

THE STRATEGIC SHIFT WITH BNPL: FROM RAPID GROWTH TO INDUSTRY CORRECTION



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Buy now pay later (BNPL) has become an important part of consumers' purchase decisions and payment behaviour, and the industry has reached a critical stage of development. As it appears to be approaching maturity, a careful analysis of the industry reveals both opportunities and risks. Furthermore, competition will increase with the direct entrance of big techs such as Apple and Block.

To succeed in the current environment, market players need to navigate increasing regulatory scrutiny, rising interest rates and an oversupply of BNPL credit that has been extended to consumers who, at times, have been too eager to spend.

In a March 2022 paper, we discussed the characteristics of the BNPL business model. This research focuses on market structure developments, the reactions of BNPL players, and mergers and acquisitions (M&A) in the industry, while providing a working hypothesis on the scaling and diversification efforts in play. Based on this analysis, we present the potential implications for business-to-consumer BNPL lenders, established financial players, technology providers and retailers alike.

CONSUMER DEMAND, SHIFTING PAYMENT HABITS AND A PREFERENCE FOR DEFERRED PAYMENT DRIVES BNPL

As explained in Arkwright's March 2022 analysis,¹ BNPL funding has increased steadily from at least US\$0.19bn in 2016 to at least US\$5.27bn in 2021.² This growing investment flow has been, and still is, driven by a demand-led growth of BNPL business pushed initially by Millennials' and Generation Z's online purchases and their preference for instalment credit. This payment behaviour started with the younger generations and is now becoming common across age groups. This is driving increasing demand from consumers and, as a consequence of increasing consumer preference and propensity to buy and spend, from merchants as well.

1 – *Disruption of BNPL in Consumer Finance: What strategic options do incumbents have?*, <https://www.arkwright.com/project/disruption-of-bnpl-in-consumer-finance-what-strategic-options-do-incumbents-have>.

2 – Arkwright research, Dealroom.co. Funding volume represents an at-minimum approach, as covered funding may not completely be exhaustive (e.g. through not covering all seed fundings).

Fig. 1 – Past and future BNPL penetration rates in the US by age group.

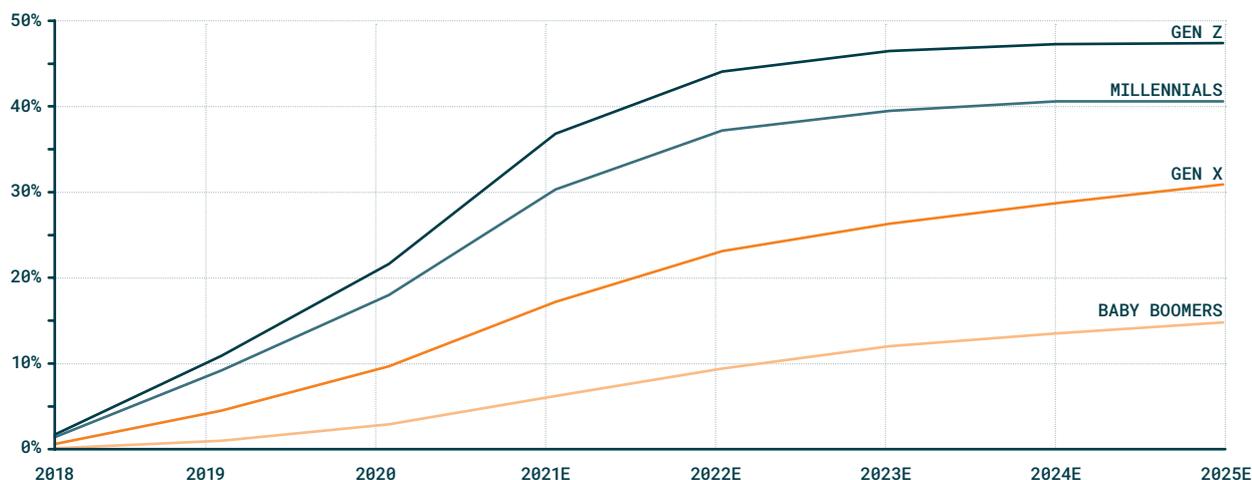


Fig. 1 provides a development trend for different age groups in the US between 2018 and 2025.³

In a 2021 survey of US consumers, 44% of respondents stated they always prefer BNPL over credit cards and a further 38% said they preferred BNPL some of the time.⁴ In particular, younger generations have developed a preference for instalment-based debt and an aversion to revolving credit, which they often do not qualify for. BNPL, on the other hand, is generally not perceived as credit because of its short-term, instalment-based nature and ‘deferred payment’ perception that seemingly leaves the customer in control of their spending commitments. Usage statistics gathered by payment service provider TSYS indicate that the majority of BNPL is provided to those born between 1986 and 2000.

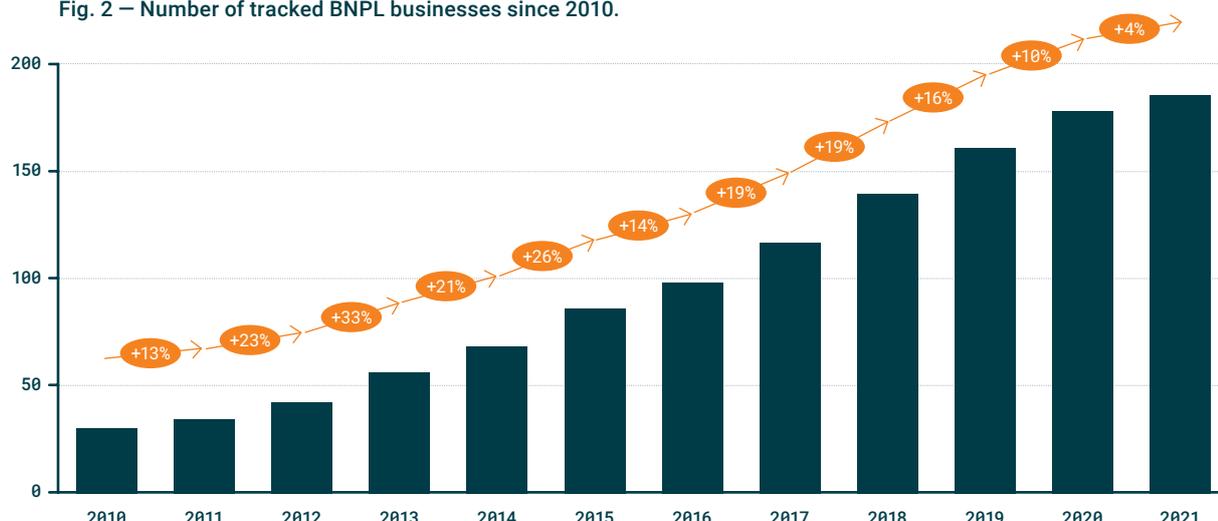
The combination of these factors, together with a regulatory grey area for short-term, small value, fee-based lending, has provided an opportunity for the emergence of a growing number of specialised BNPL providers.

Fig. 2 provides an illustration of the estimated number of BNPL providers based on company creation and M&A activity tracked by Dealroom.co. Although most privately-funded companies have not been tracked, and mixed business companies have mostly not been included either, we deem these statistics a good directional indicator of the development of BNPL companies. The combination of the two previous findings – the strong increase of BNPL supply in recent years and the potentially flattening penetration – leads to the working hypothesis that the industry has reached the state of oversupply.

3 – eMarketer. Internet users who have accessed a BNPL account digitally and have made a payment toward a purchase at least once in the past year. May 2021.

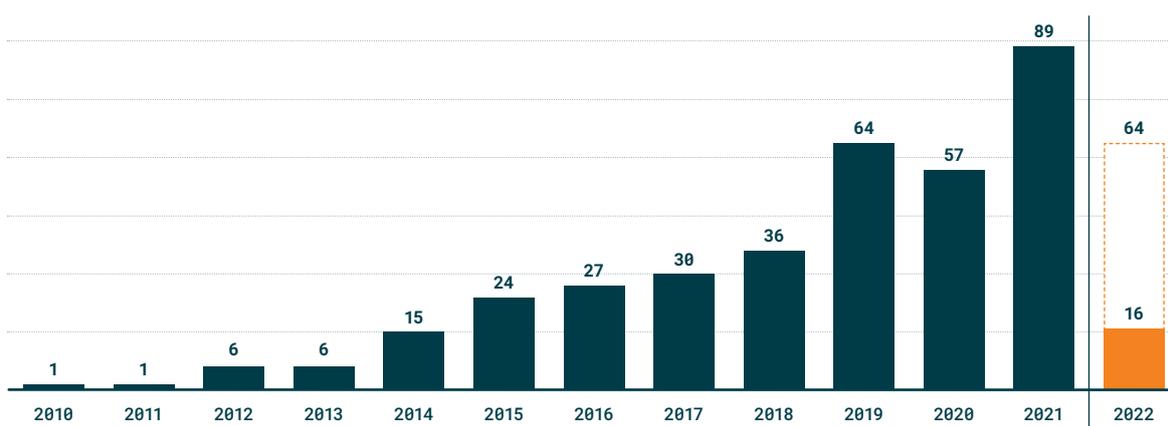
4 – Momentive, <https://www.surveymonkey.com/curiosity/momentive-study-buy-now-pay-later/>.

Fig. 2 – Number of tracked BNPL businesses since 2010.



It is interesting to note that the creation of new BNPL companies appears to have slowed over the last two years.⁵ Whether or not industry analysts’ recent forecasts of growing volumes in BNPL will prove to be accurate or not, the number of funding rounds, illustrated in Fig. 3, has risen in the most recent years as demand for BNPL increased and providers sought to grow their businesses. Early 2022 numbers indicate a potential decrease in the amount of funding rounds – in line with a general reduction in venture capital funding rounds. At the same time, big techs such as Block⁶ (formerly Square) and Apple,⁷ and neo-banks such as Zopa⁸ have broadened their value propositions to BNPL lately, compounding the competitive intensity in this space.

Fig. 3 – Number of tracked funding rounds of BNPL businesses per year since 2010.



5 – Crunchbase, Dealroom.co, Arkwright analysis.

6 – Teresa Xie: Square Enters 'Buy Now, Pay Later' Market for \$29 Billion in Biggest Acquisition Yet. Inc., <https://www.inc.com/teresa-xie/square-afterpay-buy-now-pay-later.html>.

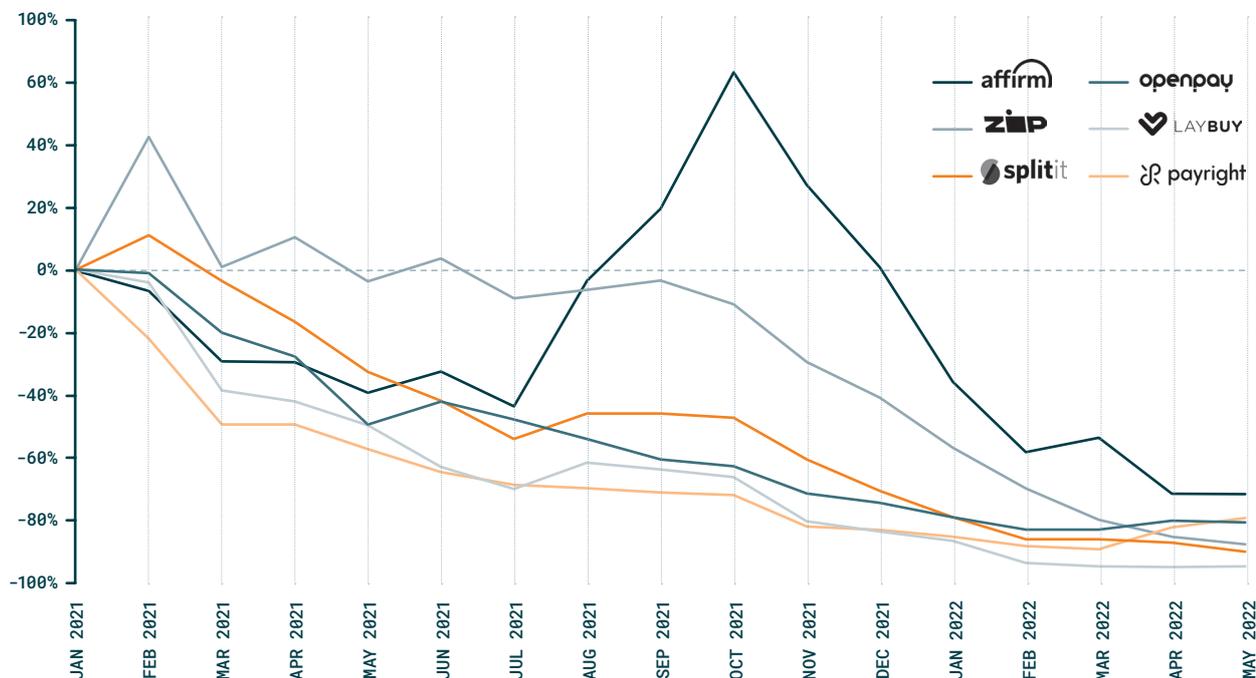
7 – BNPL Space Gets Crowded As Apple Pay Later Enters Fray. PYMNTS.com, <https://www.pymnts.com/buy-now-pay-later/2021/bnpl-space-gets-crowded-as-apple-pay-later-enters-fray/>.

8 – Zopa enters BNPL market. Finextra, <https://www.finextra.com/newsarticle/40405/zopa-enters-bnpl-market>.

While at first sight these statistics suggest BNPL to be a thriving industry, a harder look reveals it is now facing major challenges. BNPL stocks have recently performed negatively, far exceeding the already negative trend of technology stock in the same period. Since early 2021, stock prices of major BNPL companies have lost more than 70% of their values, as shown in Fig. 4.⁹ In contrast, the MSCI World Index has grown by 7.8%, and the NASDAQ Composite has fallen by 6.7% during the same period.¹⁰ This development is particularly striking among those businesses based in Australia, which is home to most of the world’s publicly listed BNPL companies.

At the same time, issues can also be noted with the companies themselves, as was made evident by the recent actions of two industry players. In March 2022, Sezzle was forced to stop its European expansion plans and lay off workers it had hired not long before.¹¹ Similarly, but to a far greater extent, Klarna announced in May 2022 the dismissal of hundreds of employees in an attempt to cut costs.¹² Evidently, a more attentive analysis of the BNPL market is warranted.

Fig. 4 – End-of-month closing price changes for selected public BNPL companies (January 2021 stock price as a baseline).



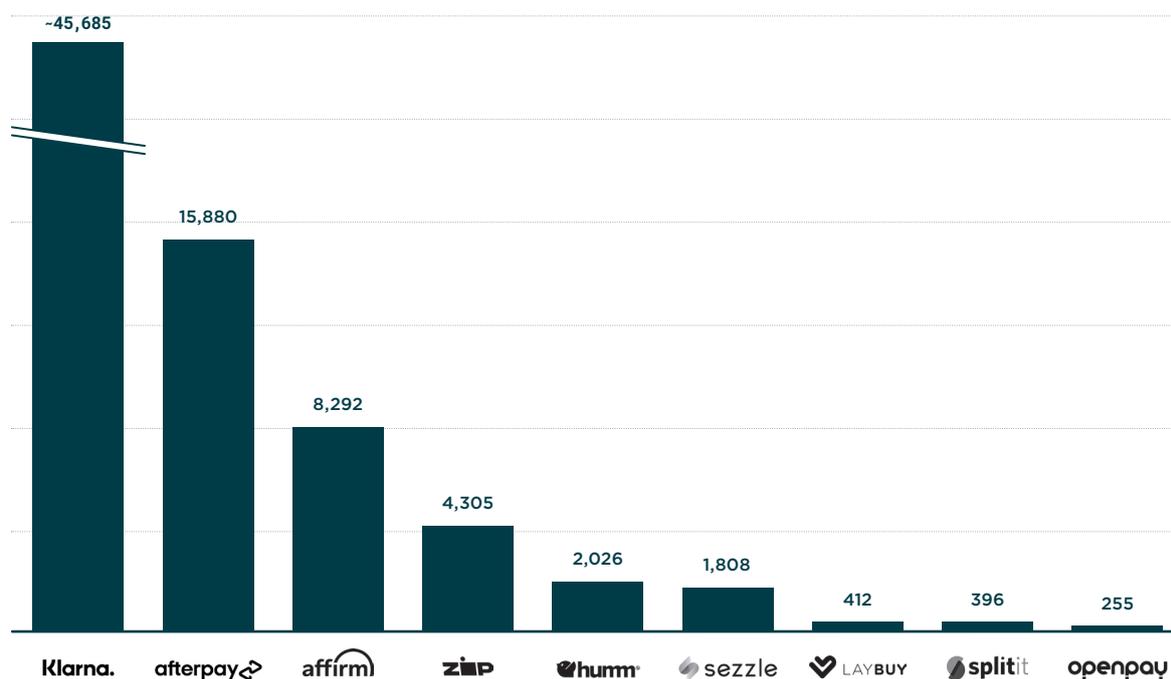
9 – ASX and Nasdaq data, Arkwright analysis.

10 – MSCI World: gross index level; NASDAQ Composite: total return index.

11 – John Stanley Hunter: “Buy now, pay later”-Anbieter Sezzle entlässt Mitarbeiter in Berlin. FinanceFWD, <https://financefwd.com/de/sezzle-europa-ende/>.

12 – Charles Daly: Klarna CEO’s LinkedIn Post Names Hundreds of Staff Dismissed in Cost-Cutting. Bloomberg, <https://www.bloomberg.com/news/articles/2022-06-01/klarna-ceo-s-linkedin-post-hailing-fired-staff-divides-opinion>.

Fig. 5 – Selected major BNPL players by total transaction value in 2021 (in US\$ millions).



EVOLUTION OF THE BNPL INDUSTRY

While merchant credit is a very old practice, Klarna (founded in 2005) was the first widely successful third-party BNPL monoline provider. Despite still being the largest BNPL provider by transaction value, Klarna faces intense competition from a growing number of smaller players. Fig. 5 provides a comparative illustration of the 2021 transaction values of the major players.¹³

All major players, with the exception of Humm, increased their revenues considerably between 2019 and 2021.¹⁴ For example, Zip, Sezzle and Splitit grew their revenues by more than 400% in this period, contributing to new industry record highs each year. At the same time, however, there is a strong trend of growing losses. Costs are rising at faster rates than revenues with growing credit losses, which are often driven by consumers committing to multiple instalment obligations that are beyond their ability to repay. Also, these obligations are becoming unsustainable as BNPL is being offered for shorter-term, everyday purchases by lenders in pursuit of scale and growth.

13 – Annual reports of Klarna, Afterpay, Affirm, Zip, Humm, Sezzle, Laybuy, Splitit and Openpay for fiscal years ended in 2019, 2020 and 2021, Arkwright analysis. Klarna's values are estimated so to get to an attribution of values to its BNPL business only. Note: Afterpay was acquired by Squire (now: Block) in August 2021, Humm flagged as a potential acquisition by Latitude since February 2022 and Sezzle by Zip in February 2022.

14 – Idem.

Fig. 6 – Revenues and net results of BNPL players from 2019 to 2021 (in US\$ millions).

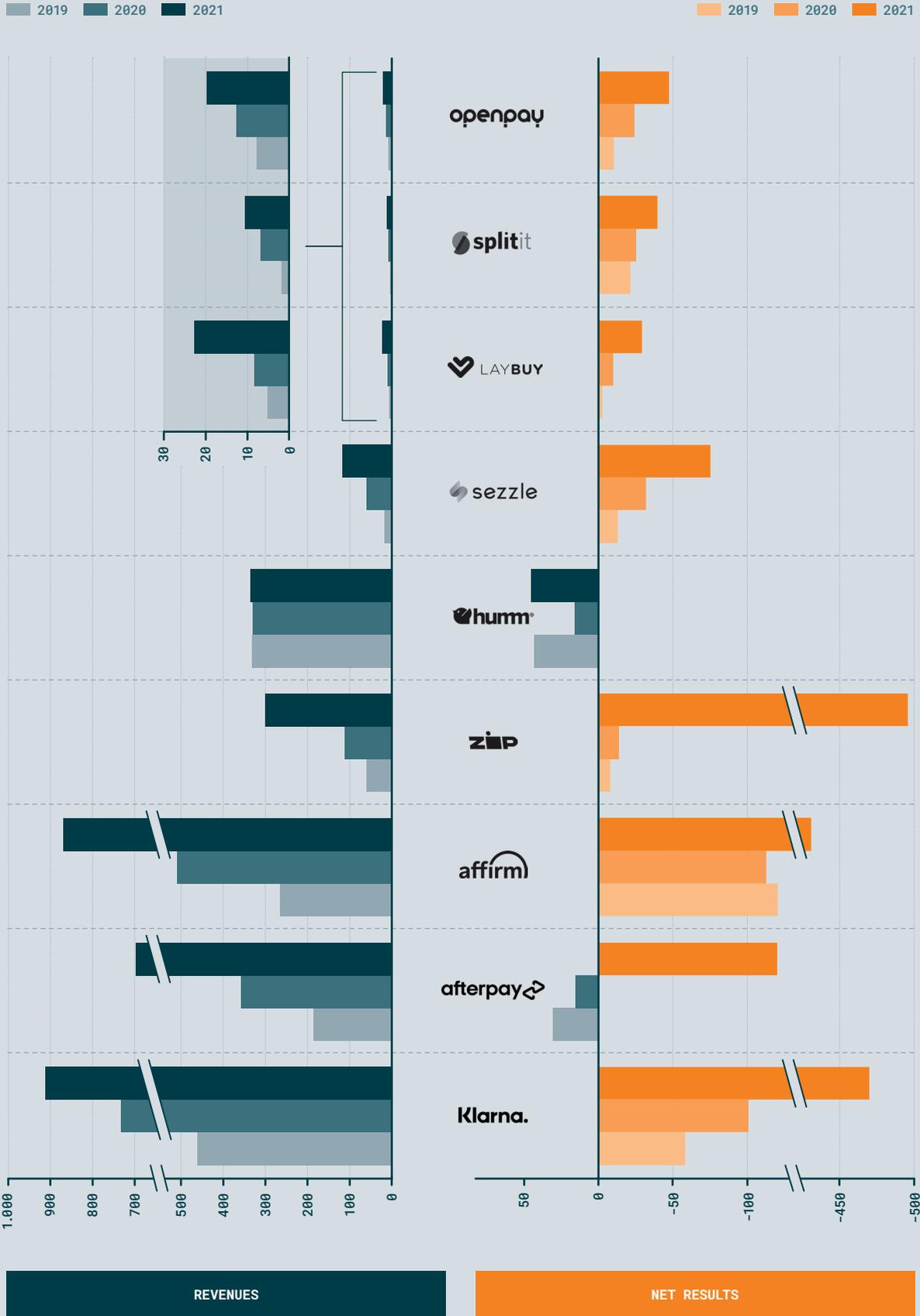


Fig. 6 illustrates the revenues and financial performance of major BNPL lenders.¹⁵

These findings support our previously established hypothesis that BNPL has reached a point of saturation, at a time when there is also growing disintermediation. For example, new services such as ACI PayAfter offer aggregation solutions that provide access to many different BNPL options via a single API. The result is increased competitive pressure due to the removal of access barriers and reduced information asymmetries for consumers and merchants.

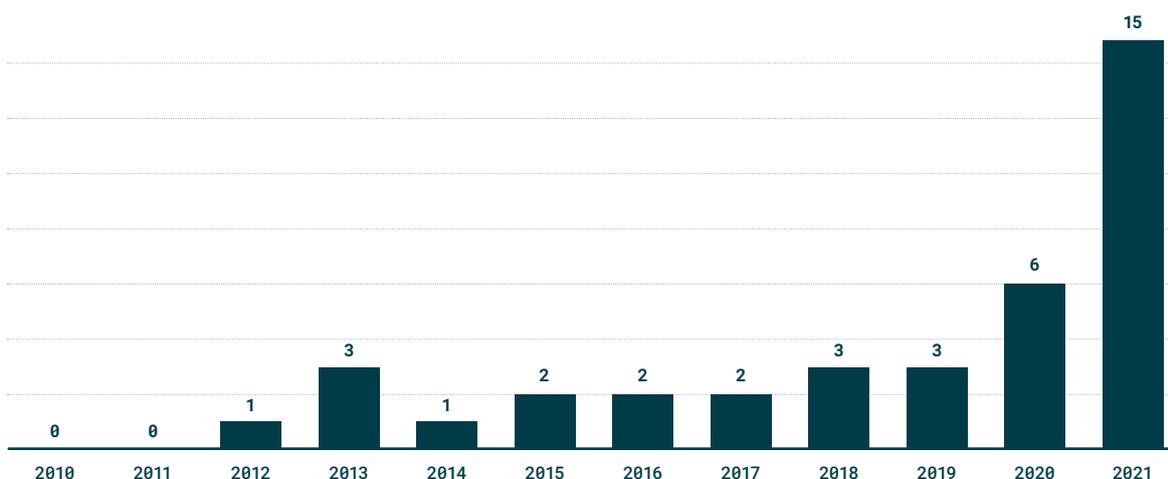
BNPL COMPANIES' M&A ACTIVITIES

Consolidation is a typical dynamic within any industry reaching maturity, and the M&A activity of BNPL companies has increased significantly lately. Fig. 7 provides an illustration of the number of deals by BNPL companies per year.¹⁶

Our analysis tracked 41 acquisitions by BNPL companies since 2008 with the finding that 23 targets were non-BNPL players, while 18 were acquisitions within the industry, as illustrated by Fig. 8 and 9.¹⁷

Consolidation is the ultimate development of any maturing industry and a key prerequisite to solving overcapacity in the market. Fig. 10 illustrates the M&A activities and focus by BNPL lenders.

Fig. 7 – Number of tracked M&A deals by BNPL companies per year since 2010.



15 – Annual reports of Klarna, Afterpay, Affirm, Zip, Humm, Sezzle, Laybuy, Splitit and Openpay for fiscal years ended in 2019, 2020 and 2021, Arkwright analysis. Klarna’s values are estimated so to get to an attribution of values to its BNPL business only.

16 – Dealroom, Crunchbase, Mergermarket, Arkwright analysis.

17 – Crunchbase, Dealroom, Mergermarket, Arkwright analysis.

Fig. 8 – BNPL industry consolidation deals.

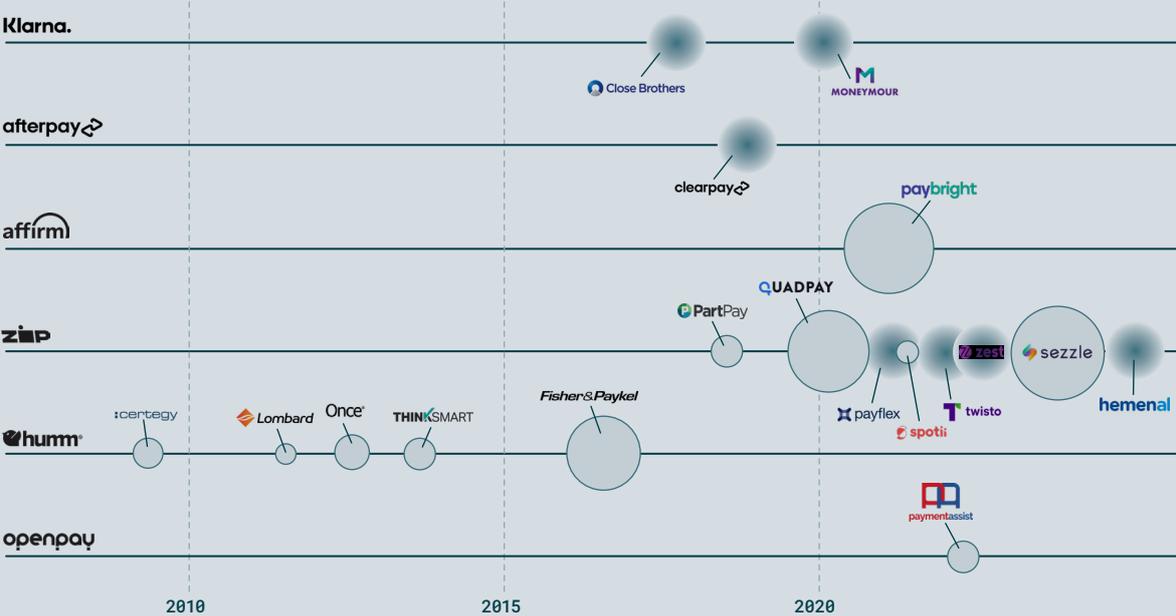
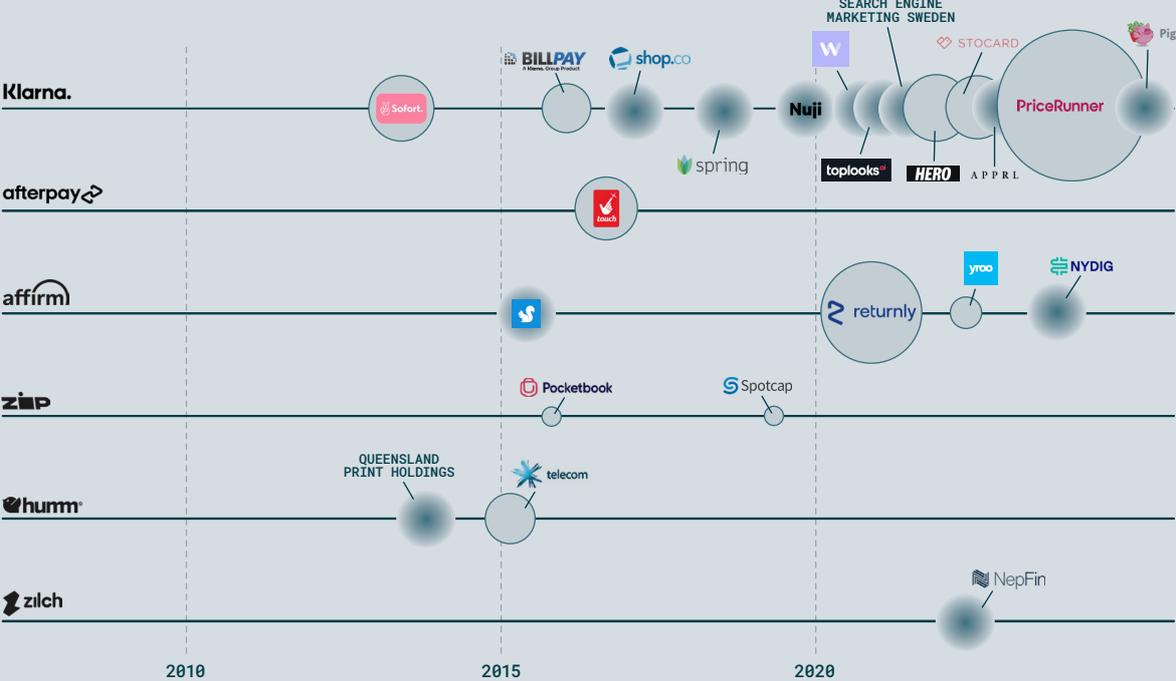


Fig. 9 – BNPL lenders acquisitions of companies in other industries.



 = US\$100MN IN DEAL VALUE. LARGER (SMALLER) BUBBLES INDICATE LARGER (SMALLER) DEAL SIZES
 = UNDISCLOSED DEAL VALUE

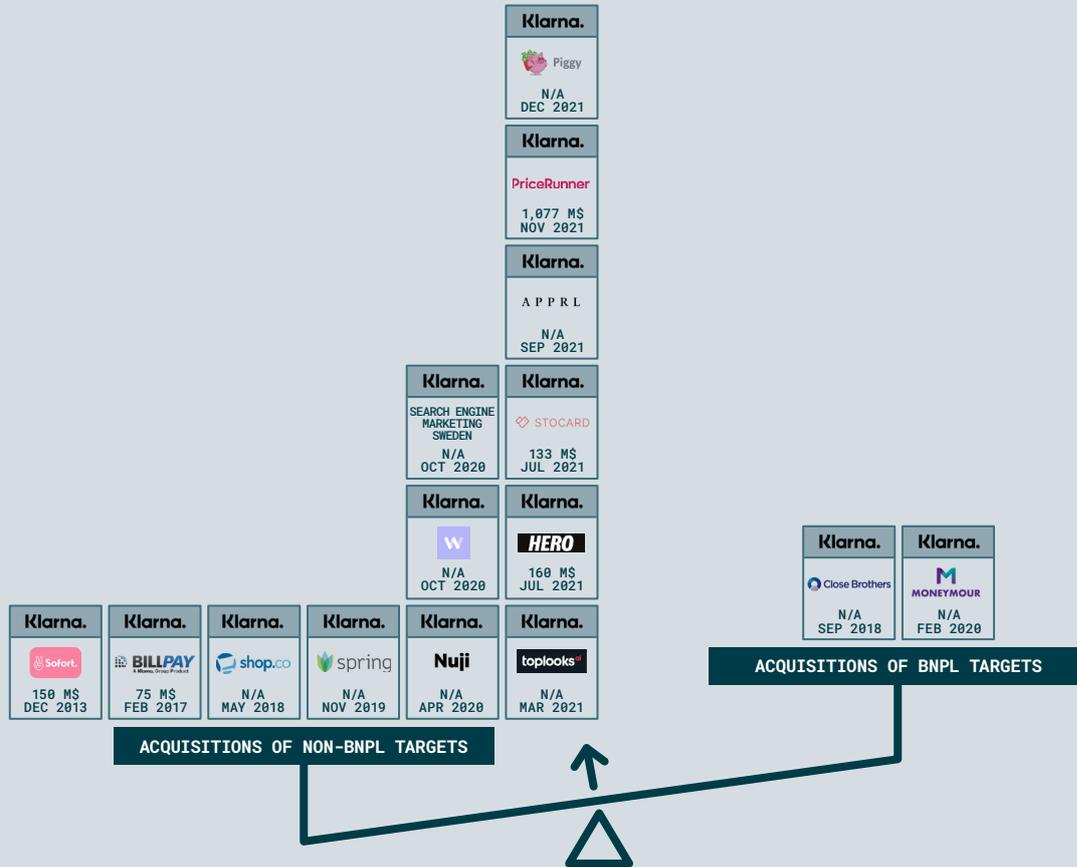
Based on these findings, we can establish the two different strategic routes that industry players are taking. Klarna and Affirm, the largest monoline players in the BNPL industry by revenue, are diversifying into new business areas, arguably seeking complementary differentiation. The acquisitions of price comparison website PriceRunner by Klarna and shopping returns platform Returnly by Affirm are an indication of their efforts to diversify.

In contrast, runners-up Humm (potentially an acquisition by Latitude itself) and Zip appeared to have focused more on pursuing scale, which would be expected by players when seeking to pursue rapid growth. This is shown by Zip's recent acquisitions of competitors Quadpay and Sezzle. Deals by target type are illustrated in [Fig. 10](#) (next pages).

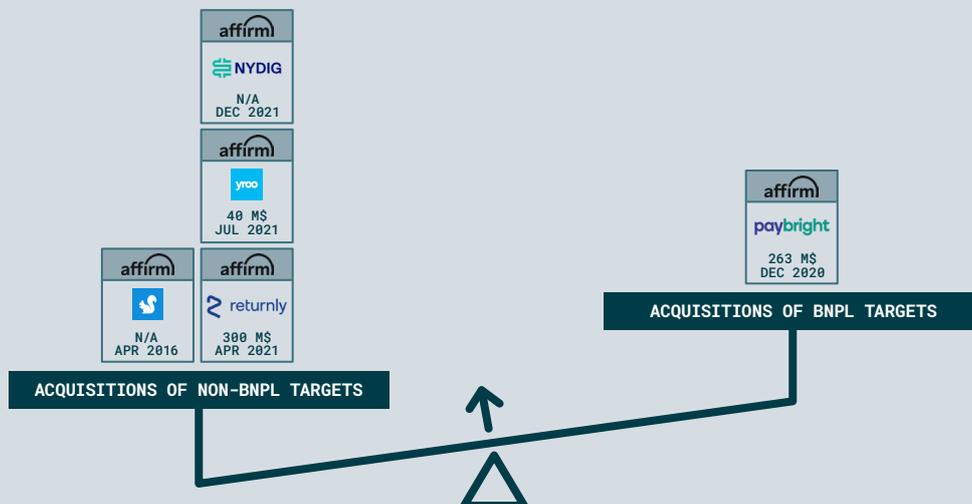
On the other hand, established financial players have recently made large investments in the industry, diversifying into BNPL. PayPal, now offering BNPL to a wide audience, acquired Paidy in 2018, and Block (previously: Square) acquired Afterpay in 2021. Competing against the financial resources and business networks of larger players will be difficult, and it is also interesting to observe that M&A activities have been undertaken by the largest players in the industry.

Fig. 10 – Acquisitions by the four most active BNPL lenders in M&A (2008 to April 2022) by type of target.

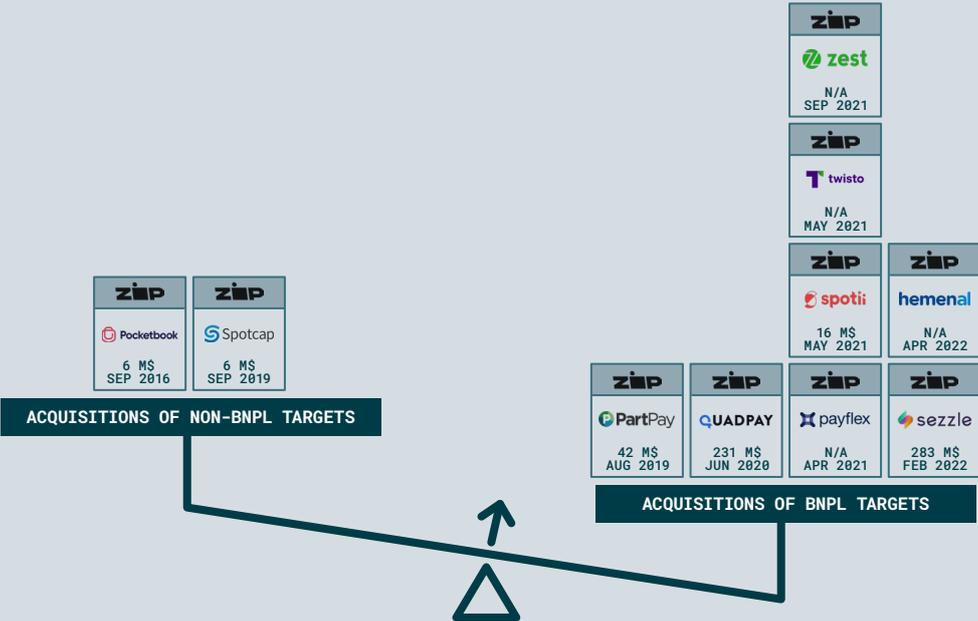
KLARNA'S ACQUISITIONS BY BUSINESS TYPE (2013-2022)



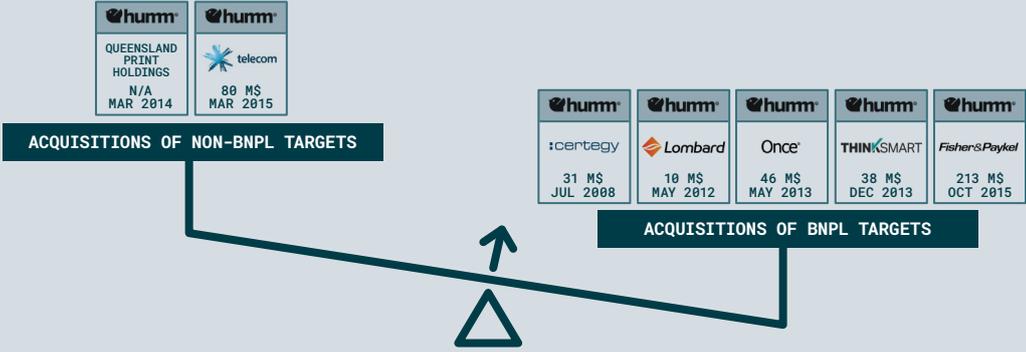
AFFIRM'S ACQUISITIONS BY BUSINESS TYPE (2016-2022)



ZIP'S ACQUISITIONS BY BUSINESS TYPE (2016-2022)



HUMM'S ACQUISITIONS BY BUSINESS TYPE (2008-2022)



BNPL OUTLOOK AND CONSIDERATIONS

The historic low-interest-rate environment of the past decade has undoubtedly benefited BNPL providers to a large extent. Offering zero-interest instalment loans was comparatively easy when refinancing costs were also low. This period, however, is coming to an end as central banks around the world are raising interest rates in response to higher inflation. Higher costs of funding may further reduce margins in the industry.

BNPL is contributing to a consumer short-term debt bubble that is negatively impacting the industry itself with increasing levels of bad debt. Reportedly, “the share price fall has been mainly driven by investor concern about the growth in bad debts from customers”.¹⁸ This is attracting regulatory attention, and, in a number of jurisdictions, central banks and financial authorities are considering consumer protection measures and increasing regulatory obligations that will ultimately result in the increased cost of lending.

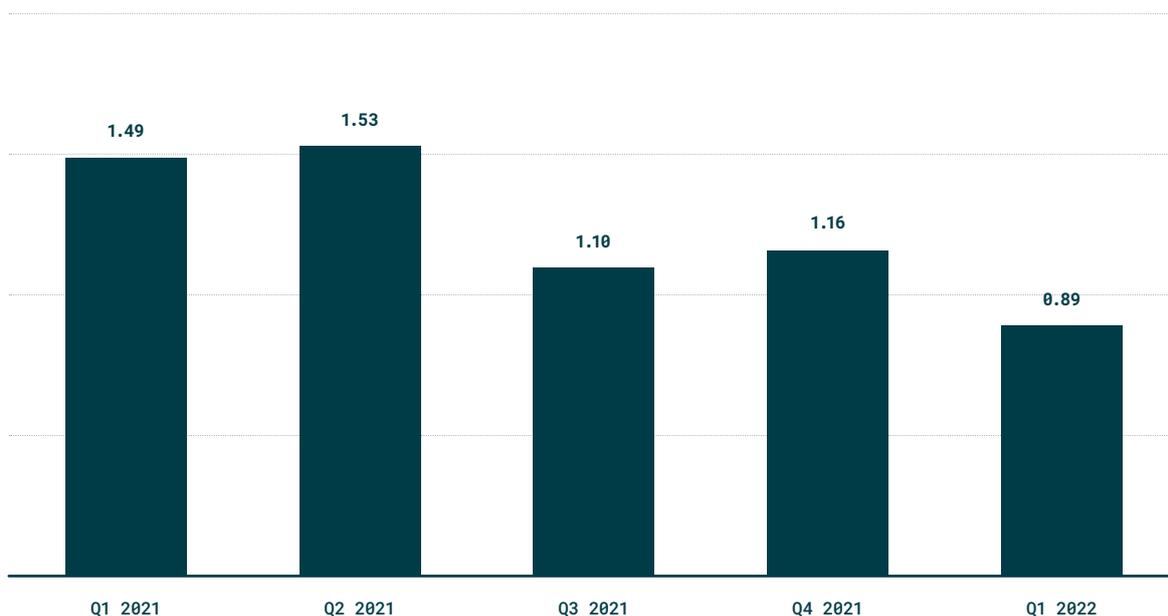
This can be particularly challenging in the context of high inflation eroding consumer spending power, the risk of recession in a number of countries, and the drying up of venture capital financing. Paying close attention to recent quarterly funding amounts reveals a potential slowdown; funding in the first quarter of 2022 was below that of each of the previous year’s quarters.¹⁹ The figures suggest it is unlikely that funding will exceed the all-time highs of 2021. However, it must be added that the 2021 amounts of investment were significantly affected by Klarna’s large funding rounds (US\$1bn and US\$0.64bn) in the first two quarters of 2021.

In contrast, during the first quarter of 2022, the largest funding rounds amounted to only US\$213mn (Scalapay), US\$150mn (Pine Labs) and US\$126.5mn (Alma), suggesting that the period of large investments into BNPL may be coming to an end. This slowdown may be the result of investors realising the current and future challenges of BNPL. Previous market forecasts may not be realised as BNPL growth could soon slow down. All this comes within the context of big tech organizations, new banks and incumbents entering the space and leveraging complementarities across value propositions to their customers.

18 – Sarah Danckert: BNPL sector needs to dig itself out bad debt hole, says Zip chair. The Sydney Morning Herald, <https://www.smh.com.au/business/companies/bnpl-sector-needs-to-dig-itself-out-bad-debt-hole-says-zip-chair-20220523-p5anpq.html>.

19 – Crunchbase, Dealroom.co, Arkwright analysis. Funding volume represents an at-minimum approach, as covered funding may not completely be exhaustive (e.g. through not covering all seed fundings).

Fig. 11 – Total tracked quarterly BNPL funding since Q1 2021 (in US\$ billions).



Despite these headwinds, predictions of a bubble bursting, and the demise of BNPL are likely to be overstated. Instalment credit remains a type of lending in demand by consumers and merchants and, despite any potential industry correction, will remain a business attractive to some providers. However, the increasing and changing nature of competition will reshape the value propositions. In particular, we would expect this change to be driven by companies, such as banks, credit card issuers and big techs, that are able to leverage BNPL to complement either other credit line types or retail propositions. They could also complement merchant value propositions, leverage existing compliance operations to comply with future compliance requirements, or use BNPL as a new customer acquisition product for a wider value proposition.

Within this context, there are going to be a variety of possible implications for companies operating within the BNPL industry. With our analysis of the industry, we would expect to see different players having very distinct positions in the short and medium term, as shown in the table on the following pages.

PLAYER TYPE	CONSIDERATIONS
MONOLINE BNPL	<ul style="list-style-type: none"> <li data-bbox="590 434 1356 712">– Business will prove challenging in view of rising costs of funding, increasing regulatory costs and high rates of bad debt, in addition to price compression from competitive rivalry. In particular, we would expect future additional affordability checks, credit reporting and increased disclosure of terms and conditions to affect negatively the ability of the embedded BNPL value proposition to be an enabler of consumers’ compulsive buying. <li data-bbox="590 757 1356 1003">– Providers, regardless of size, should pay attention to credit quality, and whenever possible, consider the opportunity to diversify into complementary value propositions (e.g. merchant services like acquiring or lending, or a broader range of consumer-related services, such as own shopping solutions) as suggested by Klarna’s acquisitions. <li data-bbox="590 1048 1356 1182">– Big tech extending their own offering to BNPL will reduce the market opportunity for monoline providers to access some channels, in addition to increasing the competitive pressure.
BANKS AND OTHER INCUMBENT LENDERS	<ul style="list-style-type: none"> <li data-bbox="590 1258 1372 1429">– The changing regulation will offer opportunities to the largest players to leverage established risk and compliance operations and to complement revolving credit and personal loan businesses with instalment credit, catering for the preference of consumers for this type of lending. <li data-bbox="590 1473 1356 1608">– Some BNPL types, like virtual card-based BNPL, are expected to benefit issuers with a better profitability. NAB’s recent entry into BNPL²⁰ is an example of the attractiveness of this type of instalment credit proposition. <li data-bbox="590 1653 1356 1859">– The worsening credit scenario will put established players with better credit quality books, larger balance sheets and lower cost of capital in a better position to tap into the market by targeting selected spending pools as a way to acquire new customers to be then migrated to other banking value propositions.

20 – Jessica Yun: NAB keen to steal Afterpay customers with belated BNPL entry. The Sydney Morning Herald, <https://www.smh.com.au/business/companies/nab-keen-to-steal-afterpay-customers-with-belated-bnpl-entry-20220526-p5aonm.html>.

PLAYER TYPE	CONSIDERATIONS
BIG TECH AND OTHER PROVIDERS TO THE MERCHANT INDUSTRY	<ul style="list-style-type: none"> – BNPL will continue to enjoy consumers’ and merchants’ preferences and will remain a key part of any merchant checkout value proposition. The pressure on BNPL monoline providers will offer opportunities of acquisitions targeting merchant relationship assets and technical capabilities. <p>Overall demand for instalment solutions will remain strong from the merchant side and keep offering an opportunity to complement acquiring and payment services. Recent moves of Apple, Block²¹ and Stripe²² in this space are examples of players leveraging these opportunities.</p>
LARGE RETAILERS	<ul style="list-style-type: none"> – Large retailers may team up with banks or white-label providers in order to keep out BNPL monliners, keep control of the customer-merchant relationship and potentially tap into a new type of revenue.

In all cases, instalment credit will continue to hold consumer and merchant preferences as a method to pay and fund transactions, while we expect a shift in the types of BNPL propositions as the industry, regulation and economic conditions evolve.

21 – More BNPL Coming as Block Connects Seller Cashapp Ecosystems. PYMNTS.com, <https://www.pymnts.com/earnings/2022/in-person-bnpl-coming-soon-as-block-connects-seller-cashapp-ecosystems/>.

22 – Joe Burns: Stripe and Klarna partner to offer BNPL to merchants. finLedger, <https://finledger.com/articles/stripe-and-klarna-partner-to-offer-bnpl-to-merchants/>.

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