

Banks: How to prepare for BNPL

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\$687
BILLION BY 2028

Buy Now Pay Later (BNPL) – which is one form of point-of-sale (POS) financing – has become increasingly popular in recent years. As of first half of 2023, there are an estimated 400 million people worldwide using BNPL service with a market size valued at \$334 billion in 2024 and predicted to rise 105% to reach 687 billion by 2028, according to Juniper Research.

But so far, it's a financing service dominated by fintechs. Largely unregulated and unburdened by monolithic legacy systems, fintechs have the size, agility, and tech-savviness to make the most of BNPL. Indeed, any list featuring the top global BNPL providers includes a host of fintechs and a noticeable lack of incumbent banks.

So, why is this? And should banks be worried? In this report, we'll look at the current state of BNPL, why banks have fallen behind their fintech competitors, the role regulations may play in the near future, and how banks can get involved in the growing phenomenon, and more particularly how to find new profitability drivers in the current economic context.

\$334
BILLION IN 2024

01 What is BNPL?

Buy Now Pay Later is a **convenient method of short-term financing that allows individuals and small businesses to make purchases and pay for them over an agreed period of time, generally with no interest.**

BNPL is great for businesses and customers since it helps individuals to purchase goods they need but otherwise couldn't afford, whether in-person or online. Additionally, it encourages buyers to buy items they fell in love with but are unable to pay for entirely up front. Even more than a discount, BNPL can raise the likelihood of a sale.

For consumers, BNPL has four main benefits:
Budgeting and Financial Planning:

- BNPL options can help consumers plan their expenses and budget effectively. It is an alternative to classic credit card and consumer loan options.
- Higher flexibility in managing cash-flow: making purchase more affordable in particular for those that do not have access to credit cards or do not want to impact their credit score.
- Lower cost compared to other credit options: Repayments are often interest-free or have lower interest rates than credit cards, although some companies charge fees for late payments.
- Convenience of use: Simple and easy process, outlined opposite.



Customers wish to **purchase a product**



Merchant provides **BNPL as payment option**



Repayment timelines & Interest rates are **informed**



Transaction is marked **successful**



The fund is settled with the merchant



BNPL platform **receives the payment**



Customer makes the payment **within the agreed timelines**

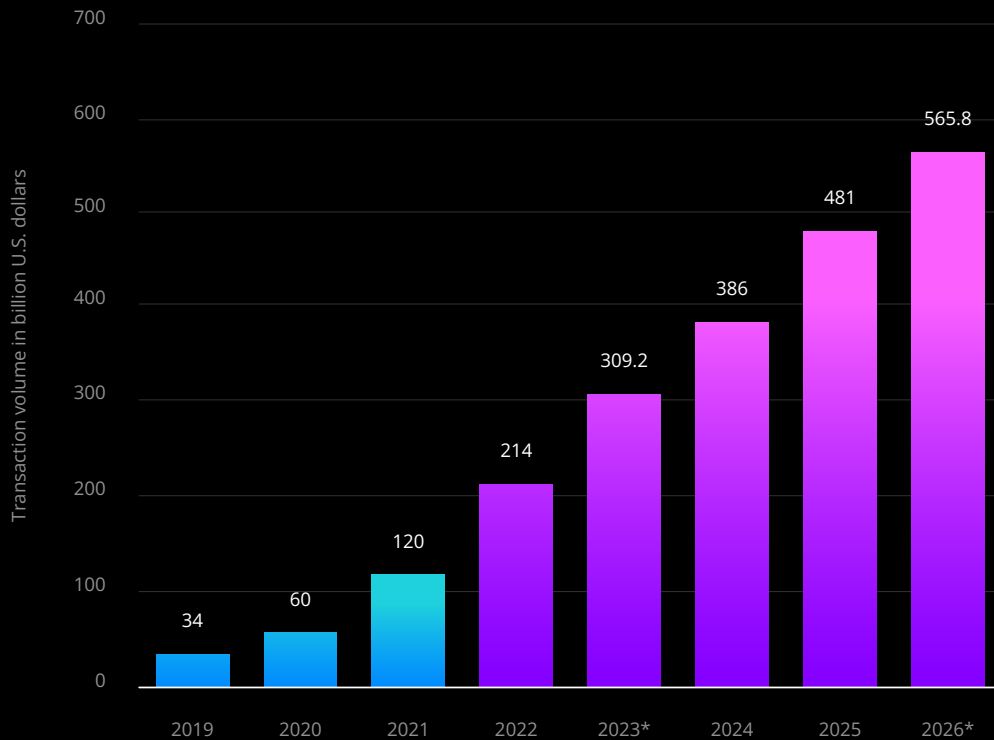
From a merchant perspective, BNPL facilitates the following:

- More buyers and repeat customers, plus bigger transaction values. As such, BNPL enables consumers to make large purchases they may have been putting off, generating higher conversion rates for merchants.
- Merchants receive full payment upfront, minus the BNPL provider's fee – typically 2% to 8% of the transaction value. As a result, merchants don't

have to worry about the financial implications, making BNPL a no-risk option.

- BNPL providers stand to profit from the transaction fees they charge retailers, but perhaps more importantly, they can build a strong base of young customers for a very low customer acquisition cost (CAC).

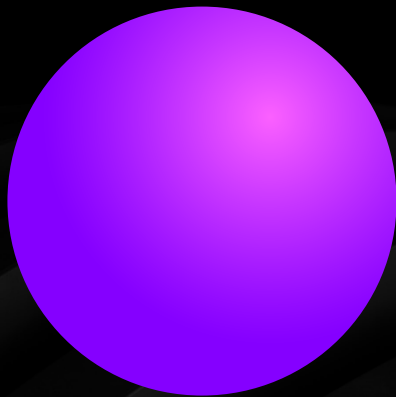
Global transaction value of buy now, pay later (BNPL) in e-commerce from 2019 to 2021, with forecasts from 2022 to 2026 (in billion U.S. dollars)



* The figures for 2023 and 2026 were updated in May 2023. All other figures were from the source's previous iteration, in 2022

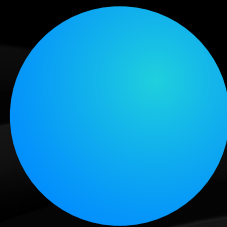
02 The rise of BNPL

BNPL's popularity has been on the rise since the pandemic and is predicted to reach \$565.8 billion in annual global transaction value by 2026, according to Statista. If the numbers continue on that trend, BNPL could become a serious competitor to traditional card payments, and it'll be vital for incumbents in the payments and banking sectors to be heavily involved. Below are some statistics outlining BNPL usage:



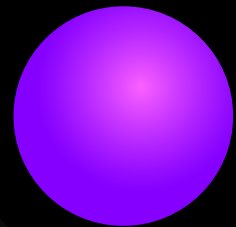
62%

of buy now, pay later users think BNPL could replace their credit cards in the future led by ease of use and service's growing ubiquity.



35%

of US consumers are using BNPL services in 2023, a decline from 50% in 2022.



56%

of millennials, 36% of GenX and 49% of GenZ use BNPL services in 2022.

03

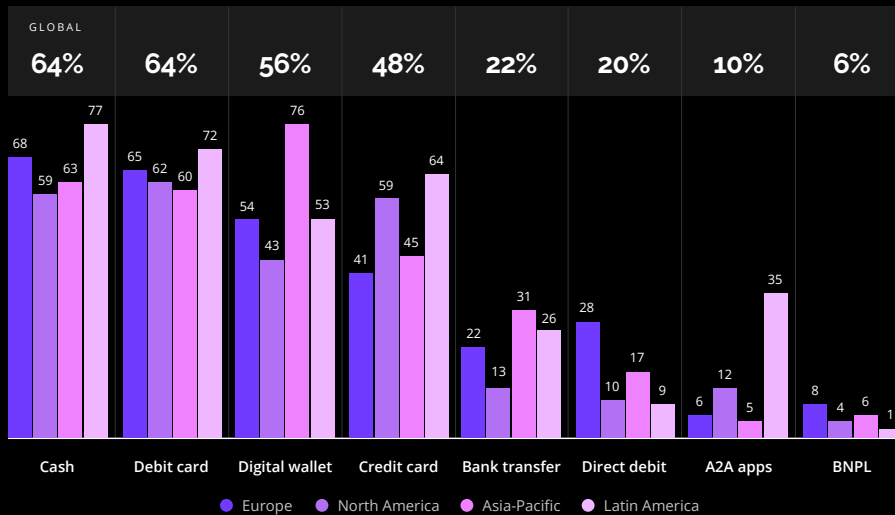
Where is BNPL popular?

As you can see, BNPL's market share is strongest in Europe, with four out of 5 top positions are held by European Countries. We expect this to change further in the coming years as BNPL becomes increasingly popular elsewhere.

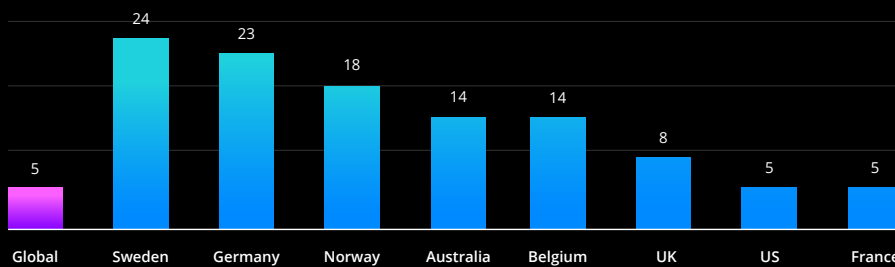
Furthermore, while only 6% of consumers globally used BNPL in 2022, 40% said they would be more willing to do so if it were offered by their primary bank, according to Accenture, "Global Consumer Payments Study".

Cash is still dominant, but digital wallet adoption is soaring.

Q: Which of the following payment methods do you use at least 5 times per month?

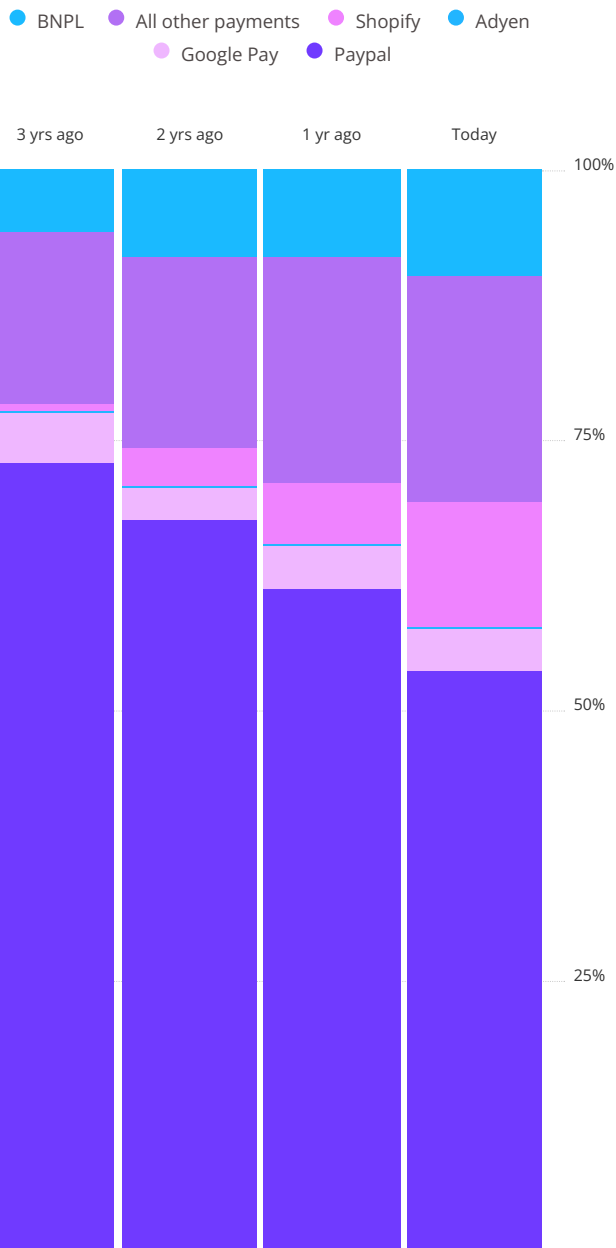


Market share of BNPL by geography in 2022 (%)



04 Who's who in BNPL?

Traffic Share



The players

Klarna.

- 💰 **Funding to date:** \$4.5 billion
- 👤 **Customers:** globally 150 million
- 🌍 **European countries in:** Germany, Netherlands, Sweden, Austria, Norway, Finland, Denmark, Belgium, Spain, Italy, France, Poland, Ireland, Portugal, Czech Republic, Greece

clearpay↻

- 💰 **Funding to date:** \$448.7 million (to parent company Afterpay)
- 👤 **Customers:** more than 2.5 million
- 🌍 **European countries in:** UK, France, Spain and Italy

Billie

- 💰 **Funding to date:** \$150 million
- 👤 **Customers:** more than 250,000 business customers
- 🌍 **European countries in:** Germany, Austria, Sweden

♥scalapay

- 💰 **Funding to date:** \$727. million
- 👤 **Customers:** 3.5 million
- 🌍 **European countries in:** Italy, France, Spain, Germany, Portugal, Australia, Belgium, Netherlands, Finland

alma

- 💰 **Funding to date:** \$220.5 million
- 👤 **Customers:** 3 million across Europe
- 🌍 **European countries in:** France and nine other countries

T twisto

- 💰 **Funding to date:** \$92.8 million
- 👤 **Customers:** 1.9 million
- 🌍 **European countries in:** Czech Republic and Poland

BNPL providers fall into three categories:

1. **Direct providers**, including Klarna, Afterpay, and Affirm that offer BNPL products at the POS on a retailer's website, and the financial risk falls wholly on them.
2. **Facilitators** like Mastercard and Stripe. These partner with merchants, allowing them to provide BNPL directly to their consumers.
3. **Retroactive providers**, including Chase and American Express. Here, shoppers use their credit cards for purchases and utilize flexible payment options.

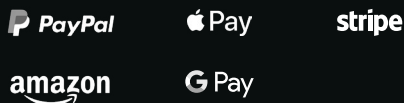
How does BNPL work?

There are four coexisting BNPL journeys, as follows:

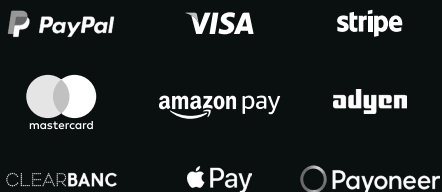
1. The most common is choosing Buy Now Pay Later as the **payment method on a merchant site**. The customer is redirected to the BNPL company and completes the subscription process, and the merchant is paid in full and irreversibly. The BNPL company manages the relationship with the customer and the collection of money. This type of BNPL journey also exists in-store, with the customer receiving an SMS message inviting them to complete the subscription on their smartphone.

2. The second journey takes the form of a **super app**. Here, the customer has previously downloaded the application and enrolled. When making a purchase on a merchant site, the customer is redirected to the app, and there's no need to subscribe or re-enter a payment method. The person can choose the number of monthly payments and validate their order. This path is also found in-store, most often via a scannable QR code, redirecting the customer to the super app.
3. The third journey involves the **merchant setting up BNPL** – the customer consents to use BNPL and the merchant handles the intermediary steps, ensuring they respect the required compliance regulations.
4. Finally, the last option involves the **customer using a credit card**. After making a purchase, they're given the option to use BNPL. If the customer accepts, they spread payments over an agreed time period. While this has the advantage of not requiring BNPL subscription or enrolment, there are two important limitations: The customer must have a big enough credit limit to pay the full amount on the day of the purchase, and the cost of the service is borne by the customer alone – unlike the other methods where costs are shared with the merchant.

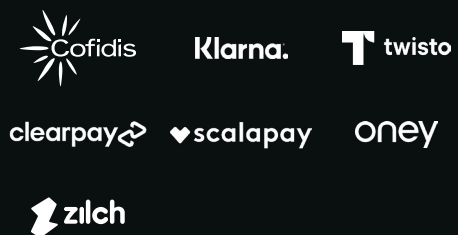
INCUMBENTS



GATEWAY PROVIDERS



BNPL PROVIDERS



05

How does BNPL financing work?

BNPL offers financing for **less than 90 days with negligible customer fees.**

The application process is simple – usually, a form that requires the input of a payment instrument (bank card or IBAN).

BNPL is generally grouped into two categories:

- **Deferred payment:** The customer doesn't pay anything at the time of purchase – payment is made either after a period stipulated in advance, or within 'x' number of days following delivery confirmation of the item(s).
- **Split payment:** The amount is divided into three or four installments of similar amounts. The first is either triggered immediately or upon confirmation of shipment. Each installment is issued in accordance with a schedule accepted by the customer at the time of purchase.

Whatever the category or journey, the granting of financing isn't guaranteed and is subject to checks by the BNPL company, which verify the payment instrument presented and involve contacting credit bureaus. Additionally:

- The merchant is paid in full for the order and the risk of non-payment is borne by the BNPL provider.
- BNPL companies must be involved in the refund or order cancellation process.
- Costs are borne by the merchant to introduce BNPL as an option in the first place, and perhaps by the customer, in the event of late payment.

Buoyant BNPL market but profitability is currently low

Under the current economic conditions where inflation is high, lowering individual buying power, consumer demand for BNPL is growing. However, from a provider's perspective the BNPL business model isn't currently profitable, with rising interest rates negatively impacting their financing capabilities.

Leading BNPL vendors

FIRM	HQ	ACTIVE MERCHANTS (in thousands)	ACTIVE USERS (in millions)	ACTIVE USERS (in millions)
Affirm	San Francisco	12	5.4	2
Afterpay	Melbourne	100	16.2	9
Klarna	Stockholm	250	90	17
PayPal	San Jose	425	4.2	4
Sezzle	Minneapolis	41.8	3	5
Splitit	New York	2.8	0.56	30
Zip	Sydney	51.3	7.3	12

06

Banks lagging behind fintech competitors

The key revolution BNPL brings to financing is the improvement of the customer journey.

However, because incumbent banks are hampered by monolithic legacy systems and poor customer interfaces, they're seriously trailing their fintech competitors when it comes to BNPL.

As the graph below shows, an increasing number of banks are creating BNPL solutions, but they're nowhere near as attractive to borrowers as those offered by fintechs.

Why? Because they rely on incorporating existing financing plans that use credit cards and interest on repayments – two of the biggest reasons borrowers are attracted to BNPL over traditional financing.

PROVIDER	OFFERING	BNPL TYPE	YEAR LAUNCHED
American Express	Pay It Plan It	Post-purchase	2017
Barclays	Easy Pay	Post-purchase	2021
Citibank	Citi Flex Bank	Pre-purchase / Post-purchase	2019
Citizen Bank	Citizens Pay	Point-of-purchase	2020
JP Morgan Chase	My Chase Plan / My Chase Loan	Pre-purchase / Post-purchase	2020
Synchrony	Pay in 4	Point-of-purchase	2021
US Bancorp	ExtendPay	Post-purchase	2021
Deutsche Bank	White label	At purchase	2022
Santander	B2B eCommerce	At purchase	2023

07

How can banks respond?

1. Partner with existing BNPL providers

As BNPL-providing fintechs grow, so do their financing expectations. This can be a challenge for new industry entrants that may not have the funding capacity to meet the needs of their growing customer base.

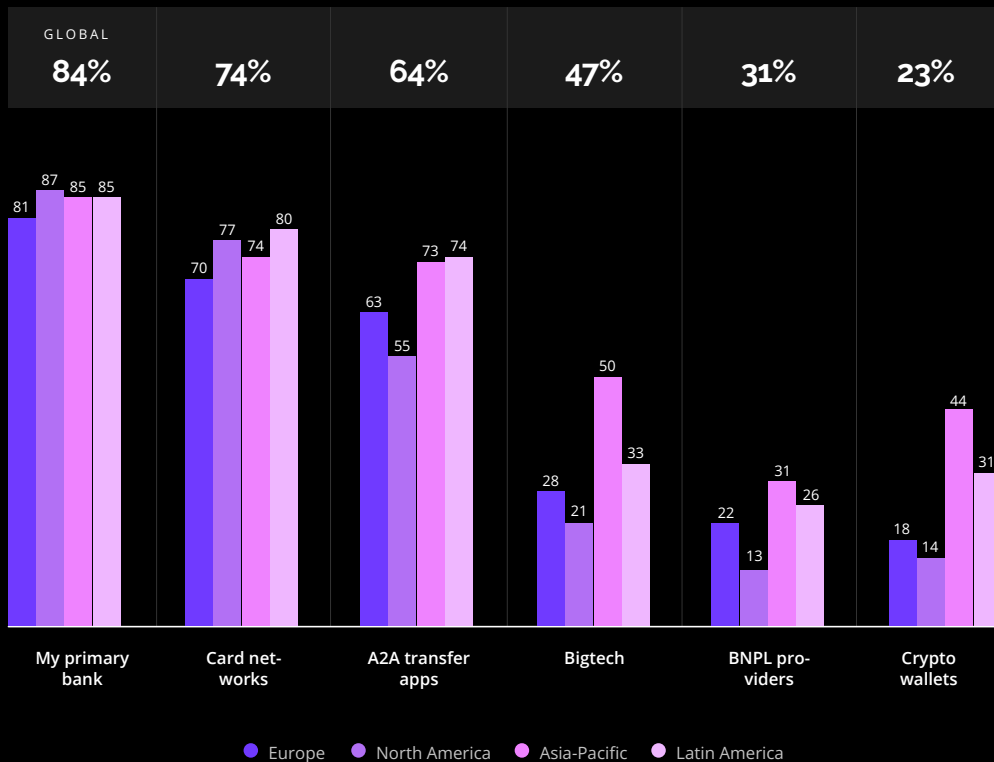
That's where banks can help. Industry incumbents often have the financial infrastructure

in place to meet these needs and can offer capacity to fintechs in return for a small percentage of the loan origination.

Moreover, despite BNPL companies being known as "customer recruitment machines", their cumbersome and time-consuming onboarding process remains the main factor of subscription abandonment. With their mastery of the know-your-customer (KYC) pro-

Banks are trusted to offer secure payments.

Percentage of consumers who trust organizations to provide a secure environment for payments and purchasing.



cess and large customer base, banks are a valuable asset.

Similarly, customer engagement with BNPL services remains low – less than two to three financings per year. Relying on a partnership for client recruitment can help bring value more quickly, as well as offering a BNPL solution to the bank's clients. However, it's important to determine the ownership of the client beforehand, so the partners don't cannibalize each other.

2. Integrate into existing products

As we saw previously, some banks are integrating BNPL and installment solutions into their current credit card offerings. For Citi and JP Morgan, that means paying off purchases through fixed payments.

However, this use case is unlikely to compete with existing BNPL solutions, because it goes through a credit card and involves interest on the aforementioned fixed payments.

The other option involves spreading the payment in installments post-purchase, across several months. This method is only for the existing bank's customers and can't be used as an incentive to attract new ones. Moreover, the solution is mainly designed for people who have the funds at their disposal at the time of purchase, but subsequently aren't sure they can pay the entire amount within a month, or perhaps face an unexpected cost that takes priority. Therefore, this type of product combines limited customers and low profitability with high risk.

Banks can also offer BNPL during the strong customer authentication (SCA) process, representing a golden opportunity.

The Revised Payment Services Directive (PSD2) introduced SCA as a mandatory requirement for online purchases in Europe, enhancing security. By combining SCA and BNPL later checks, banks can reduce onboarding friction and make the process less time-consuming for customers.

By having the ability to authorize BNPL as part of SCA, banks can offer their customers a simple and subscription-free payment solution that's more efficient than BNPL products distributed by a merchant. But this doesn't

solve the problem of profitability, since the customer assumes the cost of the credit without contribution from the merchant.

3. Acquire a BNPL fintech firm: If you can't beat them, buy them

As previously mentioned, BNPL fintechs are customer recruitment machines, representing a stake of several million dollars per year.

By acquiring already-successful BNPL providers, banks can capture an existing customer base and take out a competitor in the process.

However, the success of Buy Now Pay Later in the last couple of years means BNPL fintech providers are being assigned hefty values, so acquiring them won't come cheap.

4. Focus on underserved, high-potential customer segment like business-to-business (B2B)

While BNPL is a popular product that's well-known among individuals, the market can also serve small and medium businesses.

With that in mind, banks should focus on B2B customers – a higher-value segment that's currently neglected by mainstream BNPL providers.

Mutualizing BNPL

The Revised Payment Services Directive (PSD2) introduced SCA as a mandatory requirement for online purchases in Europe, enhancing security. By combining SCA and BNPL later checks, banks can reduce onboarding friction and make the process less time-consuming for customers.

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Delegate the customer journey

For marketplace businesses like Amazon, BNPL is an essential financial product to offer the merchants they host – among others such as wholesale financing, subscription payment, second-hand trade-in, customer delivery fee payment, etc. As part of their

BNPL offering, marketplaces design the customer onboarding journey and digital experience, but they have a BNPL partner behind the scenes to carry the liability.

As part of that, banks can play the role of global providers of financing solutions to marketplace players.

Work with an experienced partner

One of the main impediments for banks looking to launch competitive BNPL solutions is their monolithic legacy IT systems. Indeed, this is a problem not just for BNPL, but across the board, preventing banks from providing the latest financial services products and sleek customer experiences.

Banks can circumvent this issue by partnering with an external software provider. For many, this is the way forward. According to [the Digital Banking Experience report](#) conducted by Sopra Steria and Forrester Consulting, 57% of banks are planning to work with a third party to deliver digital banking products and solutions.



08 A question of regulation

At the time of writing, **BNPL is still in its “Wild West” phase – largely unregulated. We expect that to change in the near future for the following reasons.**

Contractual terms will be transparent and fair

Penalties for late payments and cancellations will be made clearer to consumers. This is the current focus of the UK's ongoing FCA inquiry, as well as in other countries of the EU.

BNPL providers will need to report to credit bureaus

Currently, the majority of BNPL loans aren't reported to credit bureaus, meaning BNPL providers are unaware of a borrower's credit history at the point of lending.

But this is changing.

The top three credit bureaus – TransUnion, Equifax, and Experian – are rolling out a BNPL bureau. This means providers will be able to check borrowers' credit ratings before approving a loan, which should result in fewer defaults for lenders and prevent vulnerable borrowers from spending beyond their means.

Customer awareness that BNPL can impact creditworthiness

It's important to educate people about BNPL financing. As a form of borrowing, although customers don't usually pay interest or

charges on purchases, creditworthiness can be undermined if they don't adhere to their repayment agreements.

Mandatory friction points in the customer journey

We're starting to see an increase in the number of customer checks during the BNPL customer journey – notably, KYC and anti-money laundering (AML).

These will likely soon become the norm. And while they'll make BNPL a safer process for both lenders and borrowers, the customer experience will be less seamless.

What does this mean for banks?

BNPL regulation will be a good thing for most banks. Why? It will raise the barrier of entry, making it more difficult for fintechs to launch their own BNPL solutions, meaning less competition for incumbents. It will also highlight the risks that come with BNPL, encouraging customers (borrowers) to opt for a trusted household name when choosing a provider.

BNPL: first step in the credit experience evolution

BNPL is an attractive form of payment that drives purchasing decisions, particularly in today's inflationary economic environment. However, there are several things to keep in mind. For example, BNPL providers also feel inflationary pressures, so they need to reimagine how to offer this type of financing and make it profitable.

Moreover, rules are on the horizon, ensuring Buy Now Pay Later is better regulated, BNPL lending by banks and fintechs is responsible, and customers are more aware of the intricacies and risks of the payment method.

The BNPL market is growing and evolving, impacting the expectations of consumers in their borrowing journeys – not just BNPL, but mortgages, standard consumer credit, auto credit, etc. As such, all forms of lending will be forced to become more transparent, ensuring customers are fully aware of what they're agreeing to and how it could affect their creditworthiness.

“““

The BNPL market is growing and evolving, impacting the expectations of consumers in their borrowing journeys



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Bettina started her career 13 years ago in consulting, leading a diverse array of projects, from the development of investment strategy to the multinational, company-wide deployment of sale enablement tools.

Since 2021 she works at Sopra Banking Software as Head of Research for the Asset and Consumer Finance business unit. She heads the customer, competitor, and market analyses used by the company to develop its industry strategy and market new and existing products.



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After 3 years in the payment systems R&D team, Nicolas joined Sopra Steria Next in 2006. Since then, he has been supporting the transformation of major players in the B2B2C retail sector and consumer loans, including BNPL. In particular, Nicolas enables the clients to take advantage of the opportunities presented by digital, build and enhance the customer experience, and maximise sales performance. In addition, he has led major design programmes for financial product departments in his 21 years of experience.

