



Embedded lending – Buy Now Pay Later (BNPL)

Priya Sharma and Rahul G

INTRODUCTION

Digital payments have gained traction in India since the pandemic breakout and one of the most popular trends in recent times has been BNPL. BNPL is a type of short-term financing that allows consumers to make purchases and pay for them at a future date. Even in a country like India where Credit card usage never quite caught on, especially in non-tier 1 cities, BNPL has been finding increasing usage across the country. BNPL arrangements have become an increasingly popular payment option, especially when shopping online and now the scope is widened. Even the banks, which were initially apprehensive have entered this segment. The demand is being fuelled by low penetration of credit cards in the country, a surge in e-commerce transactions, and smartphone penetration.

Did You Know

Cumulative no. of BNPL accounts in India are already at ~50% of no. of credit card outstanding. BNPL contributed to ~37% of retail digital lending by banks by volume in FY20

In consequence to recent RBI regulations, companies like Slice, Uni, Jupiter have suspended their operations in BNPL segment.

In 2021, Lazy Pay, reported that around 60% of their demand comes from tier-2 and tier-3 cities, with the average age of consumers being 26-27 years.

In case of default, BNPL schemes can affect your credit score. Moreover, post RBI regulation all transactions must be reported to credit bureaus.

Difference between credit cards and BNPL

| Particulars | Credit Cards | BNPL |
|---------------|--|---|
| Eligibility | Minimum income requirement. Designed for clients with a good CIBIL score | Customers may not have a credit score. |
| On-boarding | Traditionally, it takes weeks to issue a card. | In Digital KYC, one may begin engaging immediately. |
| Interest rate | Up to 48% per annum subject to the type of card, facility, and the issuer. | BNPL firms charge between 0 and 35%, depending on the merchant, the length of the loan, and the borrower. |
| Other costs | Joining fees range from INR 0 to INR 5,000 and Annual maintenance fees etc | No cost/ low cost of convenience |

In comparison to credit cards, BNPL's USP is its smooth user experience. BNPL offers the onboarding of new clients during checkout with a turnaround time of a few minutes.

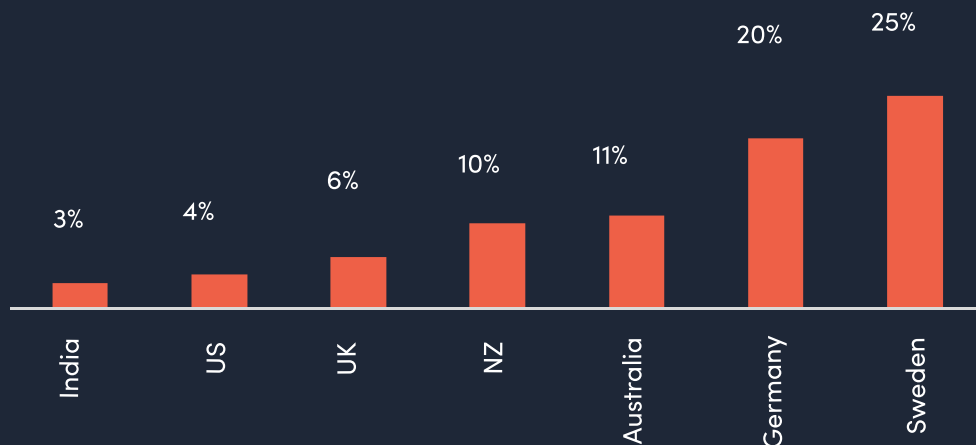


Evolution of BNPL in India:

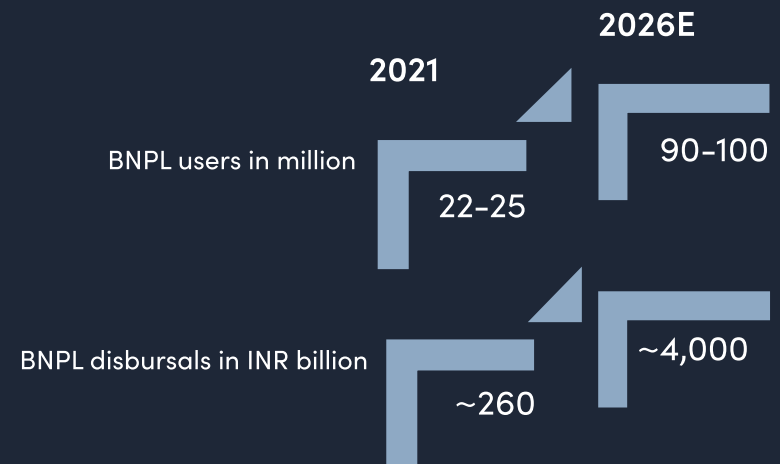
Although BNPL services have been available for approximately a decade, the COVID-19 pandemic in 2020 significantly accelerated expansion. With their BNPL solutions, FinTechs like PayPal and Paytm, e-commerce platforms like Amazon and Flipkart, and technology behemoths like Apple have also followed suit. When compared to its international competitors, India is a relative newcomer (as seen below).

Unlike conventional credit solutions, BNPL gained traction with the introduction of smaller ticket sizes at well-liked consumer checkouts and marketplaces like Amazon. Though most of the BNPL offerings are limited to B2C users, the B2B BNPL is quickly rising with compelling financial offerings for SMEs.

Country wise BNPL shares in E-commerce payments*



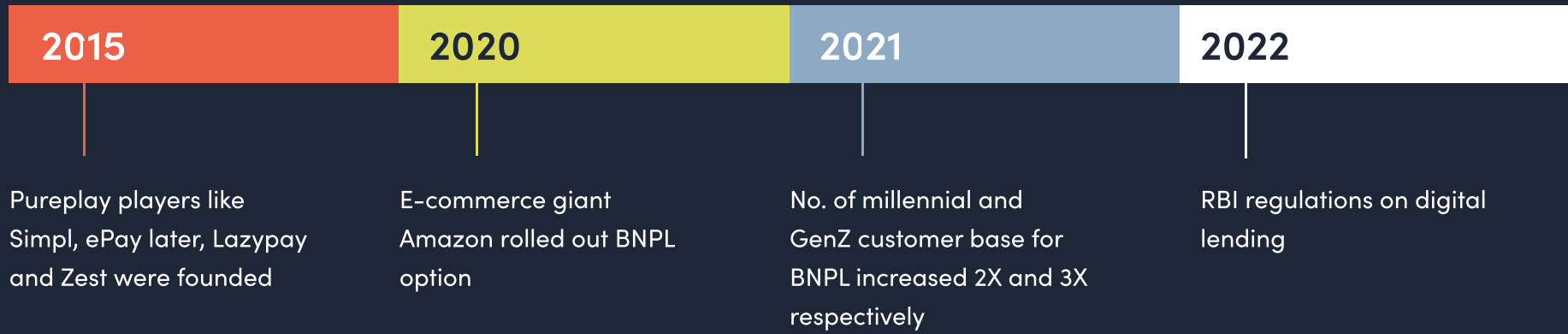
Details of BNPL market in India*



*Source: Worldpay Glo*bal Payment Report 2022, Benori report, and HSEI research



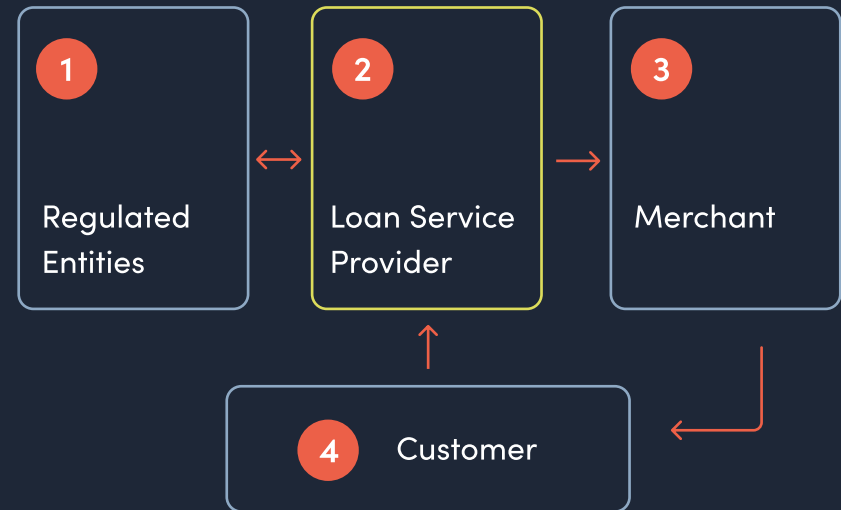
Timeline



Business and Operating models:

BNPL typically comprises 4 players:

- 01 RBI Regulated Entities (REs):**
Banks and NBFCs offering credit lines
- 02 Loan Service Providers (LSPs):**
BNPL mobile application providers that partner with REs.
- 03 Merchants**
- 04 Customers**



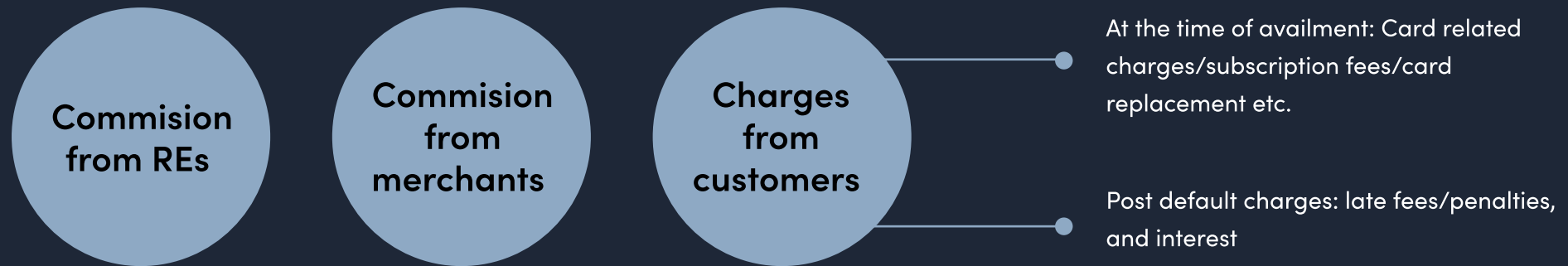
Broadly BNPL companies operate with 2 types of business model, as mentioned below:

| Particulars | Convenience Model | Credit Model |
|---------------|---|---|
| Ticket size | Small ticket size | Comparatively larger ticket size |
| Credit period | Usually about 15 days | About 3 to 12 months. |
| Merchant fee | Merchants pay a small percentage of transactions to the BNPL service provider | Has two sub-categories: 1. Zero-interest EMIs – Merchants pay a small % of the transaction to the BNPL service provider. 2. With interest EMIs – Customers are charged interest |
| Late fee | Late fee is levied to a customer | Late fee is levied to a customer |

While the convenience model is used as a gateway to customer acquisition and development of customer credit histories, the credit model is beneficial to revenue and profitability. Consequently, several BNPL players are transitioning towards a hybrid model for sustainability. Initially, BNPL was envisioned as a zero-interest rate product. Some players continue to offer products at zero-interest rate (depending on the period), but the tide has turned.



BNPL Revenue Model includes



01 Merchant fee: Ranges between 2–5% of the total value of payment. Merchants pay this fee to the BNPL player for every transaction.

02 Late payment fee: Charged on default. Unlike credit card issuers, BNPL players charge a very nominal late fee between 1–1.5%.

The market has two broad types of BNPL offerings – one is the payment method, allowing customers to check-out faster while making purchases with the option of paying later. Players like Slice, Uni, and Lazy Pay that provide credit through prepaid cards in collaboration with banks are included in the payment method. The other types of players like Zest Money and Capital Float claim to solving the issue of affordability by extending the option of paying in EMIs.



Common BNPL operating models prevalent in India are as below:

| Particulars | Traditional BNPL model | Check out financing | Existing ecosystem |
|-----------------------------------|--|---|--|
| Partnerships | No lending partners | Banks and NBFCs | Banks and NBFCs |
| Target customers | New customer onboardings through checkout page or mobile apps. | New onboardings through checkout page or mobile apps and existing customers | Existing customers |
| Eligibility and credit assessment | No KYC required | More formalised credit assessment. | Credit assessment using own transactional data. |
| Players | Simpl, postpe and Unipay | Zest, and Slice | Amazon Pay Later, Paytm and Flipkart pay later and Mobikwick |
| Ticket size | Small ticket size | Comparatively, larger ticket size | Small as well as large ticket size |



BNPL for B2B

With several fintech companies in India like Kredx, Progcap etc. offering supply-chain based short-term financing solutions, BNPL has emerged as a viable supply chain financing solution for SMEs. India has nearly 75 million small businesses in the MSME sector, contributing to around one-third of the GDP. However, most of these do not have access to formal credit as Institutional lenders often see SMEs as high-risk borrowers.

BNPL model can come to the aid of SMEs in the following ways with unrestrained cashflows:

- From a purchase & sales perspective – BNPL service provider makes payment to the supplier upfront, consequently the buyer has a facility to repay over a period via installments.
- To purchase the necessary equipment to keep their business functioning.

Benefits of BNPL in B2B Segment:

- Frictionless sales process effectively increases the seller's average order value and the value proposition of the SMEs resulting in higher conversion rates.
- BNPL has a fixed repayment schedule, and there is no need for collateral.
- This decentralized lending protocol offers a comparatively simpler documentation process.

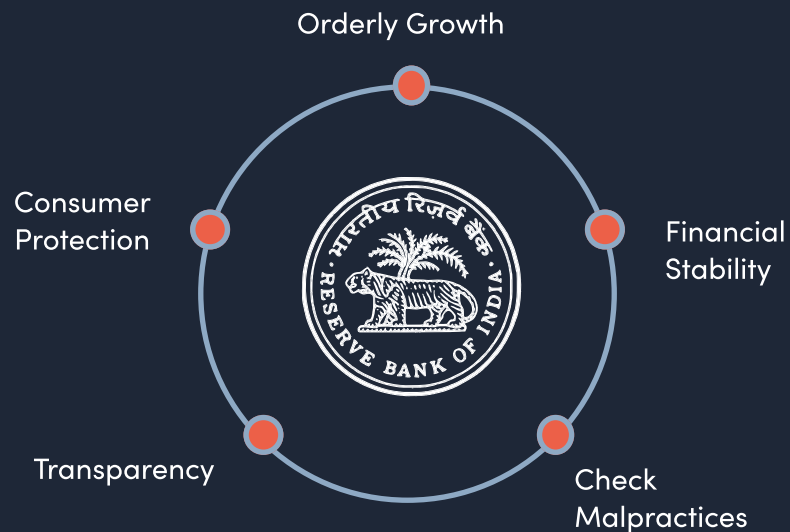
Underwriting:

BNPL uses open banking data, and proprietary behavioural data to make consumer lending decisions while available in both closed-loop and open-loop models. A huge advantage of this is that the underwriting process ranks cashflow-based metrics higher than balance sheet-based traditional metrics. This sits well with the product market, as most businesses in India fall under the unorganized sector and it's unlikely for them to have balance sheets, structured revenue streams, or formalized banking relationships. These customers are left behind in access to credit making their businesses suffer. Traditionally, invoice discounting struggled to establish the genuineness of invoices and the duplicity of financing structures.



The Dark side of BNPL companies and RBI intervention

RBI has received bundles of complaints and witnessed several such instances against fintech. RBI is not against BNPL services but intends to bring them under regulatory surveillance and discipline. The concern of the regulator is sourcing partners who are assuming risks and rewards of lending but are uncovered by RBI and protecting the interests of customers and funding partners. As a result, RBI stepped in to regulate digital lending.



[Refer to our external blog for RBI regulations on digital lending](#)

All we need to understand about BNPL Companies' dark side:

1. Credit lines offered to ineligible people (the youth are using BNPL as a lifestyle enhancement product, rather than using it to finance livelihoods)
2. Lack of transparency
3. Mis-selling / Breach of data security
4. Predatory Lending - Disbursed loans without the consent
5. Drop in Credit score of consumers on unapproved disbursal
6. Erroneous reports to collect a debt that is not owed
7. Unethical recovery practices
8. Consumers forced to pay late fees
9. Unreliable underwriting models
10. Risks of defaults- by getting into debt traps
11. Money laundering concerns



Impact of RBI regulations:

Impact to Fintech (LSP)

- Fintechs must stop lending and collections as the flow of funds is restricted
- Hit on revenue model as Fintech is not allowed to charge anything from consumers.
- However, fintech continues to earn merchant commissions and digital marketing income
- No longer required to bear collection commission
- Higher compliance costs required to be compliant with all disclosures and business conduct as specified by RBI



Impact to the Regulated Entity

- Not allowed to disburse/repay through pool account
- Higher transparency on lending results in higher interest income to the RE
- Cannot increase credit limit without consent of consumer
- Cannot Charge prepayment penalty during the cooling-off period
- Higher sourcing, underwriting and compliance costs for onboarding and continuous monitoring of LSPs
- Additional disclosure requirements and data privacy and storage costs



Impact to the Consumer

- Complete awareness about the loan terms and conditions
- Borrower would now be able to see total annual costs charged to them and compare them effectively with other options.
- Cooling-off period to exit loan by paying principle and proportionate APR.
- Consent of customer for limit upgrade
Disclosure of recovery mechanism upfront
Grievance redressal mechanism to protect consumers
- The borrower shall also have the option to either accept, deny or revoke the consent for use of any specific data with the option to delete the data collected by RE/LSP.



Conclusion

With increased digital literacy in India and higher regulatory scrutiny, the Indian BNPL market is at an inflection point. In a brief span of time, the expansion of BNPL as a mode of credit-based payments has picked up critical footing, especially among the millennials and Gen-Z. However, the recent RBI guidelines have made the BNPL companies redefine their operating models. These guidelines are only speed bumps for fast-growing BNPL lenders as the trend has already extended beyond traditional retail. To encapsulate, BNPL is not an alternative to traditional credit, but it aids to enhance and expand credit reach while providing ease of access to consumers.

