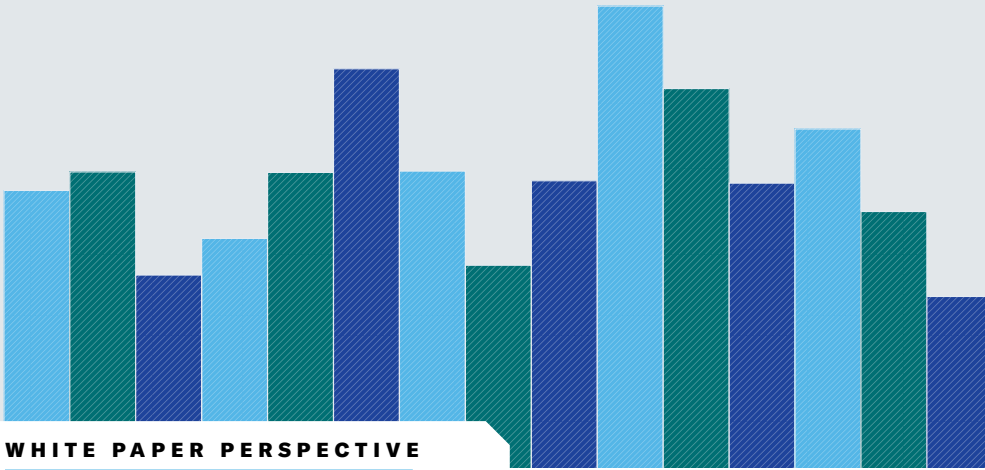




**Harvard
Business
Review**

ANALYTIC SERVICES



Transforming the Payment Experience through Innovative Buy Now, Pay Later Options



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It's no secret the commerce landscape is going through a rapid evolution. Just a couple of years ago, the commerce discussion focused on omnichannel and bringing together online and in-store functions for a singular back-office experience. Now, a global pandemic has shifted the industry's omnichannel perspective away from business-centric functionality toward a consumer experience focus that drives sales and loyalty.

It has never been clearer that consumers are looking for a seamless in-person and online shopping experience. Buy now, pay later is a clear example of this omnichannel perspective shift that has seen rapid growth in popularity because of the pandemic. Consumers not only expect but also demand payment options that offer choice and flexibility at checkout, as they have become savvier when it comes to personal budgeting and financial management.

Buy now, pay later has taken off around the globe, expanding into new retail verticals, geographies, and consumer segments along the way. This acceleration has required payment providers to develop distinctive offerings that are aligned with local customs and different generational perspectives. Of course, no two customers are the same—and no two countries are the same. Culturally relevant repayment schedules and different average purchase amounts can help increase sales for any business—especially those selling across borders.


This new research from Harvard Business Review Analytic Services, sponsored by PayPal, highlights that offering buy now, pay later is no longer just an option but also important for businesses that want to acquire and retain customers while increasing sales and loyalty. Understanding the value this flexible payment method offers both your business and your consumers is just the first step. Diving deeper into the consumer's shopping psyche and decision making unlocks why buy now, pay later has such a promising future and has become a necessary payment option to offer at checkout.

This report goes beyond examining the market size and hype around buy now, pay later—sharing deeper information about customer behavior, individual country usage, and what the future may hold for the industry at large. I encourage readers to use this report as a practical guide to understand not just the buy now, pay later market or how to get started but also the value it can truly bring to your business.



Greg Lisiewski
Vice President,
Shopping and Pay Later
PayPal

Transforming the Payment Experience through Innovative Buy Now, Pay Later Options



The idea of offering users the option to pay over time has been around for decades—even before it was popularized by the go-getting businesses of the early twentieth century that advertised “low monthly payments” for automobiles and washing machines. But recently, the concept of buy now, pay later (BNPL) has received a fintech makeover, transforming both the experience and the value proposition for consumers, businesses, and payment providers.

“Buy now, pay later has been the most defining consumer payments innovation of the last couple of years,” says Charlotte Principato, financial services analyst at the Morning Consult, a Washington, D.C.-based market intelligence firm. “The industry has done a good job of putting it right where consumers are, at the point of sale.”

Digital wallets, virtual credit cards, and new financing options are driving a major shift in retail payment choices. Consumers now expect multiple payment options across channels. With BNPL, however, consumers have a digital option that can be used not only to finance purchases but to also improve personal budgeting and planning. A quantitative online survey conducted in April 2021 by TRC Market Research that was sponsored by PayPal finds that 76% of BNPL users in the United States say the feature helps them budget, and 69% of users in the U.K. and France say the same. TRC, a market research consulting company, surveyed a total of 5,000 consumers aged 18 or older—1,000 consumers in each of five countries where BNPL is available, including the United States, the United Kingdom, Australia, France, and Germany.

HIGHLIGHTS

Buy now, pay later (BNPL) innovators are **looking beyond creating a better payment experience**. They are using their platforms to **truly engage with their users**—both customers and businesses—and offer undeniable value.

As BNPL becomes part of every business's offering, **building and maintaining relationships with users** will emerge as differentiating factors for payment providers vying to be a **part of every consumer's wallet** and shopping experience.

The end game is **deepening the relationship with consumers**, not simply offering another payment option.



“Buy now, pay later has been the most defining consumer payments innovation of the last couple of years. The industry has done a good job of putting it right where consumers are, at the point of sale,” says Charlotte Principato, financial services analyst at the Morning Consult.

Many businesses have already seen that giving shoppers the ability to break up purchases into smaller payments over time means that they are more likely to hit the buy button. Roughly seven out of 10 respondents in France say they are more likely to complete a purchase if BNPL is offered, and a similar number say they are more likely to purchase better products, according to the study.

“Payment options are no longer just about convenience,” says Ron Shevlin, managing director of fintech research at Scottsdale, Ariz.-based Cornerstone Advisors, a financial service consultancy. “The payment experience has become a new retail weapon on par with product, place, price, and promotion as an influencer of what consumers buy, where they buy, and who they buy it from.”

The TRC study confirms that the ability to pay over time impacts what, when, and how purchases are made. The majority of shoppers surveyed in the United States, the United Kingdom, France, Germany, and Australia—all countries where BNPL is available—say that they decide how they are going to pay for a purchase *before* they check out. And when BNPL is offered earlier in the shopping journey, it can help influence a consumer’s decision to buy. “We’re seeing buy now, pay later adoption around the world really taking off in developed markets like the United Kingdom, the United States, France, and Germany,” says Jeff Tijssen, London-based partner and global lead of Bain & Co.’s fintech business.

As BNPL becomes part of every business’s offering, building and maintaining relationships with users will emerge as differentiating factors for payment providers vying to be a part of every consumer’s wallet and shopping experience.

This report explores how BNPL providers have innovated payment options and how their inventiveness is benefiting businesses and consumers. It also highlights the changing

demographic of BNPL users, how they use BNPL, and what they value in BNPL options.

Taking the Pain Out of Payments

The key change that has transformed BNPL since the days of “low monthly payments” is the ease of obtaining short-term credit while making a purchase digitally. Creating a seamless process is particularly important in a business such as payments. Most industries want to be more and more present in people’s lives. “Payments is one of the few [areas] where the end state is set to become increasingly invisible from a user perspective, because people like to buy things, but they don’t like to spend time paying for them,” says Marie-Claude Nadeau, San Francisco-based senior partner and colead of payments practice at McKinsey & Co., the global consulting firm. “There are a lot of consumer trends around payments becoming so seamless they effectively disappear from sight. Think of how you use a ride service today. When you come out of the car, the payment happens in the background. You may not even notice. That’s the endpoint: where the payment is truly seamless.”

Of course, BNPL requires users to commit to repayments—as do rideshare and other applications where money changes hands virtually—but providers seek to make the application process as painless as possible. Payment integration technology has been a major factor in this seamless process for consumers—and for businesses and restaurants that can turn to specialized solutions to make a lot of the work associated with making payments disappear. At the same time, payment providers need to ensure that they are always available—especially as they are embedded in apps that become more integrated in everyday life.

“In recent years, we’ve gone from analog to digital, and that next shift that we’re seeing now is from digital to embedded,” explains Bain’s Tijssen. “There are plenty of benefits from a consumer perspective with new forms of embedded payments. But another segment that really benefits from this shift is the merchant. There’s still so much opportunity because there is still so much inefficiency in this space.”

Different BNPL providers make their money in different ways. Some charge businesses a fee, similar to the processing fees sellers pay on credit and debit purchases; transactions are nearly as effortless as using a card. Providers sometimes run a credit check or utilize proprietary algorithms to assess credit risk. Based on user data and type of purchase, buyers sometimes can receive approval on the spot without a hard credit check. Some BNPL providers are introducing rewards and channeling retailer discounts to their users similar to those of credit-card issuers.

One of the focuses of consumer finance regulators is that consumers understand that BNPL involves credit,

and providers are increasingly clarifying this in their application process.

BNPL providers have done a good job of creating an emotional affinity with their users, says Joanna Bakas, managing partner at the Berlin office of Frontira Strategic Design, a Europe-focused digital design firm. “They have created really nice platforms,” she says. “The apps are very intuitive. And the way that they communicate with you is very eye level, not like banks talking down at you.”

Shelley E. Kohan, retail expert and professor at the Martin J. Whitman School of Management at Syracuse University, points out that the providers also do a good job of staying connected to their users. “One thing that buy now, pay later companies have done really well is they’ve created a community of users. They share experiences, they provide feedback, they feel connected to the platform and to other users.”

Bigger Baskets, More Customers for Businesses

Businesses can’t afford to ignore the potential of BNPL. The vast majority of shoppers who use BNPL say they are more likely to spend more or to buy a better product if BNPL is an option, according to the TRC survey. For example, the survey finds that 77% of U.S. respondents say they see BNPL as a way to spread costs and buy a better product, and 76% of respondents in Australia say the same. **FIGURE 1** A majority, including 61% in France, also say they are more likely to shop at a business again if BNPL is offered.

The main drawback for businesses that offer BNPL options from some providers are the fees, which tend to be higher than what they would pay for credit or debit card transactions. But the tradeoff for those fees usually outweighs the cost, with higher transaction values and more completed purchases. “If your customer is happy and they’re purchasing more and becoming more loyal, that offsets some of that fee structure,” says Syracuse University’s Kohan. And as BNPL becomes more mainstream, some providers are offering more competitive terms to businesses, such as including BNPL in existing payment-processing contracts.

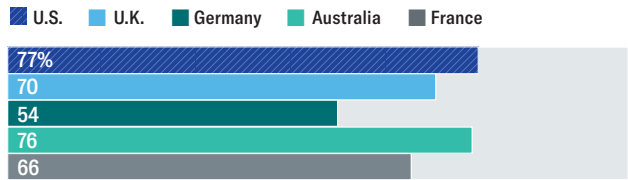
BNPL providers also give businesses tools to integrate pay later options into their own apps as well as tools to promote their own goods, “like marketing toolkits,” says Frontira’s Bakas. Once a business becomes a BNPL partner, they have access to that provider’s network, which is usually much bigger than its existing customer base. “The number of people that you’re able to promote and eventually distribute your product to is a huge target group that you’re suddenly getting access to. This is one of the key benefits as these platforms grow, because they are a huge lead generation audience that you can tap into,” says Bakas.

FIGURE 1

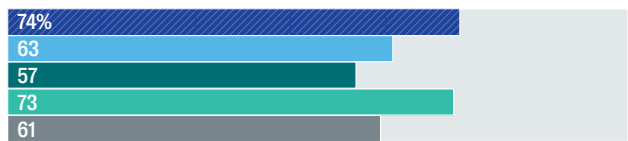
Buy Now, Pay Later Users Buy Better

Offering preferred payment options can drive trust and loyalty

Perceptions of buy now, pay later [STRONGLY AGREE/AGREE AMONG BNPL USERS]:



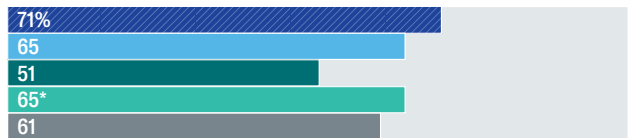
Spread cost/purchase better product



More likely to purchase more at a retailer offering their preferred payment method



Millennial/Gen Z consumers more likely to trust merchant if they offer preferred payment method



More likely to purchase more at a retailer offering their preferred payment method

*In the U.K., respondents were asked if they would be more likely to purchase more per online visit at a retailer if their preferred payment method is offered.

Source: TRC Market Research, April 2021

Bain’s research finds that 38% of merchants noted improved customer loyalty and increased customer satisfaction after introducing BNPL.¹ “The merchants we have spoken with highlight the benefits beyond improving conversion,” says Tijssen. “Average order value tends to be higher if you offer buy now, pay later as a form of payment.” For example, according to the Bain report, 54% of merchants say that once they started to offer buy now, pay later, co-marketing exposed their brand to new customers that had never bought anything from them before.

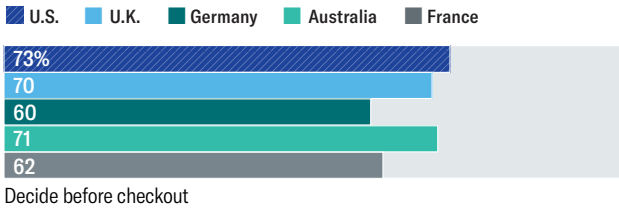
Consumers often decide how they will pay before they get to checkout, according to the TRC survey, including 70% in the U.K., 71% in Australia, and 62% in France. **FIGURE 2**

FIGURE 2

Payment Options Factor in Early

Most consumers decide how they will pay before getting to checkout

At what stage during the online shopping experience do you decide which payment method you are going to use?



Source: TRC Market Research, April 2021

“Merchants are embedding buy now, pay later offers directly into their product pages, not just waiting for somebody to go to checkout,” says Cornerstone’s Shevlin. For example, the price of an item will be listed two ways: the total price and the installment payment amount with a BNPL plan. “This is how BNPL is influencing people’s decision on what to buy and where to buy it,” he points out.

Businesses are turning to buy now, pay later providers to better understand their customers and their market. “If you’re the buy now, pay later provider to a lot of consumers, you can start to help merchants understand a lot about their customers,” Shevlin continues. “They are becoming more of an information provider to the merchants, and that is a major part of the value proposition.”

Customer Value Proposition: More Time to Pay

BNPL is forecast to grow at an annual rate of more than 26% globally between 2022 and 2030, according to Grand View Research,² and there’s a simple reason for that: it gives users the means to acquire something immediately and pay over time, usually at no cost, and with minimum effort. “We would not see millions of customers around the world using forms of buy now, pay later to pay for goods and services if they were perfectly satisfied with the products that they were using from their banks and the credit card companies,” says Tijssen.

For individuals, BNPL offers a few basic advantages over other payment options. BNPL is generally without cost to the borrower for short repayment periods—as long as payments are made on time. If payments aren’t made on time, the borrower can be issued a penalty. The ability to pay over time is a major draw for consumers. In the United States, 74% of BNPL users say that a pay-over-time message encouraged them to

make a purchase, and 66% abandoned a purchase due to not seeing an option to pay over time. “There’s a whole segment of the population who benefits from paying for items over a longer period of time,” says McKinsey’s Nadeau.

Some people choose BNPL even if they could afford to pay upfront with cash or a card, says Shevlin. “These are people who don’t really need to do buy now, pay later, but they’re doing it for budgeting purposes,” he says. “But there are also people who may be at the lower end on the income scale who are doing it to manage cash flow.”

In the TRC survey, BNPL users in five countries said they choose to pay over time because it helps them budget—particularly in the U.S., the U.K., and Australia, where roughly seven out of 10 respondents called out the budgeting advantages of BNPL. **FIGURE 3** A similar number also said BNPL helps them manage cash flow.

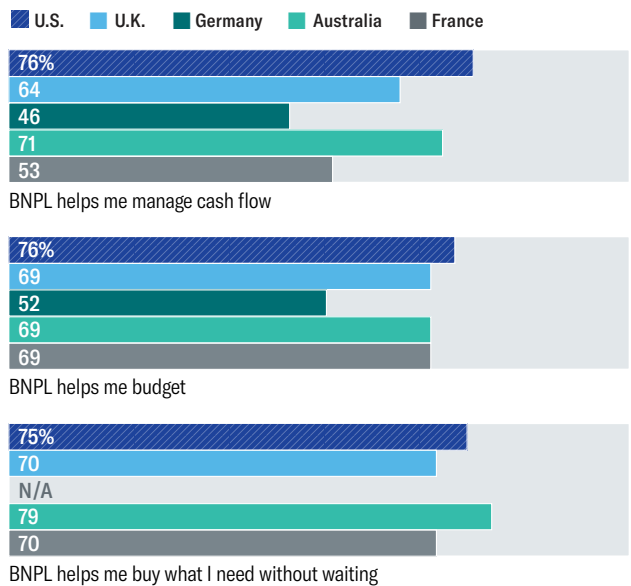
In her consumer research, Principato sees a real need for many Americans to better manage cash flow. She points to the mismatch between the timing of paychecks—usually every other week or twice a month in the U.S.—and the timing of expenses. Add to that the nearly 40% of Americans who are impacted by income volatility,³ “and it makes it a lot harder

FIGURE 3

Eliminating the Wait Helps Sway Buyers

BNPL users attracted by ability to budget and manage cash flow

Perceptions of buy now, pay later [STRONGLY AGREE/AGREE AMONG BNPL USERS]:



Source: TRC Market Research, April 2021

Some people choose BNPL even if they could afford to pay upfront with cash or a card. “These are people who don’t really need to do buy now, pay later, but they’re doing it for budgeting purposes. But there are also people who may be at the lower end on the income scale who are doing it to manage cash flow.”

**Ron Shevlin, managing
director of fintech research
at Cornerstone Advisors**



“My data indicates that people who use buy now, pay later care about budgeting more than the average consumer. ... I believe BNPL is a considered decision on their part,” says Principato.

for folks that have to budget when your expenses are fixed and charged monthly but your income isn’t coming in the same every month, even if you have a steady job.”

She says that BNPL doesn’t promote impulse buying. “There is a belief that buy now, pay later enables people to buy things on impulse that they can’t afford. But the data doesn’t agree,” says Principato. “My data indicates that people who use buy now, pay later care about budgeting more than the average consumer. They care about smoothing their finances more than the average consumer. I believe BNPL is a considered decision on their part.”

In a March 2022 consumer survey by Morning Consult, 75% of Americans responding said evening out spending month to month is a goal, compared with 85% of BNPL users responding. “This is something that matters to a lot of people that buy now, pay later can directly impact. The ability to develop and maintain a budget is a goal for so many Americans, as well—80% of the U.S. consumers we surveyed—and buy now, pay later can have direct impacts on your ability to budget, as well,” she says. Her research shows that buy now, pay later users are showing more progress in smoothing their finances relative to the average American adult.

The Changing Demographics of Buy Now, Pay Later Users

The modern take on BNPL grew out of the same forces driving shopping habits that are increasingly digital or omnichannel—channels that tend to appeal to young customers. In Germany, Bakas credits the appeal of BNPL platforms to digital natives. “They look for options that have a better digital experience and the added value that you get around platforms that are popular in Europe,” she says.

That digital preference may be one reason for BNPL’s early success. Now that a pay-over-time option is becoming more ubiquitous across e-commerce platforms and for some in-person payments, the service is proving popular with Millennials. The TRC survey finds that 25-to-34-year-olds are the primary BNPL users. More than a third of users in the U.K., Germany, and France are 25 to 34 years old. **FIGURE 4** In Australia, 42% are in this age group; and in the U.S., the figure is 49%.

“It’s really become much more of a mass-market product,” says Tijssen about buy now, pay later—particularly in Europe,

the United States, and Australia. Bain’s research further challenges some of the stereotypes about who is taking advantage of pay-over-time options. “We see significant usage for the older generation, and not only those with low income or people with poor credit. We actually see very strong usage amongst people with a high income and who have really strong credit profiles.”

In the U.K., for example, 68% of buy now, pay later users have a credit card, the Bain research shows.⁴ In the U.S., 88% have a credit card. “That tells us that buy now, pay later is an active choice. It’s not necessarily driven by an inability to access traditional forms of lending,” he points out.

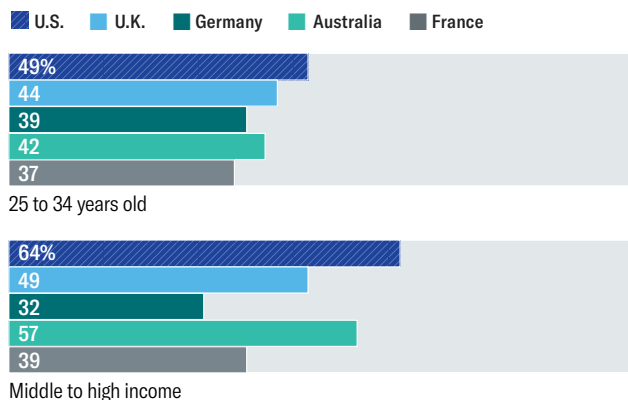
The TRC survey confirms that typical BNPL users in most countries tend to have middle to high incomes and are less likely to be savers compared to the general population, but that doesn’t mean they are not cautious about debt. BNPL may have a further appeal to anyone who suffered through credit problems during the Great Recession—or watched their parents struggle with debts they couldn’t repay.

One area where BNPL providers are differentiating their services is the transparency in their lending practices and what happens when users miss a payment. Bakas says, “There’s a lot of news lately regarding buy now, pay later platforms driving

FIGURE 4

Young Millennials Are Prevalent Users of BNPL

Many BNPL users also have higher income



Source: TRC Market Research, April 2021

people into debt. They advertise 0% interest, but then people get hit with late fees—a lot of people. Until recently, those fees have been hidden in the fine print.”

Regulators have also taken notice, particularly in the U.K. “The U.K. is making really big moves about regulating a couple of areas, including communication and advertising standards, transparency about fees, and clarity about the language that’s used, making it really clear that this is actually a debt,” she says.

In Sweden, debit options have to be presented before all credit options on e-commerce platforms, effectively pushing BNPL to the bottom of the screen, Bakas explains. There is also some pushback on social media, with young women posting videos about how much debt they are in.

As BNPL becomes more competitive and more regulated, the best providers will be those that improve transparency and help users build the concept of financial management into their daily lives.

Becoming Omnichannel

BNPL providers want to remain a preferred option in every consumer’s wallet, so some providers are even issuing physical cards. Still, most BNPL omnichannel innovations are virtual. Providers are adapting their apps to work at physical checkout counters, embedding their brands in point-of-sale (POS) terminals, or generating virtual credit cards.

With every new option there is one overriding consideration: to make transactions as seamless as using a credit or debit card. “It can’t become a pain point for the customer,” says Kohan. “The best way to accomplish that is for the buy now, pay later companies to have it as part of the app that customers are using anyway. The technology integration is a lot easier when it lives inside the app of the buy now, pay later provider, as opposed to trying to get it integrated into the POS system of a major retailer.”

In Germany, BNPL providers have signed contracts with payment terminal companies, giving them access to hundreds of thousands of individual shops that now have their brand displayed as an option at checkout, explains Bakas. “That has helped make BNPL so popular in such a short amount of time because it was possible to tap into other company’s networks to facilitate growth,” she says.

In Australia, where most people already use virtual wallets for many purchases, BNPL providers have to make it as easy as possible to stay relevant. “You’re competing with a tap-and-go scenario, so it cannot be more than one or two quick steps to do it. And they were clever enough to come up with a way to do it almost at par,” says Rajat Jain, national leader of Deloitte’s payments advisory practice in Australia. Providers in Australia have created a barcode for each customer account, which can be scanned at checkout.



The best [BNPL] providers will be those that improve transparency and help users build the concept of financial management into their daily lives.

In the U.S., the initial foray into brick-and-mortar stores came in the form of a virtual credit card number generated by a buy now, pay later app, says Nadeau. “You can push that virtual credit card number to your digital wallet and then use your phone to pay it with a one-time credit card number,” she explains.

The advantage for the lender is that it can approve credit based not only on who the borrower is but also for the outlet they are purchasing from. “If you’re underwriting for credit at a larger amount, for a bike or a couch, for example, you want to know what you are underwriting and which retailer is selling it to help you assess the risk,” she says. This option is not as seamless as tap-and-go, since it requires the borrower to enter information in the BNPL app and request a virtual credit card. Some of Europe’s biggest BNPL providers are going one step further, offering real plastic that can be used at any store for any purchase, says Tijssen. “That effectively means that buy now, pay later can be used anywhere and it is not just limited to online purchases,” he says.

Issuing a card also opens a new revenue stream for the buy now, pay later organization. “They benefit from interchange fees, and it helps with brand recognition and loyalty,” he adds.

The more options a BNPL provider can offer, the more its business customers can enhance their customers’ experience and create a deeper relationship with end users. “The more these businesses know about your spending patterns, the more they can work with retailers to offer you loyalty points or discounts to increase loyalty and retention,” Tijssen points out.

The Future of BNPL

For the fintechs that reimagined the pay-over-time options that are now ubiquitous on checkout screens, the buy now, pay later business was never the end game; it was always meant to be the entry point to a broader universe of financial and retail possibilities. “The real story is a lot more than the impressive adoption and utilization of BNPL,” says Shevlin.



“Customers win because they have more repayment options. Likewise for merchants, it’s a win because there’s so much optionality in the market,” says Rajat Jain, national leader of Deloitte’s payments advisory practice in Australia.

The end game is deepening the relationship with consumers, not simply offering another payment option.

The industry is already seeing both expansion and consolidation. Competition is heating up now that more established players, such as banks, card issuers, payment processors, and peer-to-peer payment networks, have launched their own buy now, pay later offerings. A few existing BNPL players have already been acquired by larger companies that can now add a pay-later option to their portfolio of products.

“Buy now, pay later is effectively becoming more of a feature, as opposed to a product that allows you to differentiate in the market,” explains Tijssen. “This is forcing many of these players to think about their longer-term plans and how they will diversify their existing portfolio of products.” At the same time, margins for BNPL tend to be razor thin. “Any changes in the interest rate environment will have significant consequences for unit economics and consequences on the overall business model, which is why it’s so important for many of these businesses to diversify their product portfolio,” he says.

Because of their relationships with businesses, their extensive customer network, and their expertise in marketing and retail, BNPL providers have a lot of options to expand their business model, says Nadeau.

Industry experts believe that some will diversify into related financial services, while others have ambitions to capitalize on their knowledge of retail to grow into broader e-commerce platforms or super apps. “Their broader vision is the whole retail ecosystem,” says Principato. “Buy now, pay later is their wedge product.” In Europe, there are buy now, pay later

players that are looking at applying for a banking license, which would give them the ability to offer lending products and start to take deposits, says Tijssen.

Business services is another natural path for expansion—particularly for BNPL providers that focus on smaller retailers. “Some BNPL platforms are also doing business-to-business, borrow-now-pay-later transactions, where they offer funding to the businesses in the form of short-term loans to purchase additional stock, or when they’re short on liquidity, or when they need to staff up,” says Bakas.

Conclusion

Whether a customer is visiting a store or is part of a live shopping event on a social media platform, that person expects a range of payment options to meet their needs. BNPL providers meet that need by offering pay-over-time options that help users budget—and help sellers increase basket size.

BNPL innovators are looking beyond creating a better payment experience. They are using their platforms to truly engage with their users—both customers and businesses—and offer undeniable value. Their innovations are changing the payments landscape and reshaping customer expectations.

As the industry matures, BNPL will be of great benefit to businesses and borrowers who now have more payment options and access to innovative services. “Customers win because they have more repayment options,” says Deloitte’s Jain. “Likewise for merchants, it’s a win because there’s so much optionality in the market.” BNPL is a table-stakes payment option and growth lever now. It is the new way to pay.

Endnotes

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