D&D Deep Dive –
The rise and fall of BNPL cards in India

Buy Now Pay Later (BNPL) model: An Introduction

India is the second largest online market in the world

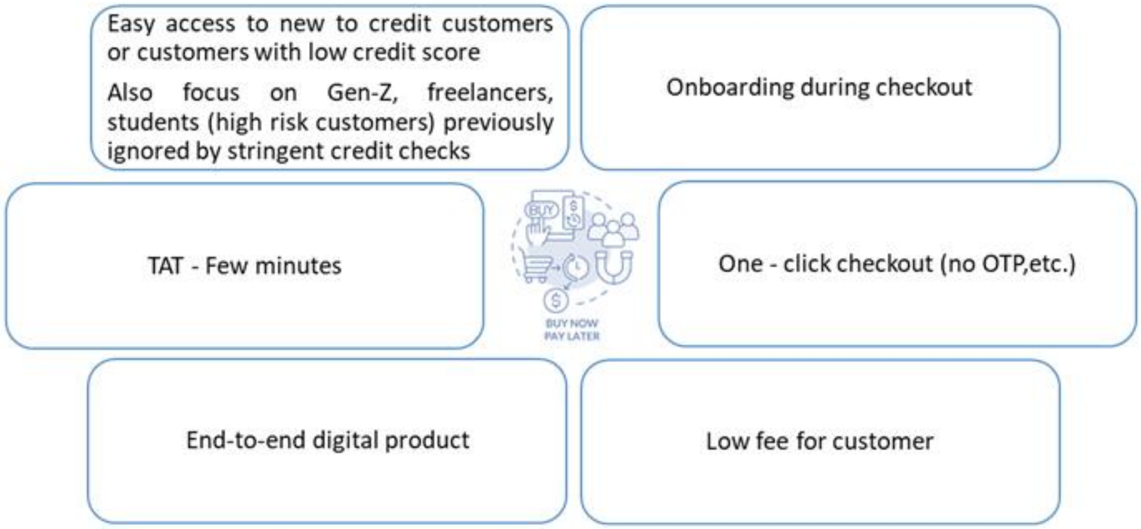
Digital technology and integration between banks, fin-techs and retailers have changed the way consumers spend and make payments. Nearly every major retail store and site now offers BNPL facility. Rise of ecommerce (28% CAGR during FY18-FY21), rising digital payments (26% CAGR during FY18-FY21), and digital infrastructure (e-KYC etc.) have enabled seamless customer onboarding, credit assessment, and usage in payments. (HDFC research).

RBI publication shows India having about 62 million active credit cards. With the assumption that each person on an average holds 2 credit cards, it is assumed that there are 31 million unique credit card users in India. However, if this data is compared with the number of users who have a record in the credit bureau(CIBIL & Experian being the primary ones), the latest numbers point to about 300 million users with a ton of users being 'thin' file users with very little credit history or short term loans. Thus there is a huge segment of users who do not have access to credit via traditional credit card services. And this is where BNPL has made its mark.Taking out a loan for as small as INR 1000 is now possible with the use of BNPL model.

Fin-techs in the lending space work on 3 main models:

1) EMI financing business involving brands bearing the interest cost for consumers and the lender offers a zero-interest EMI option
2) Consumers pay an interest for converting a purchase into EMIs where the lender extends credit and collects interest on it (BNPL player ZestMoney offers this on certain products) (Ideal for consumers with low credit score or not having a credit card)
3) Platform allows for any purchase to be converted into simple EMIs at no interest. If a customer cannot repay the amount within a specific period, say 30 or 45 days, an interest or penalty will be charged. In this case, lenders make money out of so-called revolvers. In the credit card ecosystem, an estimated 20% of users revolve the amounts due. Players like PostPe, Ola Money Postpaid and LazyPay generate revenue by charging late payees

A BNPL model was introduced with the concept of a small loan where the consumer could pay back the money within 15 days – with no interest and they could even split this payment over a 3-6-month period. This facility similar to a credit card but with no extra interest costs and no hassle of credit scores was very appealing and attractive. It was most promising since short term credit via BNPL model was also offered to students, freelancers and other people who were considered high risk by stringent credit score evaluators of traditional banks. This was publicized saying it will help build a credit score for the young users who did not ideally use credit cards.



BNPL companies offer loans to make purchases in easy installments. This means more people can now afford products that otherwise would not have been affordable for them. NBFCs underwrite the risk, banks issue the card and fin-tech companies load that money into a prepaid instrument (PPI) wallet to provide easy credit (loans) to consumers.

Step:1 A user opens an account on the app of a BNPL service provider like Slice or Uni

Step:2 The user is issued a card which can be used like a credit card but is technically a pre-paid card

Step:3 The service provider links a small credit line to that card in the back end which is mostly powered by a NBFC which has tied up with the BNPL service provider

Step:4 The card is run on a bank's wallet and is powered by Visa or Mastercard and can be used at all merchant locations that accept debit and credit cards

Step:5 Repayments can be made in 3 installments or over a longer period with a late fee

BNPL cards were marketed as a substitute to credit cards. Hence a comparison is drawn here to differentiate the features and offerings of BNPL cards against credit cards

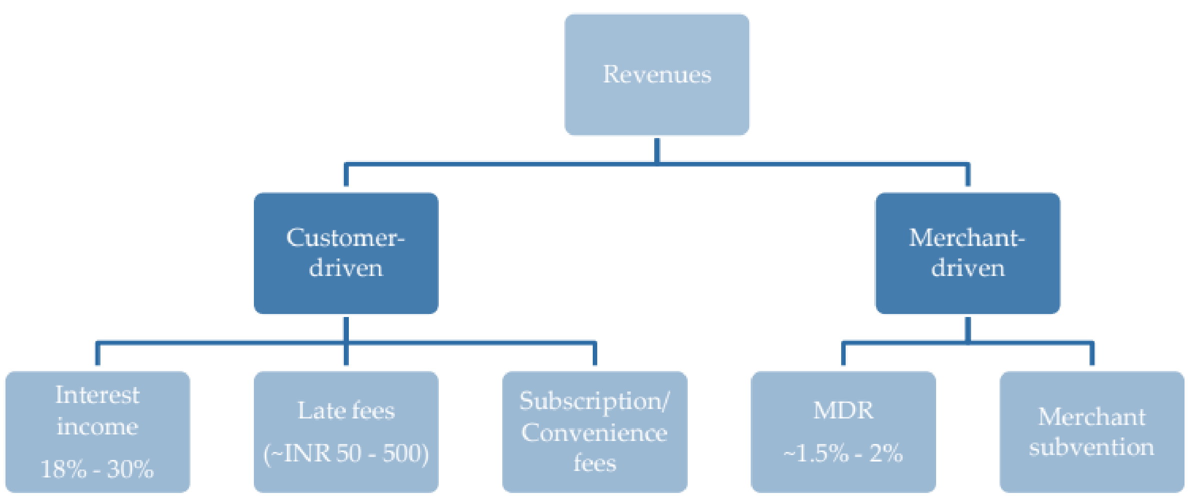
	Credit Cards	**BNPL Cards**
Customer Offerings		
Interest- free credit period	Up to 50 days	Up to 15 – 30 days
Credit limit	High	Low for Pay Later products
Revolving credit facility	~42% p.a.	×
EMI loans interest rates	0% - 20% p.a.	0% - 32% p.a.
Rewards/ cashbacks	Average of 1% cashback	Limited
Cash advances	~30% p.a.	×
Merchant network	Online + Offline	Mostly Online
International Acceptance	√	×
Balance Transfer	√	×
Complementary benefits	Lounge access, club	NA

	memberships, etc.	
Fees and Charges		
Subscription fees	INR 0 – 10,000	Mostly nil or 1 time payment upto INR 500
Late Fees	INR 250 – 500	INR 100 – 250
Merchant Discount Rate (MDR)	~ 2%	Upto ~ 2%
Cash withdrawal charges	2% - 2.5%	NA
Balance transfer charges	~1%	NA
User Experience		
KYC	Full KYC	Minimum KYC in most cases
End – to – end digital	In a few cases	In Most cases
Turn Around Time	High	Low (few minutes)
One – click checkout	×	√

Interest rates on EMI loans offered by BNPL players in India (Source: HDFC and D&D Research)

BNPL Player	EMI interest rates
ZestMoney	21% - 24%
LazyPay	Up to 32%
Amazon PayLater	Up to 24%
Filpkart PayLater	Up to 24%
Paytm Postpaid	Up to 36%
Slice	Up to 30%
HDFC Bank FlexiPay	Up to 28%
ICICI Bank Cardless EMI	10% - 22%
Kotak Cardless EMI	0% - 30%

BNPL is also compared with payday advance and check-cashing loan industry players



Most BNPL players are essentially tech platforms who provide BNPL line of credit or EMI loans through partnerships with banks and NBFCs. Several BNPL players are gradually acquiring an NBFC license through a subsidiary in order to take direct credit exposure (ZestMoney - Nahar Credits, Slice -

Quadrillion Finance etc.) - this is also reflective of multiple models searching for regulatory compliance. While they absorb the “convenience” side of the exposure on their own balance sheet (working capital financing), most of the EMI loan financing is through partnerships with banks and NBFCs (Source: HDFC research)

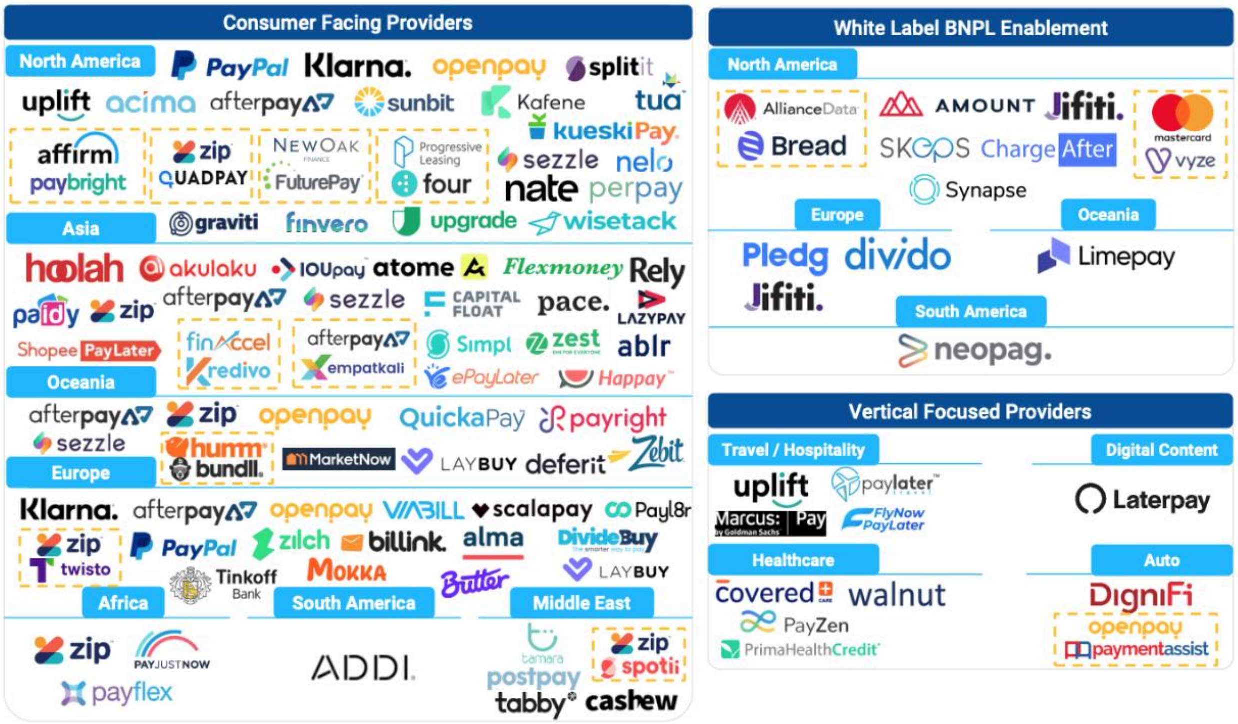
The diverse BNPL models bring about multiple sources of revenue, from customer as well as merchant side. The various revenue streams could be categorized under: (a) subscription-based fees (zero for most BNPL players), (b) spends-based fees (MDR, merchant subvention etc.), (c) instance-based fees (late fees, processing charges for EMI loans etc.) and (d) interest income on non-zero-cost-EMI product

Being a checkout financing option, BNPL players provide a short-term (15d to 30d) interest-free period to customers for their purchases. However, they also provide higher-tenure credit over 3-12 months (as high as 24 months as well) at zero interest cost (in case of merchant subvention) or at an average APR of ~24%. The higher-tenure credit is typically available for large-ticket size purchases such as smartphones, white goods etc. (typically above INR 5K). Interest income typically acts as a booster to the revenue and overall profitability of the BNPL model. As the customer profile matures, interest income should gradually start kicking in for the BNPL players to drive overall profitability. The interest rates on EMI loans offered by the BNPL players are typically than that of credit card and debit card EMI due to higher risk profile of the customer, higher cost of capital etc. (Source: HDFC research)

Merchant discount rate (MDR) charged by BNPL players to the merchants remains in the range of ~1.5-2%, as credit cards MDR is often taken as the benchmark. Merchant subvention remains limited to high-margin products for relatively higher tenure products (more than 3 months). Moreover, the high cost of capital for the BNPL players (~10% - 20%) further makes the unit economics unviable for Convenience models (pay-later and pay-in-3).

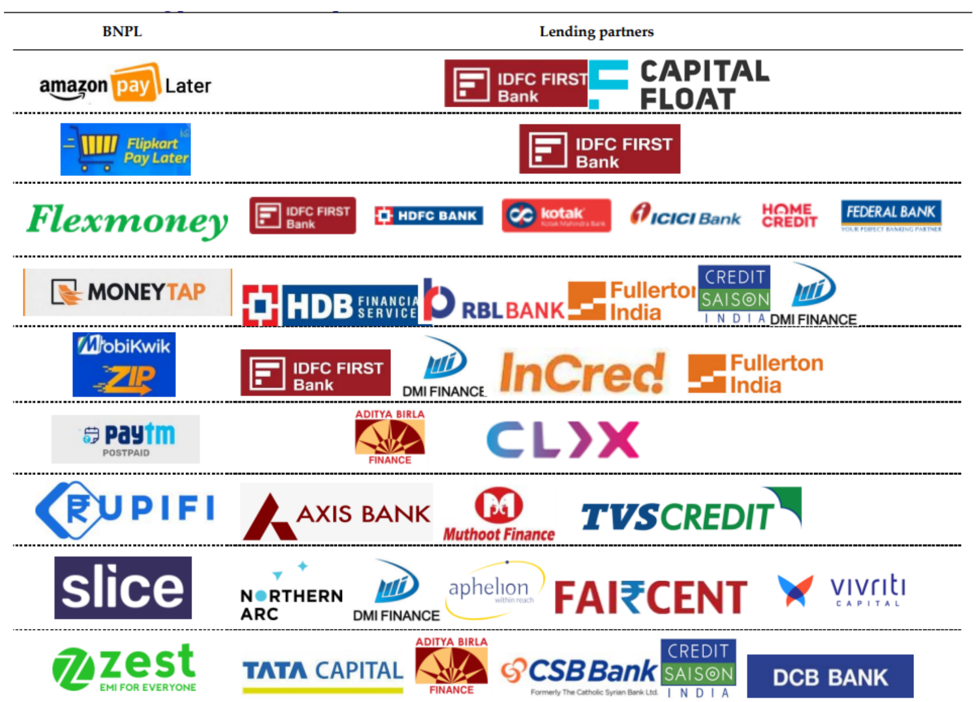
Most of the BNPL players are yet to achieve critical mass in terms of number of users and per user spends, to drive profitability. The limited revenue streams from customers and higher credit costs seem to be the key impediments even as a few players are breaking even at contribution margin.

Key BNPL Players worldwide



(image credit: FinTech news, Singapore 2021)

Key BNPL players in India



(image credit: HDFC research

The Boom of BNPL Model

The BNPL industry grew at 569% in 2020 and 637% in 2021 (Source: FinShots, June 2022)

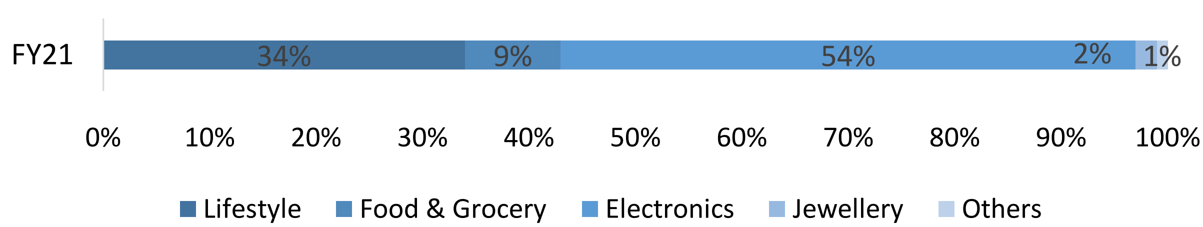
Research by PYMNTS suggest that BNPL usage virtually doubled during the holiday season from 2020-2021. 15% adults worldwide have already made use of BNPL service. Consumer debt jumped USD 52 billion in March 2022, the largest increase on record. In California, USA, 91% of consumer loans made in 2020 were BNPL loans. Further, BNPL accounted to USD 100 billion in retail purchases in 2021 worldwide. Up from USD 24 billion in 2020 as reported in Fintech times

Easy financing, rebates on online purchases and a lot of marketing initiatives fueled the popularity of BNPL model in India with approx. 2 million of such BNPL cards from fin-tech companies been issued compared with 1.5 million cards issued by banks (Source: Finshots, June 2022) Cumulative no. of BNPL accounts in India are already at ~50% of no. of credit cards outstanding. Further, ~45% of personal loans disbursed in FY21 were done through fin-techs (HDFC research)

Merchants loved BNPL because it increased the basket size by as much as 3.5 times (Source: Intelligencer 2022). The BNPL model was focused to allow users shop without second thoughts. It offered, for a limited time period, zero-interest consumer credit schemes as a competition to credit cards and zero-cost EMIs offered by banks on credit cards or by Bajaj Finance at the checkout counters of offline retail stores in India. BNPL services in India rose to 21% in 2021 to outperform global growth (Experian report, 2021)

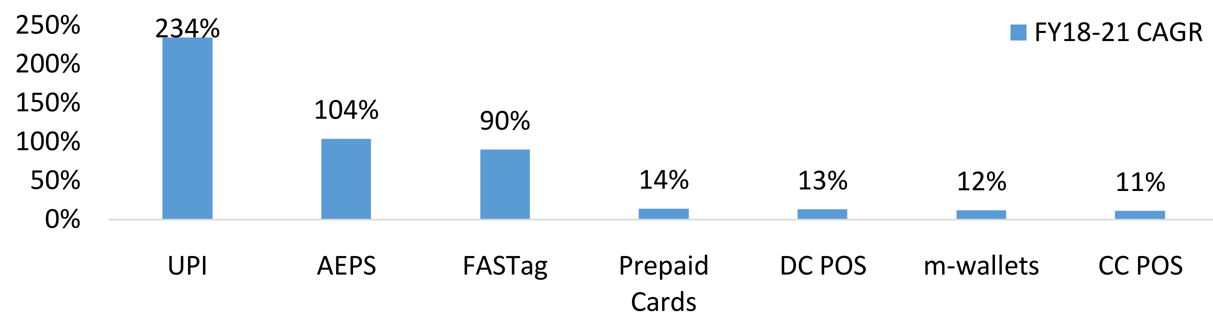
In the Indian market, the customer acquisition cost, spends per customer and average ticket size of loans is less for the BNPL model vs. credit cards. Hence, credit cards typically have been associated with higher ticket size but lower frequency purchases like electronics, shopping etc. BNPL on the other hand has grown from the convenience of the 1-click checkout — users using it for cab bookings, food delivery and other frequent purchases. Sometimes multiple times a day. (Source: Growthbug, Sept, 2021)

India's e-retail market – higher share of lifestyle, food and grocery – FY21

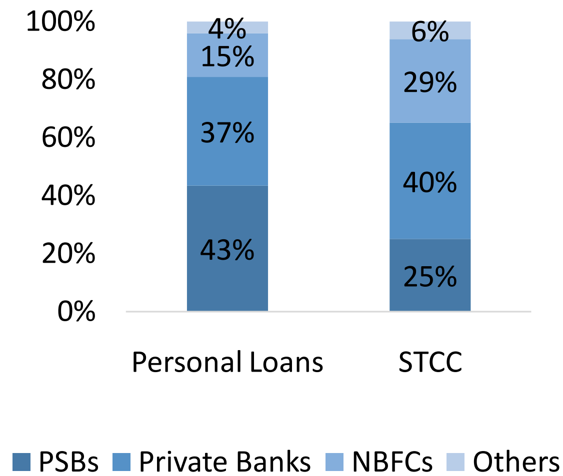


HDFC bank and SBI dominate the credit card industry in India with a combined market share of over 40% (Source: RBI, June 2022)

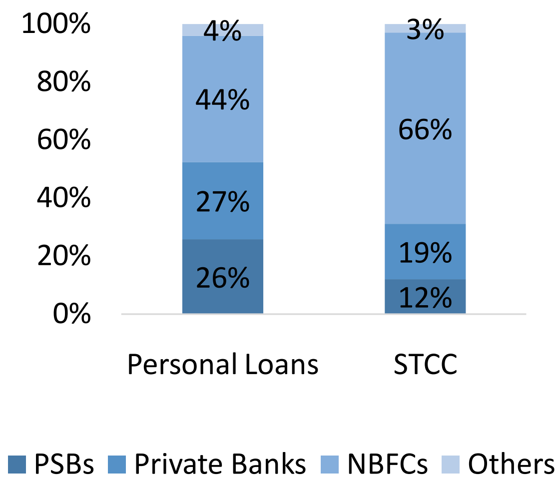
% CAGR across payment modes: FY18-FY21



Value wise market share of personal loans and Short Term Cash Credit (STCC) FY21



Volume wise market share of personal loans and Short term Cash Credit (STCC) FY21



private banks with large carded base offer BNPL exclusively to ETB customers to raise engagement, cross-sell and maintain profitability; on the other hand, those with a limited carded base have adopted the partnership route with FinTech BNPLs to tap into new-to-franchise customers

Investments in BNPL players in India

- Investments in 20 deals of over USD 100 million in BNPL firms in India were noted from 2018-2021
- CapitalFloat raised USD 50 million from Lightrock India, Sequoia Capital and others partnering its BNPL business with Amazon, MakeMyTrip and Unacademy.
- BNPL startup ZestMoney raised USD 50 million in a strategic investment from Australian BNPL company Zip

Following the BNPL saga, major fin-tech players in India like BharatPe launched a BNPL called PostPe for consumers transacting on BharatPe QR codes. Paytm started offering users of its digital wallet a postpaid product for BNPL purchases. Several consumer – facing platforms like Ola have also started their own pay-later options like Ola Money Postpaid.

Globally, Apple had announced that it would offer its own BNPL called Apple Pay Later through its subsidiary company. It is set to become the largest bank in the world with 1.8 billion active devises/ potential customers. Apple Pay Later will be an option for shoppers to repay what was spent via Apple Pay in 4 equal installments spread over 6 weeks. They intend to use FICO scores and credit score to assess the customers and also rely on their giant Apple ID data for identity verification and fraud prevention. It also intends to reduce the risk by limiting the amount of loan to USD 1000 per person and lowering it depending on individual score. It intends to set up an automatic opt-in for installment payments by requiring the users to link the BNPL service to their debit cards. While Apple is taking on the burden of credit decisions itself, it is still relying on partnerships for some of the aspects of making a successful BNPL program. Goldman Sachs, which issues the Apple card, is also serving as the loan issuer and official BIN sponsor," reports CNBC. For the interaction with vendors, it relies on Mastercard's white label BNPL product called Mastercard Installments.

BharatPe has seven million merchants using its payment QR codes, while pioneer Bajaj Finance has more than 98,000 merchants and almost 50 million consumers

The Mighty Fall

The BNPL players boomed during 2019-2021 when interest rates in most developed countries were low and cheap capital was easy and cheap to raise (less borrowing cost in the past than present times). During the pandemic, government stimulus boosted the low cost capital availability to such BNPL players. Despite this, none of the BNPL business players were making profits during that time period.

In the UK, 1 in 10 BNPL users have debt collectors on their back. (Spora banking insights, 2021). Further, 4 out of 5 BNPL customers said they use the service to avoid credit card debt and now nearly one third of them can't afford BNPL debt (Source: Intelligencer, 2022)

Globally, many fin-techs offering the BNPL service were able to stay afloat due to their partnership with larger entities who bore most of their cost. Like some examples given below (Source: Bloomberg, June 2022)

- Australia based Afterpay, underwent a USD 39 billion merger with US –based Block Inc. founded by Twitter founder, Jack Dorsey.
- Australia based Latitude Group merged with Humm, for USD 35 million cash and 150 million Latitude shares worth USD 335 million in 2021
- USA based Sezzle merged with Australia based Zip in 2021

Earlier in India, people would take loans for major expenditure in the form of a more formal transaction like buying a home. With the advent of BNPL schemes, loans are incorporated into daily purchases of people like a restaurant bill payment. It is important to note that most people still prefer to opt for BNPL plans from the banks that they already entrust with their money than new age fin-tech startups providing the same facility (PYMNTS report)

BNPL companies derive their revenue by taking ~5% of their total transaction value (TTV) and then collecting late payment fees. They pay for their user's goods and services using debt – on which they pay interest – and take the full risk associated with non-payment. Hence the viability of the model rests on low interest rates on debt they take to provide such a service and low default rates of their users

BNPL business model soared because it also issued credit lines to students, freelancers and other people who were considered high risk by stringent credit score evaluators. It worked on a basic model of giving short term loans

This model allowed new age fin-tech startups to bring more customers for their partner retailers (retailers got access to a large target market) and hence these retailers offered a discount to these BNPL companies allowing them to cover their costs and even make profits

Fin-tech startups like Slice, Uni, LazyPay, PostPe and others used credit lines provided by NBFCs and bank-issued PPIs with the fundamental concept that consumers would apply for an instant loan, pay it back over 20 to 40 days and if they are unable to do so after the credit period then apply for a second loan in such a case they borrow at a much higher interest rate

BNPL services were not advertised as a loan or credit but as a payment option however having the same repercussions as loans when it comes to lack of payments. when someone uses multiple credit lines within a short duration, the credit bureaus treat it as a sign of risk (risk with respect to a person taking a loan, on a loan, on a loan). It encouraged people to make unnecessary and larger purchases than what they can actually afford. Many borrowers quickly piled up a lot of debt while paying interest rates as high at 36% per annum and have in turn damaged their credit score. Around 40% of them default. (Source: RBI data)

For every user that defaults, a BNPL business loses more than 20x the revenue they've made from that user's sale, plus their cost of debt covering that sale, plus their SG&A expenses which is a significant amount and the cost of recovery of bad debts is also huge (Bloomberg data, June 2022)

BNPL cards boomed when they were able to convince merchants that their usage will increase the average order value. A higher average order to one merchant ideally meant that the same customer will spend less in subsequent transactions since they will eventually pay back the debt. Hence BNPL were able increased consumer spending and include consumers which were ideally ignored by strict credit vetting norms by credit card providers

According to a report by Kotak Institutional Equities based on data from Trasunion Cibil, the share of new-to-credit customers is low in the BNPL segment. The proportion of consumers having other loans stood at 75% for both BNPL and non-BNPL originations. Similarly, the share of consumers who already have atleast one live credit card account stands at 35% for BNPL originations and 25% for non-BNPL originations. This data shows that BNPL lenders seem to be less focused on driving financial inclusion than what they boasted earlier. Consumers who held a BNPL account showed a higher delinquency performance on their credit card and personal loan accounts than consumers who did not (Fintech Association for Consumer Empowerment data, June 2022)

Fin-tech companies with their NBFC licenses started issuing credit lines to people with poor or no credit history to support the BNPL business model. However, BNPL has over 10% NPAs which increases the systematic risk across the banking sector

Customers spend impulsively and take on more debt than their repayment capacity and in the end get subjected to aggressive debt collection practices.

Cost of living pressures under inflationary markets have reduced spontaneous purchases among consumers, hence reducing the popularity of BNPL cards

BNPL players typically do not charge the consumer, but make money from the merchant or the brand. Large retail brands have historically offered commission ranging from 4%-12% to check out EMI players depending on the product, whereas small retailers find offering even 2% margin difficult. Hence BNPL players concentrated on the top 10,000 merchants in India and only a selected few online stores Merchants were paying a high fee to attract traffic via BNPL players and these BNPL players had underpriced their unsecured lending

BNPL works best on high –margin discretionary products. Eg. Affirm grew its business by offering easy pay later options on expensive fitness products. In India, discretionary spending is restricted to smartphones and fashion. The smartphone market, for both online and large retailers, is dominated by banks and Bajaj Finance. Smaller retailers typically sell medium- or lower-priced smartphones and are not always keen on giving extra commissions to these platforms. (Captable research, June 2022)

The most prominent BNPL players worldwide are Swedish fin-tech Klarna and US – based Sezzle and Affirm.

1) Swedish giant Klarna

   Klarna Valuation in June 2021: USD 45.6 billion

   Klarna Valuation in July 2022: USD 6.7 billion

   A 87% price cut

   Klarna booked more than USD 700 million in losses in 2021 and 65% of it was from credit defaults.

2) Zip, the 2nd largest Australian BNPL service provider saw its market value drop from almost USD 9 billion to only USD 350 million. They had acquired USA based Sezzle for USD 355 million and both have piled up huge losses. Sezzle share prices fell 96% from a high of USD 9.20 to just US 40 cents.
3) Affirm, a major publically listed BNPL service provider saw its market value drop from USD 47 billion to USD 5.7 billion in less than 1 yr. It has consistently reported operating losses and its stock is currently trading at 50% below its listing price. Its exclusive partnership with Amazon also failed to impress customers. It booked almost USD 700 million in losses while their marketing expenses tripled to USD 427 million in 2021
4) Afterpay and Humm offering BNPL services in Australia are also facing huge financial lossesAfterpay has more than USD 246 million in cumulative losses and has negative USD 655 million in reserves

In India, RBI had allowed only banks to issue credit cards. The new age fin-tech startups flourished by optimizing PPIs – Prepaid Payment Instruments. A digital wallet is created by these fin-tech startups which can be recharged using a bank account, debit or credit card. When fin-tech startups partner with entities with PPI licenses, they can offer an imitation of credit card (BNPL card) with an added credit line feature and zero cost installment payment option. Such credit lines are ideally not provided by banks but by NBFCs (banks usually stay away from underlying such high risk category loans) (Card is issued in association with a bank but credit underwriting is done in collaboration with NBFCs)

As a risk reduction process, RBI ordered fin-tech businesses using non-bank prepaid payment instruments (PPIs) to stop extending credit lines.RBI imposed ban as on June 20, 2022

According to the new guidelines issued by RBI, Prepaid cards and mobile wallets cannot be used for micro lending. Hence if credit lines are underwritten by banks then there is no issue. However, if it is underwritten by NBFCs then they will not be able to offer credit to consumers

RBI bars NBFCs from loading credit directly into PPI wallets since its purpose is of a payment instrument and not a credit instrument

PPI instruments were only given the right to allow users to loan money in it and only use that

This halt in operations is set to affect 8-10 million users of the BNPL model. In such a halted case, repayment of loans will be affected and will pose a systematic risk to the Fin-tech firms and the NBFCs who have backed such loans

BNPL model is congratulated for bringing on new customers into the formal credit ecosystem making it cheaper for them to borrow

The ban threatens the effort of BNPL model of financial inclusion of customers previously ignored by traditional banks due to stringent credit quality checks if partnering with banks is the only option left for Fin-techs providing BNPL facility to survive.

India currently has around 22-25 million BNPL users, according to Benori Knowledge, a global provider of custom research and analytics solutions. As per reports, RBI's move may affect 8-10 million or about 40 percent of total users.

"If the intention is to stop PPI loading, what you are saying is non-banking financial companies (NBFCs) can't load loans directly to merchant's account. If NBFCs cannot lend merchants, all the BNPL innovation that has been happening in the country goes down the drain. This gives out a message that the RBI is supporting the banks over fin-techs. The BNPL sector has 8-10 million customers. And if the regulator wants to hand over these customers to banks, there will be no investor to invest in the Indian Fin-tech sector," said a payment Industry official from the Digital Lenders Association of India, in an interview with Business Standard, June 2022. The BNPL fin-tech players seek to get more clarity from RBI about the imposition

Future prospects of BNPL model in India

As online platforms become more accessible, convenient and inclusive, consumer's expectations for superior digital experiences, friction-free and secure digital experience will earn consumer trust and loyalty.

According to a survey conducted by Delloite UK (published in June 2022), 42% of consumers surveyed said that they fear transacting online and approx. 60% of consumers have faced issues or has had some unpleasant experience while transacting online and hence it is believed that the fin-techs that will deliver the most secure and seamless experience to customers will survive in the long run, irrespective of the payment or credit instrument they offer. They may provide credit lines, bullet loans, equated daily installments, or any other form of credit but only those companies will survive in the long run who try to simplify and secure consumer experience.

Now fin-techs are exploring new ways to use BNPL like a credit card like issuing an add-on debit card with their savings account (already PSUs and Private Banks are providing that facility and hence no significant value addition) or issue a co-branded credit card with a bank (mere marketing and distribution activity for such fin-techs with banks running the major business and since in such a case fin-techs wont have access to consumer data they wont be able to build new credit models. Hence the service of BNPL players in such a case is low value addition in nature) or Put money directly into customer’s bank account (NBFCs have more reach and are currently efficiently doing it, hence BNPL having less value addition service in such a case)

Online brands with co-branded credit cards like Amazon-ICICI, Flipkart- Axis, Zomato-RBL will sail through the crisis since they have access to alternate data in terms of users past purchase behaviors and that may help them extend and expand new credit models

Partnering with banks will help Fin-techs stay afloat.