent purchases, the negative effect can be disproportionate and persist for months, despite timely repayments.

Many BNPL providers thus don’t conduct hard checks on their customers. Laybuy and Openpay are the only companies that perform hard searches as part of their underwriting process, and they search only once when a customer opens a new account, or when a customer requests a higher spending limit. A number of other BNPL providers and CRAs are exploring how more comprehensive data sharing might work. It will take a lot of data for the CRAs’ scoring models to know how BNPL behavior, such as a missed payment, should affect the consumer’s credit score. Consequently, the data and infrastructural challenges are significant, and developing scalable solutions could take a few years.

How then might BNPL companies and CRAs work more closely in the future? We see a few promising paths. First, data-sharing mechanisms should become more inclusive of thin-file customers. This includes not just younger individuals, but also those with a limited credit history because they’re new to the UK or simply haven’t wanted a credit card or loan in the past. Reforms should take into account the proprietary nature of customer data, and not encumber their ability to monetize this data. CRAs can also help educate other types of institutions—mortgage lenders, for example—on fairly assessing the impact of BNPL debt on a user’s overall creditworthiness.

Second, credit-scoring methods should adjust for the short-term, lower-value nature of BNPL balances. Frameworks and infrastructure that cater to the particulars of BNPL products will be instrumental to fostering collaboration. Lastly, open banking regulations could enable BNPL companies to work with CRAs and banks to help customers build their credit profiles. Klarna and others are exploring possible solutions with the recent launch of their open banking platforms in the UK. New credit bureaus have also stepped up. Credit Kudos, for instance, has partnered with BNPL start-up Zilch to offer open banking affordability assessments on users.

With appropriate systems and incentives in place, BNPL companies will be able to help consumers with no credit file, or a thin one, to access the broader credit ecosystem. The vast majority of consumers make timely repayments; 69% of users we surveyed said they had never missed a payment. This data supports the goals of building their credit profiles and unlocking access to other financial services. Indeed, of the more than 400 BNPL users under age 45 in our survey, two-thirds wanted their BNPL usage to contribute toward their credit score, so BNPL providers have a unique opportunity to build this into their service offering.
The user profile

Recall our estimate that in the last year, 10.1 million people used BNPL in the UK. Based on this and other survey data, BNPL has become a mass-market product, though there are some interesting trends to observe. Throughout this report, we compared BNPL with credit cards because they share many of the same use cases and are seen by many as alternatives to each other. While credit cards still dominate across generations, the data points to younger, digital-native consumers increasingly adopting BNPL over credit cards (see Figure 6). Based on what we know about BNPL and demographic changes, the following may explain the preference: young people are attracted to digital-first services, are more engaged with lifestyle-oriented products, and are more averse to traditional credit.

Though BNPL is popular with young people, it also has broader appeal. Our survey found BNPL adoption was highest among respondents aged 25 to 34, and significant even for those in the 45-to-54 cohort. Some 68% of people who used BNPL in the previous six months also have access to a credit card (compared with 62% across the entire sample), suggesting significant penetration among people with prime and near-prime credit profiles. We found BNPL usage was relatively consistent across household income levels, and for men and women.

**Figure 6:** While buy now, pay later is most popular with younger consumers, it also appeals to many older ones as well

**Percentage of online shoppers who are credit card or BNPL users**

<table>
<thead>
<tr>
<th>Age</th>
<th>Percentage of respondents who are credit card users</th>
<th>Percentage of respondents who are BNPL users</th>
</tr>
</thead>
<tbody>
<tr>
<td>65–74</td>
<td>76%</td>
<td>10%</td>
</tr>
<tr>
<td>55–64</td>
<td>73%</td>
<td>16%</td>
</tr>
<tr>
<td>45–54</td>
<td>62%</td>
<td>25%</td>
</tr>
<tr>
<td>35–44</td>
<td>63%</td>
<td>46%</td>
</tr>
<tr>
<td>25–34</td>
<td>51%</td>
<td>49%</td>
</tr>
<tr>
<td>18–24</td>
<td>31%</td>
<td>42%</td>
</tr>
</tbody>
</table>

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021
Of the more than 400 BNPL users under age 45 in our survey, two-thirds wanted their BNPL usage to contribute toward their credit score.
Only 3% of those who used BNPL described their financial situation as vulnerable, while 35% indicated they have little to no savings every month. This is broadly in line with the overall population of online shoppers. We found that 63% of BNPL users are in full-time employment, meaning they are nearly 29% more likely to be in full-time employment than all respondents to the survey. In addition, it is worth noting that more than 40% of users have a university or higher level of education.

Younger people tend to use BNPL products for smaller, higher-frequency purchases, whereas older consumers turn to it for larger items (see Figures 7 and 8). Across all age groups, a majority of BNPL users use it less than once a month and for purchases under £100 in value. By comparison, the average credit card in the UK is used two or three times a month, with an average value of £50 per transaction. Users also buy a wide range of products. When asked what types of purchases they used BNPL for, the most frequent answers were in the categories of clothing and shoes (45%), electronics (43%), and home and garden (28%).

Finally, adoption spans the socioeconomic and demographic spectrum—it isn’t confined to the financially vulnerable—and many users have access to other forms of credit (see Figure 9).

**Figure 7:** Young consumers using buy now, pay later tend to buy low-priced items

**Average order value (£, 2020)**

Source: Capital Economics
**Figure 8:** Younger consumers use buy now, pay later more frequently

**Frequency of buy now, pay later purchases by age**

“Over the last six months, how frequently have you made a purchase using BNPL?”

![Bar chart showing frequency of BNPL purchases by age group](chart)

*Because few people age 65–74 use BNPL, the sample size is low.*

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021

**Figure 9:** The financial situation of buy now, pay later users resembles that of other consumers

“Which of the following most closely describes the current financial situation of your household?”

![Bar chart showing financial situation](chart)

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021
67% of online shoppers who used BNPL in the past six months also have access to a credit card.
Deconstructing the two BNPL 2.0 business models

There are two versions of the BNPL economic model, each consisting of three main parties: end customer, merchant, and acquirer. The customer pays no interest or fee (with the exception of late-payment penalties from some providers). Instead, merchants pay the BNPL provider a service fee, which isn’t visible to the consumer. Part of the customer appeal of these offerings has been their simple and transparent nature, the absence of hidden fees common in other forms of unsecured lending, and the fact that all consumers get the same repayment terms if they’re accepted, without higher fees or APRs for those deemed higher-risk borrowers. Similarly, merchants see benefits in the form of increased online sales, higher conversion rates, and new customers.

Credit typically relies on the balance sheet of the BNPL provider, as part of the two basic business models, the most prevalent being embedded in an e-commerce website, the other being merchant agnostic (see Figure 10).

In the embedded model, the provider acts as intermediary between merchant, acquirer, and customer. The ability to aggregate demand enables the provider to negotiate lower acquirer discounts than individual merchants can. Simultaneously, merchants pay the provider a higher service fee in return for the embedded credit service and its ability to lift commercial metrics such as traffic, conversion rates, and AOVs.

Figure 10: There are two basic business models for buy now, pay later 2.0

Source: Bain & Company
The merchant-agnostic model has quickly gained ground. Proprietary apps and web platforms combine the roles of e-commerce aggregator and affiliate marketer, allowing users to apply BNPL to any purchase, independent of the merchant. They do this by issuing a virtual card or similar payment tool directly to the customer, replicating the cash flows of an embedded BNPL loan. Instead of a typical service fee, providers seek to charge merchants an affiliate commission or an interchange fee (although statutory caps on interchange fees mean this will not likely be a key component of the transaction economics). Prominent affiliate marketing networks have already partnered with BNPL firms in the UK to enable this merchant-agnostic model. Notably, Rakuten, Awin, and Sovrn have all partnered with Laybuy to give customers access to more than 5,000 merchants in the UK.

The next section of the report delves into consumer and merchant experiences of using BNPL. We evaluate criticisms of BNPL by viewing them through a customer lens, based on research with both consumers and merchants that illuminates the benefits and challenges of using these services.

- 63% BNPL users who have full-time employment
- 40% BNPL users with a university or higher level of education
Assessing BNPL’s Benefits and Challenges
On balance, the benefits are substantial and the risks manageable.

Benefits and criticisms of BNPL have emerged on several fronts. On the one hand, these services unlock purchasing power, helping customers manage their finances by accessing affordable, low-cost credit. On the other hand, questions have been raised around their impact on households’ debt loads. But what do consumers and merchants actually experience? To cut through the conjecture, our research shines a brighter light on the advantages and challenges of using this form of payment.

How BNPL benefits consumers

Understanding the realities of how people engage with BNPL products will be instrumental to regulating the industry proportionately and without prejudicing the interests of consumers. We estimate that approximately 10.1 million people in the UK have used BNPL in the past 12 months. Our survey of more than 2,000 UK consumers found that general consumer satisfaction has propelled the growth in adoption and usage of BNPL. When we asked respondents how likely they were to recommend the consumer credit products they use to a friend, they clearly viewed the BNPL experience as better than that of credit cards or overdrafts (see Figure 11). Only 8% preferred to use a credit card or overdraft when a BNPL option is available.

These views reflect a wide range of user benefits, with the following benefits being the most important.

Cost savings relative to credit cards, even for users who miss a payment. The absence of fees or interest was the single most common benefit named by respondents; 52% cited it as one of the top three reasons for using these services. Had all BNPL purchases in the UK over the past 12 months been conducted using rolled-over credit card debt, the equivalent interest paid by customers would amount to approximately £103 million. The UK paid roughly £5.6 billion in total credit card interest in 2020. BNPL providers are able to subsidize or eliminate short-term borrowing costs for consumers by charging merchants a fee. This model has allowed providers to fundamentally change the structure of consumer credit. The absence of interest and self-imposed (not legally imposed) caps on late fees also incentivizes providers against allowing unpaid balances or rolled-over debt, as often happens with credit cards. Providers prefer to spur greater usage but with timely repayments; for example, users typically are barred from making further purchases if they leave an installment unpaid.

While differences in operating models make like-for-like comparisons difficult, in most analogous situations, BNPL is a more cost-effective method of borrowing than traditional alternatives (see Figure 12).
**Figure 11:** Consumers generally prefer buy now, pay later to credit cards or overdrafts

### Net Promoter Score℠ for each option

<table>
<thead>
<tr>
<th>Option</th>
<th>BNPL</th>
<th>Credit cards</th>
<th>Overdrafts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>30</td>
<td>6</td>
<td>-15</td>
</tr>
</tbody>
</table>


**Figure 12:** Buy now, pay later tends to be the cheaper alternative

### Illustrative comparison of fees and interest on a single £75 purchase (£)

<table>
<thead>
<tr>
<th>Option</th>
<th>BNPL</th>
<th>BNPL</th>
<th>BNPL</th>
<th>BNPL</th>
<th>BNPL</th>
<th>Credit card</th>
<th>Credit card</th>
</tr>
</thead>
<tbody>
<tr>
<td>On-time and full repayments</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>On-time and full repayments</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>3 equal payments over 3 months</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>77</td>
<td>81</td>
<td>88</td>
<td>101</td>
</tr>
<tr>
<td>3 equal payments over 3 months</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>8%</td>
<td>18%</td>
<td>35%</td>
</tr>
<tr>
<td>One installment missed</td>
<td>81</td>
<td>88</td>
<td>94</td>
<td>101</td>
<td>94</td>
<td>129</td>
<td>72%</td>
</tr>
<tr>
<td>One payment missed, one month’s interest</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>18%</td>
<td>35%</td>
</tr>
<tr>
<td>4 fortnightly installments missed (max. possible)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>User blocked from making any further purchases</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit card: 2 payments missed, 2 months’ interest</td>
<td>94</td>
<td>101</td>
<td>94</td>
<td>129</td>
<td>72%</td>
<td>14%</td>
<td>72%</td>
</tr>
<tr>
<td>Credit card: 4 payments missed, 4 months’ interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>User can continue making additional purchases</td>
<td></td>
<td></td>
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<tr>
<td>User can continue making additional purchases</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>BNPL: 4 fortnightly installments missed (max. possible)</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CNPL: 4 fortnightly installments missed (max. possible)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fees and interest as % of purchase price</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BNPL</td>
<td>Credit card</td>
<td>BNPL</td>
<td>Credit card</td>
<td>BNPL</td>
<td>Credit card</td>
<td>BNPL</td>
<td>Credit card</td>
</tr>
<tr>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>8%</td>
<td>18%</td>
<td>25%</td>
<td>35%</td>
</tr>
</tbody>
</table>

Notes: BNPL late fees are assumed to be £6 (Clearpay and Laybuy) while credit card late fees are assumed to be £12 and APR is assumed to be ~18% (2020 average); in the UK, Klarna does not charge late fees; all other BNPL 2.0 providers do charge late fees; BNPL 2.0 late fees reflect the late fees that would be accrued if the purchase were made using Clearpay, where the late fee on an installment is £6, and for each order of £25 or above, the total of the late fees that may be applied is capped at 25% of the original order value or £36, whichever is less; the maximum is £24 for Laybuy, £15 for Openpay, and £24 for PayPal Sources: Bain analysis of company websites; Bank of England data
Help with managing finances and making important purchases. The vast majority of BNPL customers we surveyed use these products responsibly and in ways that benefit them financially. Some 40% of users we surveyed highlighted “spreading out the cost of a purchase” as one of their top three reasons for use, making it the second most commonly stated reason. Asked whether spreading out the cost of purchases helped them manage their finances, 77% strongly or somewhat agreed. This sentiment applied across the income spectrum.

Respondents are more likely to use BNPL for things that they need than for discretionary items, dispelling the myth that these services exist primarily for superfluous purchases. Moreover, people with lower economic standing are just as likely as wealthier respondents to use BNPL for important purchases (see Figure 13). Consumers across the wealth spectrum are beginning to depend on BNPL to manage their finances and put essential items within reach.

Making life more affordable. BNPL is becoming an important tool to make a range of goods and services more affordable. “Couldn’t afford the whole price of a purchase up front” was the third most common reason to buy through BNPL, with 34% of users selecting it as one of their top three reasons. This share was even higher among people from the lower end of the economic spectrum, with 48% selecting that reason. In short, people are using BNPL to unlock purchasing power.

Figure 13: Consumers use BNPL more for essentials than for superfluous purchases

Survey respondents who either strongly or somewhat agreed with the statements:

<table>
<thead>
<tr>
<th>Statement</th>
<th>Good to very comfortable</th>
<th>Average to struggling</th>
</tr>
</thead>
<tbody>
<tr>
<td>BNPL has made it easier for me to buy things that I need</td>
<td>74%</td>
<td>81%</td>
</tr>
<tr>
<td>BNPL has made me more likely to buy things I don’t need</td>
<td>50%</td>
<td>44%</td>
</tr>
</tbody>
</table>

Financial situation of survey respondent

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021
The UK paid roughly £5.6 billion in total credit card interest in 2020.
Figure 14: Most consumers use buy now, pay later to make products more affordable

78% of BNPL users either strongly or somewhat agreed with the statement “I can easily afford my BNPL payments”

Even among users from lower financial backgrounds, the majority (69%) agreed

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021

Most BNPL users said they could easily afford their payments on time (see Figure 14). Even among people with fewer economic resources, 69% indicated they could easily afford payments, and 9% said they didn’t find them affordable. Data on missed payments supports this perspective: 69% of BNPL users said they had never missed a payment, and the share was 75% among respondents with lower financial standing (see Figure 15). Although the majority of users find BNPL affordable, the 9% who don’t merit the focus of providers and regulators in order to reduce that level over time.

Convenience and ease of use. BNPL offers other benefits that combine to make a compelling proposition:

• Intuitive navigation and interface. Intuitive workflows, instant credit decisions, and an easy-to-use interface create an overall experience that resonates with younger, digital-native consumers. Functionality such as in-app reminders of upcoming payments, direct debits, and temporarily snoozing payments makes managing debts hassle-free and transparent.

• Wide availability. Presence at the point of purchase across a wide range of e-commerce websites has made BNPL a trusted, convenient alternative to credit cards.

• Discounts and offers. As BNPL apps become platforms where customers search and discover e-commerce items, merchants are beginning to use them as marketing channels where they offer discounts and promotions.
**Figure 15:** A majority of consumers using buy now, pay later have never missed a payment

Proportion of survey respondents who have never missed a payment

<table>
<thead>
<tr>
<th>Financial situation of survey respondents</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good to very comfortable</td>
<td>66%</td>
</tr>
<tr>
<td>Average to struggling</td>
<td>75%</td>
</tr>
</tbody>
</table>

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021

- **Customer service.** Service compares favorably against traditional credit products, as users can self-serve through a native chat functionality offered on BNPL apps and websites. In turn, this enables customer service agents to respond in a more targeted, helpful manner.

- **Try before you buy.** Many users still use BNPL to try purchases before being charged. If they return an item, they simply log on to their BNPL account and halt installments.

- **Keeping track of online purchases.** By linking transactions to specific items purchased, BNPL apps and websites make it easy for users to keep track of their online shopping. By contrast, bank or credit card statements typically display transactions only by merchant.

**The growth of merchant adoption**

BNPL has been widely adopted by merchants in the UK. We estimate that approximately 20,000 merchants in the UK offer a BNPL checkout option (estimates exclude PayPal). The number of merchants offering BNPL is increasing, with BNPL volumes expected to grow 29% annually to account for 10% of all e-commerce spending by 2024. From larger retailers that are becoming more digital to small merchants competing to acquire customers, BNPL is supporting greater democratization in online retail. As an example, more than 90% of Klarna’s merchant partners in the UK are small and medium sized enterprises (SMEs) with under £2 million in annual turnover.
“Brilliant service, can pay over months without having to pay APR.”

—BNPL user
We interviewed executives from large online brands, specialty retailers, and smaller merchants to understand how they perceived the benefits of BNPL and what caused them to integrate these services. We also surveyed 104 merchants that use BNPL to quantify its effects. Broad adoption by consumers has led online shoppers to expect a BNPL option at checkout, 71% of merchants acknowledged. But the benefits of offering BNPL at checkout extend beyond responding to consumer preferences.

The speed of adoption is remarkable, with 92% of merchants surveyed having integrated their first BNPL solution since the start of the pandemic in early 2020. BNPL now accounts for 20% of sales from retailers offering BNPL, the same share of sales using digital wallets.

Many of the recent adopters are small retailers, half of which reported that BNPL played a significant role in helping them to endure very uncertain times. Furthermore, 75% of the surveyed merchants believe BNPL solutions will play a big role in their growth plans over the next year. What is it about BNPL that makes it so attractive to merchants?

### The business benefits of BNPL

Listening to merchants describe their experience with using BNPL solutions, we identified nine benefits that we measured in the survey, grouped into the categories of sales, customer acquisition, customer experience, and costs (see Figure 16). Some 90% of merchants have experienced at least one benefit.

**Figure 16:** Merchants reap many benefits from BNPL

<table>
<thead>
<tr>
<th>Category</th>
<th>Benefit</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>Increase in checkout or basket conversion</td>
<td>57%</td>
</tr>
<tr>
<td></td>
<td>Increase in average order value</td>
<td>47%</td>
</tr>
<tr>
<td>Customer acquisition</td>
<td>Exposed my brand to new customers</td>
<td>53%</td>
</tr>
<tr>
<td></td>
<td>New customer referrals from buy now, pay later provider</td>
<td>23%</td>
</tr>
<tr>
<td>Customer experience</td>
<td>Improved customer loyalty</td>
<td>38%</td>
</tr>
<tr>
<td></td>
<td>Increased customer satisfaction</td>
<td>38%</td>
</tr>
<tr>
<td>Costs</td>
<td>Lower fraud levels</td>
<td>23%</td>
</tr>
<tr>
<td></td>
<td>Reduced burden on customer support</td>
<td>14%</td>
</tr>
<tr>
<td></td>
<td>Improved efficiency in managing returns</td>
<td>8%</td>
</tr>
<tr>
<td></td>
<td>None of the above</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Bain survey of UK merchants (n=104)
Sales

BNPL solutions can improve sales or checkout metrics in two ways:

Checkout or basket conversion. This was the most widely reported benefit, with 57% of merchants seeing improved conversion. Many online shoppers prize affordability, and flexibility of repayment helps to make a purchase more affordable. Consumers using BNPL are thus less likely to abandon their baskets.

Average order value. Some 46% of merchants surveyed experienced lifts in AOV, the third most prevalent benefit. Again, the benefits are circular. Consumers benefit from better managing their spending by spreading payments over multiple installments. This allows them to get what they need, resulting in larger baskets. With 78% of consumers surveyed easily able to afford their BNPL payments, the option benefits all parties in most instances.

Customer acquisition

Customer growth can be difficult to achieve in retail. The survey shows that BNPL providers boost merchants’ customer growth strategy in several ways:

Merchant brand exposure to new customers. Some 54% of merchants reported experiencing this benefit, the second-highest response. BNPL providers conduct a significant amount of advertising and marketing, which stimulates demand among consumers for BNPL services. Certain merchants also invest in co-branded marketing activities to boost awareness of their stores and reinforce the message that they offer BNPL at checkout.
**Direct referrals of new customers from BNPL providers’ digital channels.** This benefit applied to 23% of surveyed merchants, based on the BNPL provider listing the retailer partner on the provider’s website or app. While this benefit is experienced by fewer merchants than other benefits, we expect it to increase over time. BNPL providers occupy a strategically valuable position, having direct relationships with both merchants and consumers, and bringing the two together creates significant value and insight.

**Customer experience**

Once a customer has visited a merchant, creating the best experience possible is essential to spreading word of mouth and motivating repeat business, and the convenient digital nature of BNPL checkout options add to the experience. This plays out in two ways:

**Customer satisfaction.** The survey found that 38% of merchants have experienced a rise in customer satisfaction since first offering BNPL as a checkout option. With 88% of the sample starting to use BNPL within the past 12 months, we have a high degree of confidence in this data.

**Customer loyalty.** Similarly, 38% of the merchants surveyed reported evidence of increased repeat purchasing from customers using BNPL. When you combine a good shopping experience with a fast, familiar checkout experience, customers will return.

**Costs**

Some merchants are experiencing cost-reduction benefits from BNPL as well.

**Fraud levels.** Compared to other forms of payment, 23% of merchants surveyed experienced less fraud with BNPL. As a proportion of sales, they had an average fraud rate of 1.5%, but with BNPL payments this fell to 0.6%. The BNPL provider takes on the full risk of payment and lending.

**Customer support.** Some 13% of merchants using BNPL solutions reported greater efficiencies for their support teams. Customers who use BNPL have relationships with the BNPL provider and the retailer. The providers have strong smartphone apps and customer support teams who can answer questions about payments, repayment dates, and order details.

**Managing returns.** Only 8% of merchants using BNPL reported this benefit. The status of returns and the refund of payments can be covered by the BNPL provider, easing the burden on the retailer. However, delivery and return of the product goes through a shipping company or the postal service, is coordinated by the retailer, and is handled by the warehouses they use. The many dependencies and third parties involved reduce the BNPL provider’s role.
“[Provider] is a reputable, secure, quality brand with a good online website and app. It is easy to make payments and view your balance.”

—BNPL user
How does the value to merchants stack up?

Every merchant has a cost to accept payments. On average, fees that smaller merchants incur for accepting Visa or Mastercard payments are around 1.5%. Fees charged by BNPL providers average 4.84% as reported by the merchants we surveyed, more than three times higher. However, with more than 90% of these merchants experiencing on average three of the benefits described above, it’s easy to see how the 3.3 percentage point difference can be made up.

When we spoke with merchants about their experiences, they consistently quoted 20%–30% lifts in AOV relative to credit card payments. This is consistent with a market survey by Zip. Even using the more conservative 20% lift in AOV, it makes sense for merchants to pay the extra fees for BNPL solutions at checkout (see Figure 17). The additional benefits of higher sales and lower costs make BNPL a compelling choice.

Clear benefits for merchants, but some price inflation for consumers

On average, merchants experience three benefits that increase sales or help cut costs, so BNPL is worth more than the fees charged for the majority of merchants.

However, we shouldn’t ignore the 10% of merchants that report no benefits from using BNPL solutions or the fact that benefits lead to higher prices for consumers. In our merchant survey, about

Figure 17: The economics of buy now, pay later vs. credit cards

<table>
<thead>
<tr>
<th>Payment type</th>
<th>Credit cards</th>
<th>Buy now, pay later</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average order value</td>
<td>£100</td>
<td>£120</td>
</tr>
<tr>
<td>Merchant fees</td>
<td>1.5% (£1.50)</td>
<td>5% (£6)</td>
</tr>
<tr>
<td>Revenue less fees</td>
<td>£98.50</td>
<td>£114</td>
</tr>
</tbody>
</table>

Notes: Assumes average order value (AOV) of £100 and a 20% lift in AOV for buy now, pay later vs. card payments; AOV lift reflects the conservative measure of 20% based on merchant surveys. Sources: Bain survey of UK merchants (n=104); Zip survey of UK merchants (n=1,114)
30% of respondents had increased the price of their products due to the fees charged by BNPL providers. Among those retailers, prices increased an average 4%–5%. Consumers using one of these merchants are paying for the lending, one way or another.

**BNPL’s data and insight benefits**

BNPL does not only produce monetary benefits. Because the providers have relationships with consumers and merchants, they often generate powerful insights from the data exhaust of those two groups. By being present from the initial search and discovery on BNPL apps and websites to the checkout and payment, providers can provide merchant partners with valuable data on several fronts:

- **Who their customers are.** With data such as age, gender, location, and credit score from their BNPL provider, merchants can better understand their target customer segments.

- **The types of products customers prefer.** Providers can aggregate data on past purchases, items viewed and saved, time spent browsing, and social sharing. Merchants can use the data to segment customers and help send targeted marketing.

- **Where they shop.** Repeat purchases and in-app engagement can be used to understand loyalty and tailor offerings to meet customer needs.

From the consumer and merchant research conducted by Bain, clear benefits accrue. BNPL helps merchants grow sales, acquire customers, cut costs, and gain better insights on their customers.
Risks and challenges

Like any form of payment or credit, BNPL comes with risks that must be managed. We’ll explore three of the most commonly cited challenges.

Risk of debt spirals across multiple BNPL providers. Perhaps the main challenge for BNPL companies is protecting customers from overuse across multiple providers, be it intentional or inadvertent. Because these services can be easily accessed and providers currently cannot share data with each other through credit reference agencies (CRAs), there’s a significant risk of users racking up unaffordable debt. As highlighted in the Woolard Review, there is also a perception that “some consumers don’t view BNPL as credit” owing to the “zero cost” nature (among other things), creating a risk that consumers might not apply the same level of scrutiny as they do on traditional forms of credit.

In our survey, 58% of BNPL users aged 18–24 and 49% of those aged 25–34 agreed with the statement “BNPL services ... do not qualify as debt because they don’t charge interest.” However, our research suggests this view doesn’t translate into irresponsible usage and unaffordable indebtedness. Moreover, recently released guidelines from the UK Advertising Standards Authority (ASA) have been welcomed by industry participants. These guidelines require BNPL providers advertising their products to clearly state that their services are a form of credit that might not be suitable for all and can affect credit scores.

We calculated how much UK online shoppers owed on BNPL accounts, credit cards, and overdrafts. The great majority had balances under £100 across all BNPL providers (see Figure 18). For credit cards and overdrafts, we found that 43% of users have balances above £300 (compared with 18% of BNPL users) and 21% have an open balance of more than £1,000 (compared with only 3% of BNPL users).

We also asked BNPL users how many different BNPL accounts they have an open balance on. Even here, the results were encouraging, as 73% indicated they had an open account with either one or no providers at the time of completing the survey.

That said, as BNPL adoption and usage continues to expand and reach larger individual purchases, it is possible that average balances and the resulting costs to consumers (such as in late payment fees) will grow. There is a long tail of at-risk users. For example, 6% of users in our survey had an open balance across three or more providers, and 10% said one of their top three reasons for using BNPL was that they had maxed out their credit card limit. Effective mechanisms to limit such customers from incurring too much debt will help create a sustainable BNPL ecosystem. Klarna, Laybuy, Openpay, and others are exploring integration with CRAs as a possible way to obtain better data on borrowers. Open Banking also offers promising pathways to assessing affordability, which will further reduce risk for borrowers and lenders alike.
In most cases, the affordability of BNPL is similar to credit cards. Our survey suggests that 78% of users find their repayments to be easily affordable, compared with 82% of credit card users. And when we compare BNPL users with consumers at a lower financial standing, a larger proportion tend to find BNPL slightly more affordable than credit cards (see Figure 19).

Therefore, in most cases, the risk of someone getting stuck with unaffordable BNPL debt is low. But these small at-risk groups require the most attention. While 9% of average or struggling consumers who can’t easily afford BNPL repayments sounds like a low number, providers and regulators should work to reduce this level further. Here, BNPL providers have controls in place. A user’s eligibility is assessed at every transaction, and credit limits are adjusted based on past timely repayments. People who leave installments unpaid are usually barred from further usage, and as a result, irresponsible borrowers are automatically prevented from incurring additional debt.

However, BNPL brings a level of seamlessness that can blur the lines between payment method and form of borrowing. Engaging user experiences are generally a good thing, but they can come with potential harms (as we’ve seen with other consumer technology products). Proportionate and timely regulation that adds a small degree of positive friction, such as the disclaimers mandated by the ASA guidelines, can help mitigate the risk of misuse and create an environment in which responsible practices become the norm.

**Figure 18:** Buy now, pay later compares favorably to credit cards and overdrafts in terms of combined open balance

**Combined open balance across all providers (proportion of users)**

![Figure 18](source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021)
Figure 19: Consumers on average consider buy now, pay later more affordable than credit cards

Respondents with “average to struggling” financial backgrounds

Risk of defaults and missed payments. We asked users of BNPL and credit cards about their outlook and frequency of missed payments. Some 41% of BNPL users either strongly or somewhat agreed with the statement “I am worried about missing payments on my BNPL purchase,” whereas only 30% agreed with an analogous statement about credit cards. While this is not surprising given that credit cards require much smaller monthly minimum payments, it still reflects a material degree of repayment anxiety among BNPL users.

We further tested the reasons that users tend to miss payments. While the overall frequency of missed payments was higher for BNPL, for those who have missed multiple payments, not being able to afford a payment was more commonly cited as a reason with credit cards and overdrafts (Figure 20). In our discussions with BNPL providers, we found that BNPL default rates were low but varied across providers, ranging from under 1% for Klarna and Afterpay Global to a maximum of 5% of gross transaction value.

By comparison, default rates on UK credit cards amounted to 0.8% of gross lending in 2020 (although these could rise as stimulus schemes expire). However, according to the FCA, roughly 5% of credit card users were also in persistent revolving debt, paying more in fees and interest than in repayments. That differs from BNPL, where users who miss payments are typically barred from making further purchases and incurring additional debt. The absence of interest combined with caps on a
late fee means that providers have no incentive to serve people who are unable to repay. BNPL providers told us that up to 40% of orders are fully repaid early, although this varies across companies.

Turning to the overall contribution of late fees to total income, while high for some BNPL providers, it has been declining steadily. (Klarna, the largest provider, does not charge a late fee to UK customers, and PayPal is removing late fees on new purchases beginning October 1, 2021.) Our survey found that 52% of BNPL users (excluding Klarna) who had missed a payment were charged a late fee, compared to 62% of credit card users. This might mean that BNPL users are more likely to quickly rectify a missed payment, despite minimum payments on credit cards being much smaller than a BNPL installment. It also reflects the greater level of transparency that BNPL companies provide to users.

BNPL companies generally do not depend on late fees to break even, but a reasonable and capped late fee can help deter misuse. Such penalties should also be combined with user education on the consequences of missing payments. Reports suggest that BNPL users who have missed payments are sometimes caught off guard when these are reported to CRAs, affecting their credit score and future ability to borrow. Better awareness of such matters will help drive down defaults while encouraging healthy and sustainable borrowing behavior.

Figure 20: The frequency of missed payments is higher for buy now, pay later than for credit cards or overdrafts, but affordability is less commonly cited

“How many times have you missed a [X] payment in the last 12 months?” and “What were your reasons for missing a payment?”

<table>
<thead>
<tr>
<th>BNPL</th>
<th>Credit card or overdraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>Missed a payment in the last 12 months</td>
<td>None: 69%</td>
</tr>
<tr>
<td>Reasons for missing payments</td>
<td>Only once: 16%</td>
</tr>
<tr>
<td></td>
<td>More than once: 15%</td>
</tr>
<tr>
<td></td>
<td>Ran out of funds/ couldn't afford full payment: 44%</td>
</tr>
<tr>
<td></td>
<td>Other/technical issue: 6%</td>
</tr>
<tr>
<td></td>
<td>Honest mistake/ oversight: 50%</td>
</tr>
</tbody>
</table>

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021
BNPL has been a lifeline for small firms that might have otherwise struggled to survive a downturn.
Impulse purchasing and vulnerable users. Another common criticism of BNPL has claimed that it appeals disproportionately to young, financially vulnerable individuals who are prone to irresponsible spending. We tested these points in our survey and found that BNPL adoption was consistent across income groups, except among people with less than £20,000 in gross household income, where adoption was significantly lower than average. Usage was also not as heavily concentrated among millennials as is often believed, with meaningful adoption even among people aged 45–54 (see Figure 21). These facts provide more evidence of a genuine mass market and also suggest that lower-income consumers are less likely to use BNPL.

Regarding impulse purchases, we tested the likelihood of consumers to do this online by scoring survey respondents on their reactions to the following statements:

- “When shopping online I often end up purchasing items that I wasn’t originally planning on buying.”
- “I often spend significantly more money than planned when I shop online.”

Younger people with access to more than one form of credit are generally the most likely to make purchases on impulse. On average, credit card users tend to be slightly more conservative spenders than BNPL users (see Figure 22). This is not unexpected; BNPL usage remains narrower than credit card usage, skews toward discretionary e-commerce purchases, and credit cards are more common among older people, who tend to be more conservative spenders.

40% of orders through BNPL are fully repaid early

62% of credit card users surveyed are charged a late fee, vs. 52% of BNPL users
Figure 21: Buy now, pay later has significant usage among most age groups

BNPL usage is highest in the 25–44 age groups, but it also is meaningful among 45-to-54-year-olds

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021

Figure 22: Younger shoppers are most likely to make purchases on impulse

Likelihood to make impulse purchases (5=very high; 1=very low)

Source: Bain & Company survey of 2,002 UK consumers who shopped online in the past 12 months, conducted July 2021
An appreciable minority of BNPL users feel anxious about being able to repay and believe that BNPL can encourage unnecessary spending. We thus see a case for implementing additional support measures for vulnerable users and incorporating affordability assessments into the underwriting process. Fortunately, providers in the UK have actively been addressing these issues. Last year, Klarna launched its KlarnaSense program that seeks to educate consumers around shopping responsibly by asking, “Do I love it? Will I use it? Is it worth it?” Clearpay, PayPal, Laybuy, and Zip, among others, offer confidential hardship assistance programs that involve a combination of postponing or rescheduling payments and capping or waiving some or all late fees.

Summing up the benefits and risks, then, BNPL holds its own relative to credit cards (see Figure 23).

**Figure 23:** How buy now, pay later stacks up against credit cards

<table>
<thead>
<tr>
<th>BNPL</th>
<th>Credit cards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business model</strong></td>
<td></td>
</tr>
<tr>
<td>Interest-free, merchant funded</td>
<td>Interest-free if paid in full each month, consumer funded</td>
</tr>
<tr>
<td>Late fee on missed payments, with overall fee capped</td>
<td>Late fee on missed payments</td>
</tr>
<tr>
<td>No incentive (or mechanism) to roll over customers’ debt</td>
<td>Issuer charges compounding interest on any debt rolled over</td>
</tr>
<tr>
<td>Eligibility assessed before each purchase</td>
<td>Eligibility assessed once up front</td>
</tr>
<tr>
<td>Defaulting users barred from further purchases</td>
<td>Users can continue purchasing as long as they make minimum payments</td>
</tr>
<tr>
<td><strong>Key customer benefits</strong></td>
<td></td>
</tr>
<tr>
<td>Saved interest and structured payments</td>
<td>Ability to manage finances and unlock purchasing power</td>
</tr>
<tr>
<td>Ability to manage finances and unlock purchasing power</td>
<td>Ubiquitous and established</td>
</tr>
<tr>
<td>Digital user experience and customer service</td>
<td>Flexible borrowing duration</td>
</tr>
<tr>
<td>Instant credit decisions</td>
<td>Rewards and cash back</td>
</tr>
<tr>
<td>“Try before you buy”</td>
<td>Responsible use helps build credit score</td>
</tr>
<tr>
<td>Merchant discounts</td>
<td>Refunds/Section 75 protections</td>
</tr>
<tr>
<td>Transparent and easy to understand</td>
<td></td>
</tr>
<tr>
<td><strong>Key merchant benefits</strong></td>
<td></td>
</tr>
<tr>
<td>E-commerce sales</td>
<td>Widely used across online and physical channels</td>
</tr>
<tr>
<td>Enhanced conversion</td>
<td>Typically lower fees</td>
</tr>
<tr>
<td>Lift in average order value compared with debit cards</td>
<td>Reliable</td>
</tr>
<tr>
<td>Leads, traffic, and comarketing</td>
<td></td>
</tr>
<tr>
<td>Data and customer insights</td>
<td></td>
</tr>
<tr>
<td><strong>Considerations</strong></td>
<td></td>
</tr>
<tr>
<td>Providers unable to share credit information with each other and other lenders</td>
<td>Hidden fees and high APRs</td>
</tr>
<tr>
<td>Higher incidence of missed payments</td>
<td>Users permitted to keep rolling over and increasing debt</td>
</tr>
<tr>
<td>Impulse purchasing risk</td>
<td>Impulse purchasing risk</td>
</tr>
</tbody>
</table>

Source: Bain & Company
Ingredients of a Healthy Next Phase
Balanced regulation and innovation in BNPL will unlock consumer purchasing power while improving companies’ economics.

Now that we’ve defined BNPL and evaluated the benefits and challenges experienced by consumers and merchants, we’ll explore how the market could evolve in the future. Digital wallet providers, banks, card schemes, and big technology firms are all looking to offer BNPL services, so the exact contours of competition are uncertain. However, the key components of a healthy industry in the future have already become evident.

How fintech has developed

The first wave of fintech companies radically improved the customer experience. Banks historically sold banking products such as checking (current) accounts, credit cards, and loans. In the UK, early digital challenger banks including Monzo, Starling, and Revolut created digital services that operated in real time and helped customers get a handle on their finances. Today, the bar has risen, even if some banks are catching up. Financial services businesses that design mobile experiences around addressing customer needs and priorities will succeed in the long term.

However, the shift to digital banking has coincided with a low interest rate environment and stronger regulation on fees. This has made it much harder for banks to turn a profit on two major revenue lines: net interest margin (NIM) on lending and interchange fees via card payments. UK consumers are not accustomed to paying for everyday banking, so fintechs that offer subscriptions (the most popular technology business model) for banking services have struggled to make this a primary revenue stream.

The fintechs scaling up faster are those offering financial services at a largely free entry point, or at least a much lower cost than competitors. Examples include Wise (formerly Transferwise) in remittances, Robinhood in wealth, a variety of digital wallets for peer-to-peer payments, and of course, BNPL providers for lending on consumer spending.

The second fintech wave consists of embedded finance, enabled by infrastructure companies that offer banking-as-a-service to customer-facing banks and non-banks. Here, examples include US-based Marqeta, whose valuation reached more than $15 billion after its IPO in June; PPS (a leading processor and issuer powering many of the UK fintechs such as NatWest’s Mettle, Tide, and Monese;) and Stripe, the world’s most valuable privately owned fintech.
BNPL providers have been quick to innovate in both the products they offer and the experience they create across several touchpoints.
Bill Gates famously said: “Banking is necessary, banks are not.” Angela Strange from a16z argues that “Every company will be a fintech company.” And Bain Capital’s Matthew Harris contends that “Fintech is the fourth platform (on top of the internet, cloud and mobile).” The common thread in these assertions is that banking products will soon come to be distributed through a wider variety of businesses, and the direct relationship with the customer will not reside only with banks. Instead, banking will become invisible and embedded within the services we use every day.

As the Covid-19 pandemic hit last year, much of life shifted online and accelerated the use of embedded finance products, especially in e-commerce. Consumers and businesses had to adapt quickly and the two waves of fintech collided as online e-commerce and digital payments boomed. BNPL services, which had made good progress before the pandemic, found themselves in the middle of a shift to digital payments, embedded lending, and e-commerce. Many retailers that relied heavily on in-store sales had to quickly increase their online sales volumes. BNPL helped retailers improve the consumer’s checkout experience, and helped customers manage payments over several installments. BNPL providers are digitally native and their checkout APIs are easy to integrate. What’s more, retailers could minimize the risk of capital management during a period of huge economic uncertainty, worldwide lockdowns, and the temporary closure of non-essential physical stores.

**Where payments, lending, and e-commerce trends converge**

BNPL providers blend the frictionless user experience of the first wave of fintech products with the embeddable nature of the second wave. This report has offered strong evidence that BNPL now has mass-market appeal and covers multiple use cases for consumers and merchants. Born in fashion and electronics, it has spread to furniture, housewares, and other categories. It is used mostly for physical

42% of respondents age 18–24 used BNPL vs. 31% credit cards

44% of BNPL users agreed that “BNPL services do not qualify as debt”
goods, though there are signs of it expanding into services such as event tickets and vacations. It also follows behavioral patterns similar to credit cards, typically being used for low-value purchases.

BNPL solved a central problem for online shoppers, who wanted to try items before they paid for them. It has since evolved into a digital user experience that fulfills a number of customer Jobs to Be Done. For a long time, making online purchases involved a lot of friction compared to in-store purchases where, regardless of whether they were contactless or chip and pin, card payments were comparatively easy. Today, however, much of the innovation in payments is taking place in the digital realm, and customers expect to see those experiences replicated across channels.

BNPL providers have been quick to innovate in both the products they offer and the experience they create across several touchpoints. From their initial embedded BNPL checkout product, they’ve expanded into in-store payments and personalized shopping recommendations via their apps.

The inventiveness of BNPL providers, the mass-market adoption by consumers, and the benefits to merchants has led to many types of companies looking to enter the market. One of the most commercially attractive aspects of BNPL products is that they build direct relationships with consumers and merchants (see Figure 24). Bringing the two together can activate network effects and become integral to the exchange of value on both sides of the market, as PayPal and Amazon have done over the years.

**Figure 24:** Buy now, pay later helps financial services firms build relationships with UK merchants and consumers

Sources: Bain & Company analysis and interviews with market participants
The rise of BNPL may seem like a threat to incumbent companies in the payments, lending, and e-commerce markets, but in fact it creates opportunities for all when one views the product as sitting within a larger financial and retail proposition. BNPL providers already offer more than a checkout payment option and deferred repayment plans; many offer interest-bearing financing and over-the-top payments with any merchant via their smartphone apps, QR codes, and virtual cards.

Most of the UK BNPL providers’ smartphone apps have become points of discovery for retail. All offer retailer directories, with features extending to product wish lists and deal or discount trackers. These providers sit a level above the retailers, operating as a shopping assistant. True, they’re building strong brands and customer relationships, but with the intent of driving traffic to their retail partners and building non-financial revenue streams in affiliate and advertising fees.

Their next moves are uncertain. In the current low-interest-rate environment, capital is cheap, but if rates rise in the coming years, that will increase the cost of funding for BNPL products. Providers would then have to reduce the cost of funding by, for example, taking customers’ deposits as Klarna has begun doing in Germany and Sweden. They might also need to diversify their revenue streams, which for BNPL firms typically means new services for merchants.

Designing propositions that solve more merchant Jobs to Be Done, such as managing their cash flow and linking that to sales and marketing metrics, could be promising growth areas. For example, Square’s purchase of Afterpay (Clearpay in the UK) marks another step in strengthening consumer relationships built with their Cash App. The acquisition also strengthens Square’s portfolio of payment options for small businesses, exemplifying BNPL as part of a broader proposition to merchants and consumers.

**An extension of digital and mobile wallets**

Mobile and digital wallets as a form of payment have shown sharp, sustained growth because of their convenience in-store and online. Consumers connect their credit and debit cards to mobile and digital wallets, which then reduces the hassle of paying for things. Providers of mobile and digital wallets thus have quickly added BNPL functionality. They offer increasingly flexible payment mechanisms, in order to capture a greater share of the customer’s payment methods. Curve, for instance, announced that users will be able to choose to make a purchase using BNPL or Apple Pay Later.

Indeed, PayPal, the original digital wallet and with a market cap larger than most large US banks, introduced a Pay Later functionality in November 2020. PayPal also signaled its intent to become a “super app” combining financial services for both consumers and merchants with shopping tools, integrating its $4 billion purchase of Honey and more recent acquisition of Happy Returns, and peer-to-peer messaging. PayPal’s ability to connect shoppers and retailers in product discovery and financial services could quickly blur category lines.

Similarly, Shopify, an e-commerce and financial services infrastructure provider, is helping its merchants build stronger consumer relationships to complement its strong relationships with merchants. To that end, the company has deployed its Shop Pay digital wallet, and has partnered with Affirm to offer BNPL.
products. Various levels of embedded financial services come into play here. Like PayPal, Shop Pay is a digital wallet that can be used across any e-commerce store offering BNPL (even non-Shopify stores, it recently announced). The only difference is the partnership with Affirm.

What’s clear is that having a clear fintech strategy has become essential for outsized growth, especially when consumer preferences on payments and lending are changing.

**Generational changes threaten existing business models**

A Capital Economics report notes evidence in the UK and internationally that younger generations are more reluctant to use credit cards and other forms of debt. The same report shows that debit card payment volumes have grown threefold since 2009, much faster than credit cards. One of the most striking findings from Bain’s survey of online shoppers is that among respondents age 18–24, more used BNPL (42%) than credit cards (31%). If this trend continues as the younger generation ages, we could see further shifts in payment and lending behavior.

In response to this trend, we are already seeing innovation in cards. Tymit aims to reinvent credit cards by offering BNPL repayment functionality and help customers avoid interest charges. Visa offers credit card issuers BNPL application programming interfaces to add new functionality to credit card payments. Consumers clearly benefit from access to no-interest deferred repayment plans. However, card providers depend on consumer interest charges and fees as a key revenue source, so offering BNPL repayment features without the merchant services (and associated fees) could threaten their business model.

**Can banks quickly follow BNPL providers?**

Big banks have all the right ingredients to turn the BNPL threat into an opportunity. They have a huge base of retail customers with a variety of credit products, and many of the established banking providers have merchant acquiring services. Those with direct consumer and merchant relationships could theoretically move into the top right of Figure 24. But can they operationally align their retail and commercial capabilities to create a compelling proposition that resonates with generational shifts around payments and lending? Structurally, this will be a challenge because their consumer credit businesses own P&Ls separate from their commercial banking businesses. If they can overcome organizational and technology challenges, they’ll be well placed to compete with new BNPL services and do so at scale.

**White-labeled credit products for retailers**

While the most prominent BNPL products have been fintech branded, an alternative approach, more aligned to their core capabilities, is to create white-labeled credit and BNPL products for retailers. One high-profile example is Barclays’ partnership with Amazon in the US (coming soon to the UK) to offer BNPL at checkout for qualifying Amazon purchases. A BNPL checkout option would provide more choice for customers and could create a lucrative business line for Barclays.
Retailers partner heavily to offer their credit products. In the UK, Amazon partners with NewDay to offer its branded credit cards. NewDay’s white-labeled credit products are well positioned because, while not a household consumer brand, they provide financial products to many companies that are. NewDay offers a range of co-branded credit cards, POS financing products, and digital BNPL 1.0 products to high-profile retailers. It recently launched NewPay for retailers in the UK enabling BNPL, installment loans, and no-interest financing. A sister company, Deko, provides the same products to smaller merchants and also offers software to enable the right financing offer to be shown on the product page as well as at checkout. In addition, NewDay administers its own credit cards targeted at specific customer segments; Aqua, for instance, helps customers improve their credit scores.

Many merchants value a branded BNPL checkout option, as customers often are more likely to use a payment method they recognize. Companies such as NewDay offer an alternative, with white-labeled lending products enabling retailers to deepen their customer relationships through financial services. Other banks are considering this space. HSBC, for instance, recently led an investment round in the white-labeled, multi-lender, and multi-product provider Divido.

The crossover of financial services and retail presents a broad opportunity, because so many types of businesses could execute different strategies. At the moment, BNPL sits at the center of much of the product innovation and growth. It allows brands (financial or not) to strengthen their customer and merchant relationships, which positions them favorably in the developing digital-first economy. How this opportunity pans out will hinge in part on the shape of upcoming regulation.

Financial services businesses that design mobile experiences around addressing customer needs and priorities will succeed in the long term.

At the moment, BNPL sits at the center of much of the product innovation and growth.
Big banks have all the right ingredients to turn the BNPL threat into an opportunity. They have a huge base of retail customers with a variety of credit products, and many of the established banking providers have merchant acquiring services.
BNPL as a regulated product

BNPL products in the UK will soon become regulated. Earlier this year, the Woolard Review identified areas of focus ranging from disclosure requirements to affordability assessments to ensuring that regulation is proportionate given the typical size and low-cost nature of BNPL debts.

To be sure, the industry has a stake in adequately protecting consumers, but regulation should also allow innovation to flourish. As noted earlier, consumers generally give higher ratings to their experience of BNPL products than to other forms of unsecured lending (Figure 11). As usage grows and more companies enter the market, we believe regulation should focus on consumer outcomes such as driving low levels of missed payments and default rates—which can negatively affect both BNPL providers and users—and pushing for even higher levels of customer satisfaction.

Based on our research and the recommendations from the Woolard Review, we propose three areas for business leaders to emphasize in planning for BNPL regulation.

1. **Education and clear communication.** Lending helps people spread the cost of purchases to align with their income and ability to pay. When taking on debt, though, people need to be fully aware that they are entering into credit agreements with repayment implications. Even BNPL products that are free of interest and late fees are a form of credit that must be repaid.

Compared to other forms of unsecured credit, BNPL 2.0 is relatively new. Educational initiatives and clear communication thus should play a role in helping consumers understand how BNPL works and how to use it responsibly.

Effective education requires a long-term commitment. We’re encouraged by a number of initiatives to date. In late 2020, the Advertising Standards Authority (ASA) published guidance on advertising BNPL products, which took full effect in March 2021. That guidance calls for all advertising to clearly state that BNPL services are a form of credit. This message bears repeating every time a consumer uses the product, which currently does not happen when consumers pay with credit cards.

BNPL providers have taken visible steps on this issue. Klarna, for example, launched the KlarnaSense campaign to encourage customers to ask themselves, “Do I love it? Will I use it? Is it worth it?” As people increasingly turn to social media for financial advice, Klarna created the Influencer Council to promote better standards for promoting financial services on social media.

These positive steps are just the start. Financial education doesn’t create awareness or change perceptions overnight, as our survey shows that 44% of all BNPL users either strongly or somewhat agreed that “BNPL services do not qualify as debt because they don’t charge interest.” This sentiment was especially strong among younger respondents. Changing perceptions requires a sustained effort by all providers of BNPL services in their various forms.
Advertising has a role, but other digital realms do as well. The more financial services become embedded into lifestyle services, the more “invisible” they become. Over time, every payment innovation (credit cards included) has moved users away from physical cash, which reduces friction and makes spending money (and the associated borrowing) easier. Hence the “denomination effect”: People tend to spend more when using a credit card than they do when using cash. Recent technologies such as digital wallets and BNPL further minimize this psychological barrier. As money continues to turn invisible, payment service providers need to design products in ways that help users to spend and borrow responsibly.

Some BNPL providers are taking on these challenges. Clearpay’s guiding design principles include the realization that “late payments are bad business.” The company has backed up this principle by launching flexible money management features to help customers repay on time or early, and through Pulse Rewards that motivate responsible spending. Instead of offering reward points to encourage spending, it offers points for payments made on time. Rewards are a classic behavioral design technique that could counterbalance frictionless, invisible payment experiences.

Besides advertising, communication, and behavioral design changes, BNPL services have controls built into them on every purchase. Each provider assesses the credit risk for a purchase and freezes accounts if payments are missed. Again, this is a positive step, but making such missed payments visible to other lenders and BNPL providers remains an issue.

2. Integration and sharing of credit information. Addressing two connected needs will improve outcomes for BNPL customers and providers alike. The first is the need for providers and other lenders to accurately assess a customer’s overall indebtedness and credit risk across products. Current data sharing and credit scoring mechanisms were not designed for the frequent underwriting of low-value purchases that are repaid in short-term installments. Redesigning data-sharing frameworks that incorporate affordability assessments will be central to better underwriting. This broader view of BNPL debt will also promote equitable treatment of consumers when they engage with other financial services. As the BNPL providers take on the credit risk, many already have been working with CRAs to find a solution, although these may take a few years to formally implement.

The second need involves a central place for users to track their spending and borrowing, a need not unique to BNPL. Digital consumption forces people to pay in new ways, such as subscribing to services rather than paying once up front or on credit. People might have multiple subscriptions and credit purchases simultaneously across different platforms. This complicates management of their financial lives, so solutions that incorporate open banking can make a difference.

Regulation will play a pivotal role in integrating the credit information ecosystem. Working more closely with CRAs will allow BNPL companies to assess credit comprehensively. BNPL companies can further reduce risks by helping customers manage their finances centrally through open banking platforms. Such platforms can also give customers control over their financial data, allowing them to share it directly with CRAs and lenders. CreditLadder, for example, allows users to share rent payment information with CRAs.
For businesses in financial services, over the past few years it has been essential to have a fintech strategy. Now it’s also essential for businesses that intersect payments, lending, and e-commerce to formulate a BNPL strategy.
3. Empowerment of small and medium-sized merchants. Regulation should ensure that BNPL products remain accessible to merchants of all types. Given the typical economics of enabling products like BNPL, larger merchants often can negotiate lower merchant service fees and marketing commissions. That said, smaller merchants have come to find such services highly valuable as well, especially over the past year or so. Offering BNPL lends credibility, drives conversion, opens up co-marketing opportunities, and supports customer acquisition.

Regulatory compliance, if made applicable to merchants, can be proportionately more burdensome and costly for smaller firms than larger ones. Interventions should therefore seek to ensure that the cost of compliance does not unduly affect small firms, or worse, lock some of them out of the market. As BNPL companies move closer to the customer by becoming e-commerce aggregators, keeping their platforms open and democratic will be critical to fostering a vibrant, inclusive e-commerce ecosystem in the UK.

More essential, more strategic

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As with all innovation, social and customer-level challenges have surfaced. Regulation will help protect consumers by creating standards for BNPL providers to follow. Yet just as important is the willingness of BNPL companies to actively put customers’ welfare and priorities front and center. Companies will thrive by combining the conveniences of new digital experiences with active measures to promote healthy financial management and debt repayment. Fortunately, we have already seen numerous positive steps along these lines.

Looking ahead, we expect to see some big strides in how credit referencing data is shared across the industry. Here, the maturing of open banking offers inventive ways to share data.

We also expect to see more banks, lenders, fintechs, and retailers add BNPL to their mix of payment and lending options. Digital payments, once seen as a complex feature, has become a more strategic area for companies aiming to deepen customer relationships. The next few years thus hold great promise for digital payments and embedded finance in the UK, as well as across the globe.