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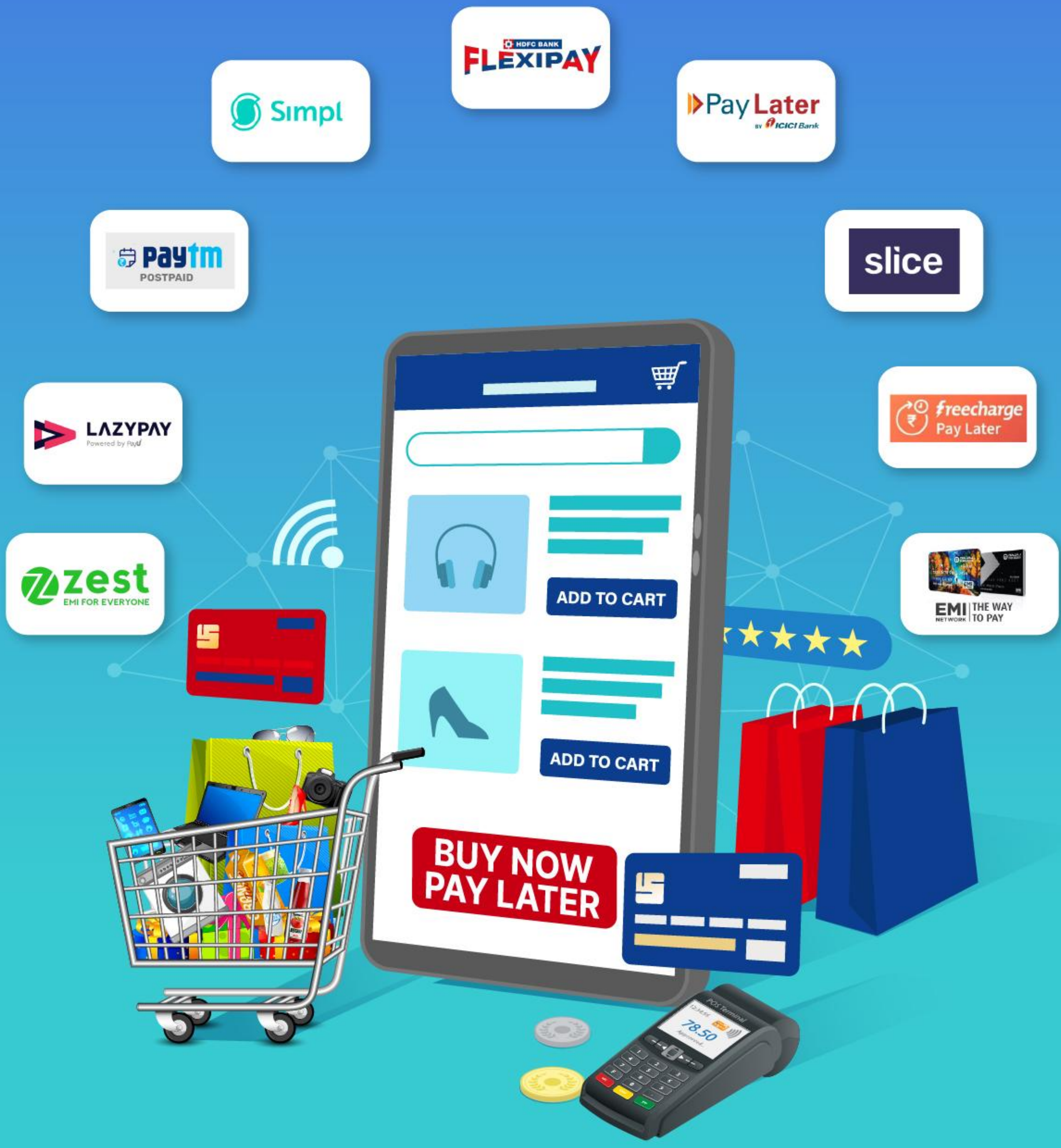

FinTech Playbook

BUY NOW PAY LATER

Buy Now Pay Later

De-mystifying the tablestakes

India's Buy-Now-Pay-Later (BNPL) is positioned as a source of gateway credit and poised to grow to USD56bn by FY26 (~5% of digital P2M payments) on the back of rising ecommerce and digital payments penetration. BNPL players are exploring multiple business models (interest-free vs. EMI, distribution vs. balance sheet lending) and are yet to establish economic viability with limited revenue drivers and high delinquencies (unsecured credit and higher mix of NTC customers). Although FinTech BNPLs enjoy favourable regulatory arbitrage, incumbents have an opportunity to expand their customer funnels either through in-house offerings (HDFC Bank FlexiPay, ICICI PayLater) or partnerships. We expect regulatory convergence on the back of the RBI's recent narrative for digital lenders although FinTech BNPLs are likely to sustain their superior user experience. Within a bouquet of BNPL options, credit cards remain the most exhaustive and profitable and, in fact, offer an up-sell opportunity for credit-tested top-of-the-BNPL-pyramid customers.

- **USD56bn BNPL market by FY26; ~5% of digital P2M payments:** India's BNPL is at an inflexion point with rising ecommerce and digital P2M payments (FY21-FY26E CAGR of 28%/26% respectively) fuelling deferred payments. BNPL GMV is poised to exhibit ~74% CAGR and account for ~5% of digital P2M payments by FY26E.
- **Multiple models at play; Zest and Slice emerge with early leads:** BNPL players are experimenting with different models (closed loop vs. open loop, convenience vs. credit, offline vs. online, and partnerships vs. balance sheet lending) in their efforts to discover viability. While the jury is still out on the "ideal" model, Zest and Slice emerge with early leads on our proprietary BNPL Quotient, built on vectors such as platform scale, engagement levels, revenue drivers, propensity to cross-sell, and risk management.
- **Business viability gaps need addressing:** With limited revenue drivers (such as MDR and low customer-driven fees) and low per user spends, our analysis suggests limited economic viability, particularly of the convenience-led model and a need for customer-led fees (EMI financing, personal loans, etc.). The BNPL model has a significantly high dependence on late fees (~3-10% of spends), which also mirrors itself in elevated credit costs (unsecured nature of credit, high share of NTC customers, limited recourse with digital collections), although digitisation drives lower opex.
- **Regulatory convergence ahead:** BNPL FinTechs disproportionately benefit from favourable regulatory arbitrage around the ease of onboarding, risk-sharing, bureau-reporting, and customer disclosures, which we expect will converge on the back of the RBI's impending regulatory approach.
- **Tablestakes for incumbents but differentiated approaches:** Incumbents are approaching "new-age" BNPL as tablestakes either through in-house offerings or partnerships. We see two distinct approaches: 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.
- **BNPL to add significant addressable market to credit cards:** Credit cards, the most exhaustive form of BNPL, in our view, are expected to benefit from BNPL, as the format acts as a feeder engine, adding credit-tested and more potentially cardable customers to the addressable market.

Company	Mcap (INR bn)	CMP (INR)	Reco.	TP (INR)
SBICARD	875	928	BUY	1,100

DID YOU KNOW?

- *BNPL has been in existence in India for a long time (Credit cards and EMI financing)*
- *BNPL is now the most preferred mode of ecom payment in Sweden*
- *>50% of consumers in US have used BNPL at least once, according to Survey*
- *Cumulative no. of BNPL accounts in India are already at ~50% of no. of credit card outstanding*
- *~45% of personal loans disbursements in Q4CY20 were done through FinTechs*
- *Indian incumbents are better placed compared to global peers in confronting the BNPL wave*
- *Credit card remains the by far the most exhaustive form of BNPL product in terms of offerings to the consumer*

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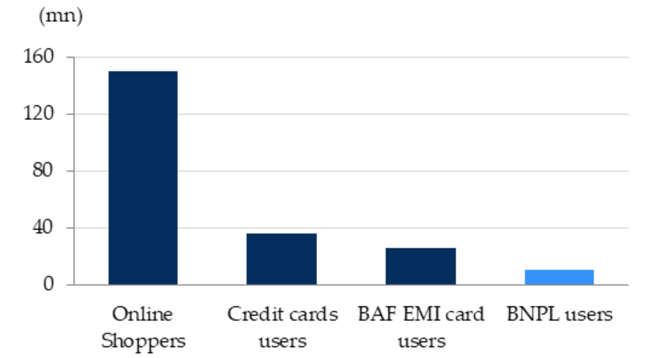
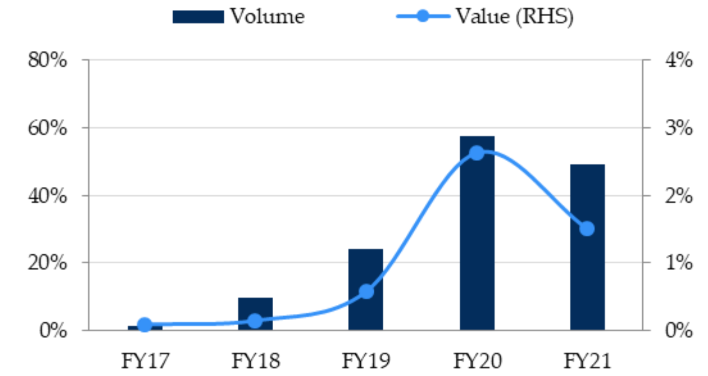
Exhibit 1: No. of BNPL users already at ~1/3rd of credit cards user base



Source: Industry, Company, Transunion CIBIL, RedSeer, HSIE Research

Exhibit 2: Share of personals loans < INR 10K in personal loans disbursals



Note: CRIF High Mark, HSIE Research

Exhibit 3: Vanilla BNPL - unviable business model; shift towards EMI financing imperative

(% of spends)	Vanilla BNPL	EMI mix BNPL	EMI financing	Credit cards
NII	-0.9%	1.0%	2.1%	2.8%
Fee income	2.3%	2.2%	1.8%	3.7%
Total income	1.4%	3.2%	3.8%	6.5%
Opex	1.2%	1.1%	1.2%	3.8%
PPOP	0.2%	2.0%	2.6%	2.8%
Credit costs	3.3%	2.3%	1.9%	1.5%
PBT	-3.1%	-0.3%	0.7%	1.2%
Tax	-0.8%	-0.1%	0.2%	0.4%
PAT	**-2.3%**	**-0.2%**	**0.5%**	**0.9%**

Source: Company, Industry, HSIE Research

Exhibit 4: FinTech disbursals at ~5% of digital P2M payments by FY26

	Units	FY21	FY26E	CAGR
# Unique BNPL users	mn	10	100	58%
Disbursals/user /month	INR' 000	2.2	3.5	10%
BNPL disbursals	INR bn	260	4,187	74%
P2M payments	INR bn	22,984	91,585	32%
% of P2M payments	%	1%	5%	

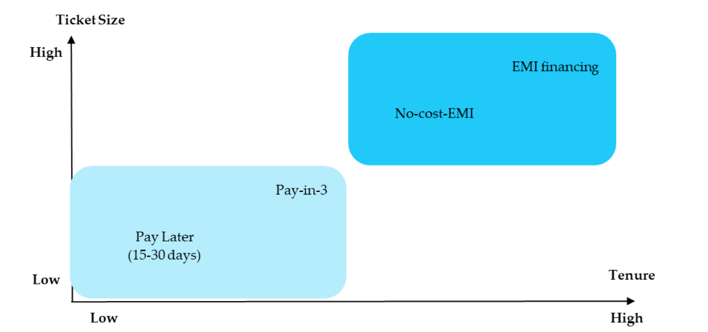
Source: RBI, NPCI, Industry, Company, HSIE Research

Exhibit 5: Credit cards have wider customer value proposition compared to FinTech BNPL

	Credit cards	BNPL
Interest-free credit period	Up to 50 days	Up to 15 – 30 days
Credit limit	High	Low
Revolving credit facility	~42% APR	×
EMI loans interest rates	0% - 20% APR	0% - 32% APR
Rewards/cashbacks	~1% cashback	Limited
Cash advances	~30% APR	×
Merchant network	Offline + Online	Mostly online
International acceptance	✓	×
Balance Transfer	✓	×
Complementary benefits	Several	NA

Source: Company, Industry, HSIE Research

Exhibit 6: BNPL models at play – Convenience vs. credit model



Source: Industry, HSIE Research

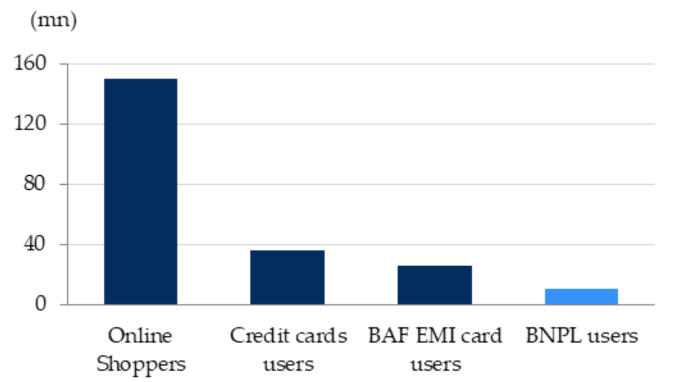
BNPL = Commerce + Payments + Credit

- **Old wine, re-branded:** The proliferation of Buy-Now-Pay-Later (BNPL) as a mode of credit-based payment is gaining significant traction, particularly amongst the millennials and Gen-Z population (~51% of India's population) within a short span of time. Proliferation 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.

  However, BNPL as a concept in India has been in existence for years, in the form of "No-cost-EMIs" through merchant subvention. Merchants have also been increasingly willing to pay “swipe fees” for commerce-enablement and business-enhancement, higher authorisation rates and better end-to-end management of the point-of-purchase or point-of-sale financing journey.

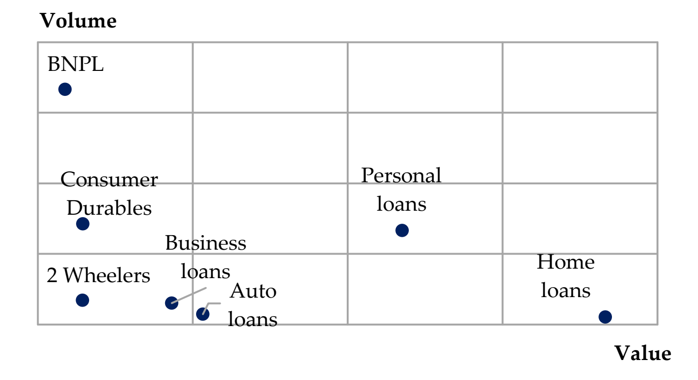
  Credit cards are also technically a form of BNPL. However, this new form of BNPL benefits from the sheer pace of adoption and the proliferation of ecommerce, with technology being leveraged to blitzscale across multiple categories of individual consumption. The number of unique BNPL users has zoomed to 10mn in a span of a couple of years, compared to ~35mn unique credit card users during this time.

Exhibit 7: BNPL userbase at ~1/3rd of credit card users



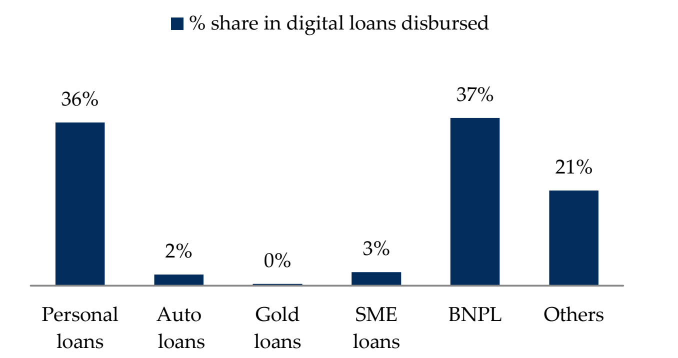
Source: Industry, Company, Transunion CIBIL, RedSeer, HSIE Research

Exhibit 8: BNPL-high on volumes, low on loans outstanding



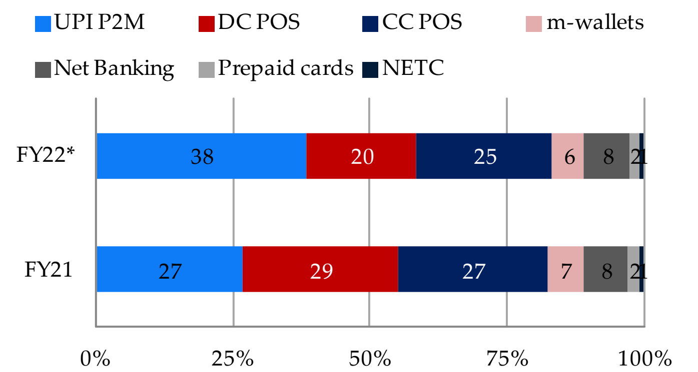
Source: RBI, CRIF High Mark, HSIE Research | *Note: BNPL disbursals exclude credit cards spends and cards-based EMI loans*

Exhibit 9: BNPL contributed to ~37% of retail digital lending by banks by volume in FY20



Source: RBI, HSIE Research

Exhibit 10: Increasing share of UPI in P2M payments

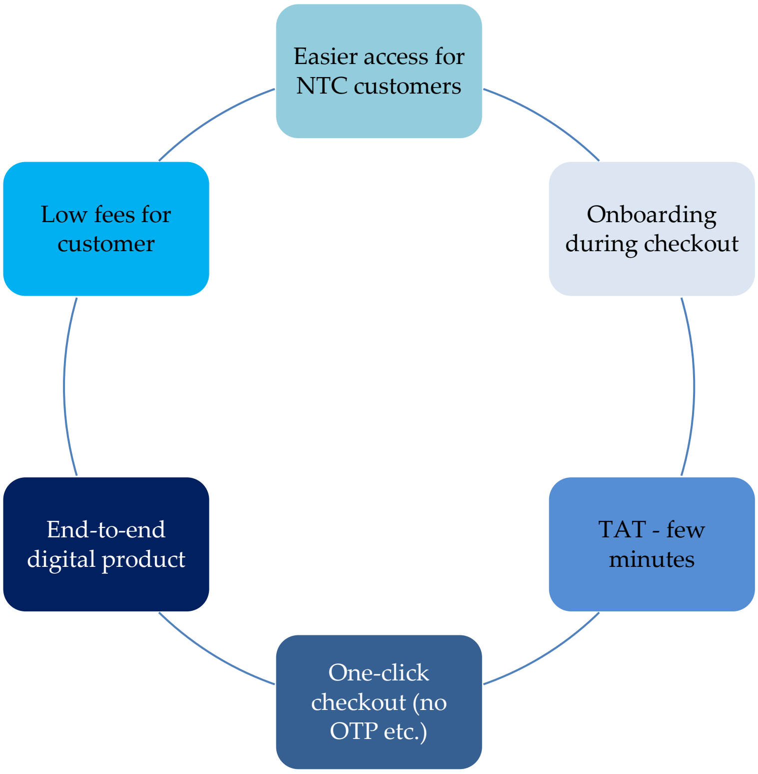


Source: RBI, NPCI, HSIE Research | Note: * 8MFY22

- **What makes BNPL so unique?** BNPL has proliferated at a furious pace in the past couple of years, primarily due to two key reasons: relatively easy availability of credit for NTC customers (albeit with lower credit limits) and seamless user experience from onboarding to payments. BNPL players' credit assessment relies on several parameters beyond bureau score and the credit limits are fairly dynamic (based on spends and repayment history).

  However, the biggest value proposition of BNPL over other payment modes (including credit cards), is the seamless user experience. Most BNPL players provide for onboarding of new customers during checkout (online as well as offline) with turnaround time of a few minutes. Further, payments for online purchases are made with a single click (choosing the BNPL option) with no need for an OTP or any other authentication (regulatory arbitrage). Low fees from the customer (0% interest products, low subscription fees etc.) and end-to-end digitisation are some other features that are lucrative, particularly for the younger generation and new-to-credit (NTC) cohorts.

Exhibit 11: BNPL's customer value proposition in a nutshell



Source: Industry, HSIE Research

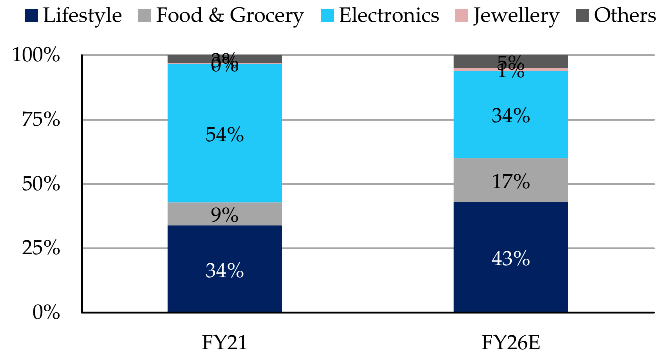
- **Digital commerce-penetration driven growth:** The Indian online commerce market, comprising e-retail, online travel, online food delivery, education, e-Health etc., is poised for stupendous growth in the medium-term, led by economic growth and improving penetration of online commerce with more use cases, deeper geographic penetration (tier 2/3 cities) and rising number of online shoppers. India's online commerce market is poised to grow at ~30% CAGR to reach ~USD184bn by FY2026.

Exhibit 12: India's private final consumption expenditure

Category (% of Total)	FY17	FY18	FY19	FY20
Food and non-alcoholic beverages	30.4	29.5	28.3	29.1
Transport	15.0	16.3	16.7	16.9
Housing, water, electricity, gas and other fuels	14.2	14.1	13.8	13.3
Clothing and footwear	6.7	6.5	6.4	5.7
Health	4.5	4.4	4.6	4.9
Education	4.0	4.3	4.5	4.7
Furnishing, household maintenance	3.0	3.0	3.0	2.8
Communication	2.1	2.4	2.5	2.4
Alcoholic beverages, tobacco and others	2.3	2.2	2.3	2.1
Restaurants and hotels	2.0	2.0	2.1	2.1
Recreation and culture	0.8	0.9	0.9	0.8
Miscellaneous	14.9	14.5	14.9	15.3
Total (INR trn)	**91.8**	**101.0**	**112.7**	**123.7**
Total (USD trn)	**1.2**	**1.3**	**1.5**	**1.6**

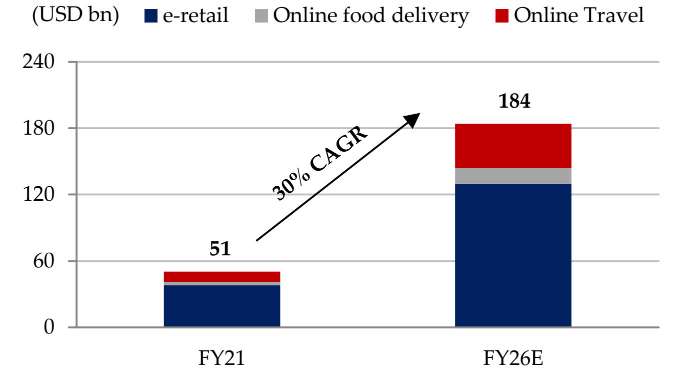
Source: MOSPI, HSIE Research | 1 USD = INR 75

Exhibit 13: India's e-retail market–increasing share of Lifestyle, Food & grocery



Source: RedSeer Report, Snapdeal DRHP, HSIE Research | Note: Lifestyle comprises Fashion, general food and merchandise, Beauty & Personal care and others

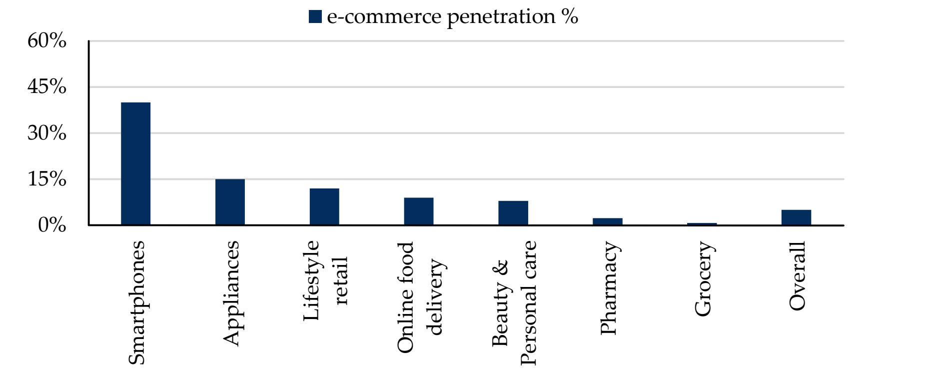
Exhibit 14: Online commerce–poised to grow at 30% CAGR during FY21-FY26E



Source: Bain & Company, RedSeer report, Mobikwik DRHP, HSIE Research

- **Rising online penetration across categories:** Rising penetration of internet and smartphones and increasing propensity towards online shopping are likely to drive penetration in various categories of Indian retail. Further, the rising investments in tech companies are driving online penetration in several new categories such as Education (poised for USD5bn opportunity by FY26) and e-Health (e-pharmacy, e-diagnostics and e-consultations).

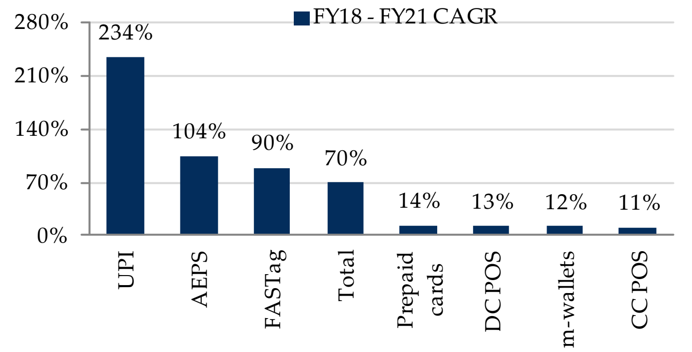
Exhibit 15: ecommerce penetration across segments-significant opportunity (FY21E)



Source: RedSeer, Zomato, Nykaa, Snapdeal API Holdings DRHP, GfK Research, HSIE Research

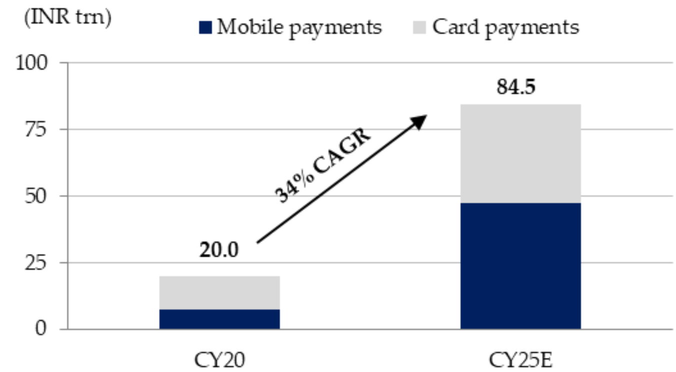
- **Digital P2M payments surging like never before:** Digital P2M payments continue to witness strong growth momentum after registering 26% CAGR between FY18 and FY21. The surge has been led by increasing smartphone and internet penetration, further catalysed by the pandemic and investments by FinTechs, incumbents, and policymakers in the payments ecosystem. As highlighted in our thematic report, P2M Payments – Surging pool, dwindling yields, Digital P2M payments are expected to exhibit 34% CAGR to USD1trn by CY25, driven by increasing digital penetration (~50% of ecommerce transactions payments are done through cash-on-delivery) and more use cases, with a disproportionate contribution from mobile payments (UPI), which have emerged as the single largest mode of P2M payments.

Exhibit 16: % CAGR across payment modes: FY18 - FY21



Source: RBI, NPCI, HSIE Research

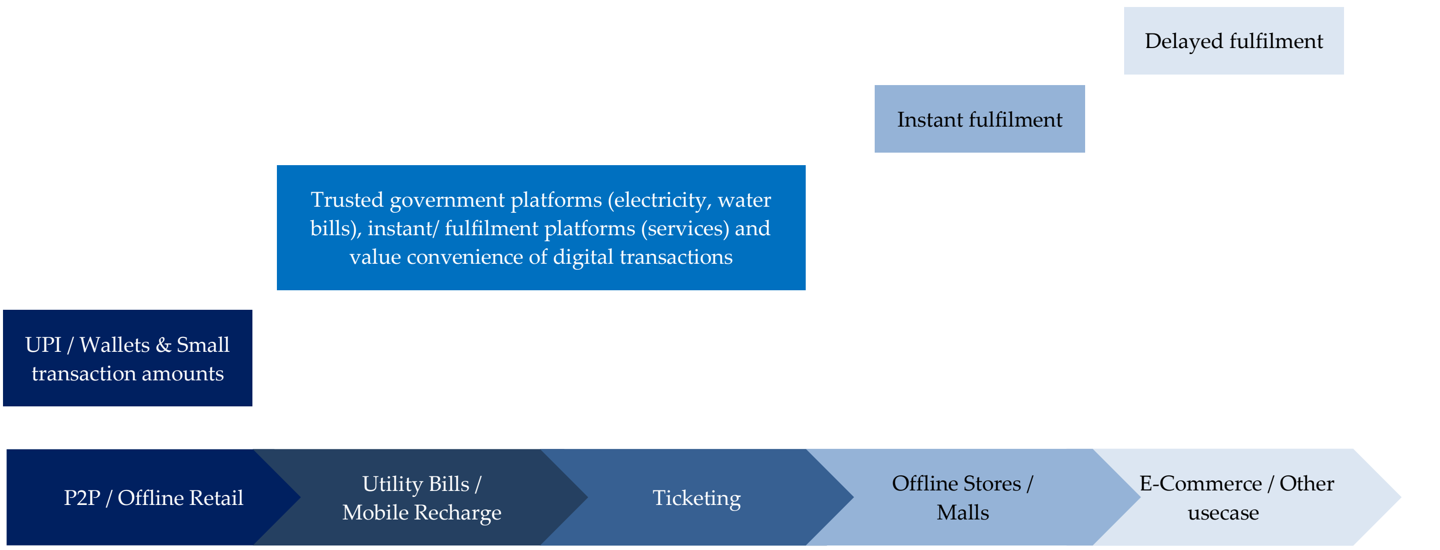
Exhibit 17: P2M payments expected to grow to USD 1trn by CY25E



Source: Industry, RBI, NPCI, HSIE Research

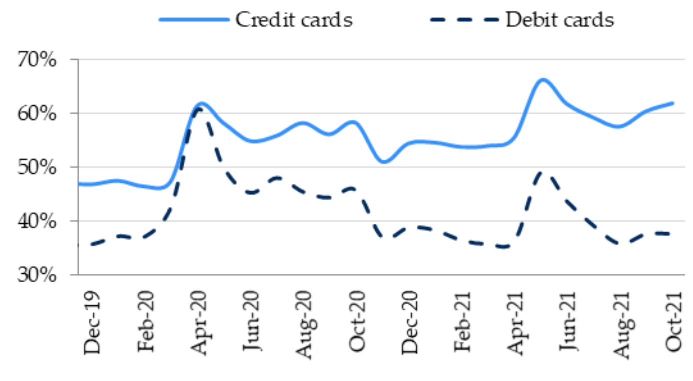
- **Increasing shift towards digital payments augurs well for BNPL**: The increasing penetration of digital payments on merchants (~25% penetrated) and consumers (22% penetration) augurs well for the BNPL industry. Delayed fulfilment (ecommerce) or in-store purchases are typically the last use cases in a customer's digital journey, P2P transfers being among the first followed by ticketing and bill payments. The increasing pool of digital payments creates a sizeable addressable market for credit-based payments such as credit cards, BNPL, and checkout financing.

Exhibit 18: Understanding the user's digital journey



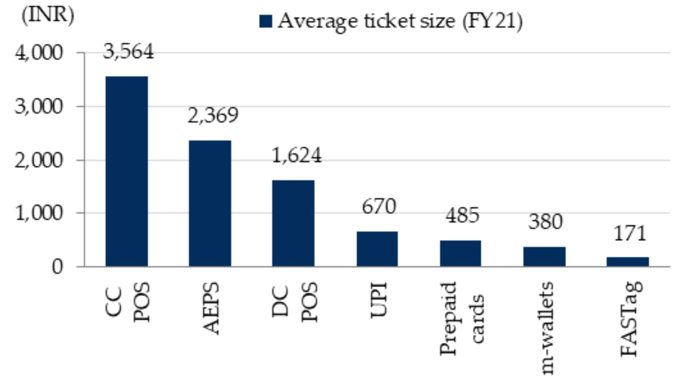
Source: Industry, HSIE Research

Exhibit 19: ecom as a percentage of total spends–cards-based payments (by value)



Source: RBI, HSIE Research

Exhibit 20: Average ticket size across payment modes

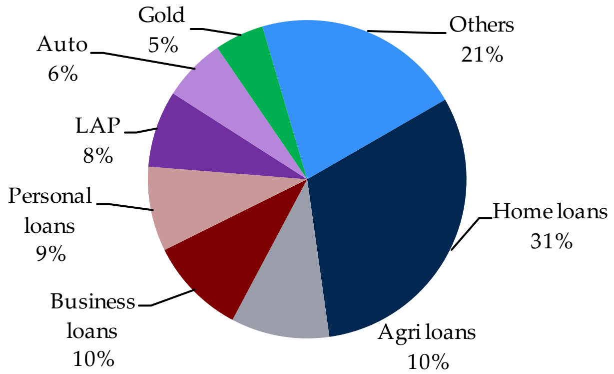


Source: RBI, NPCI, HSIE Research | UPI denotes UPI P2M

- **Proliferation of short-term consumer credit:** Short-term consumer credit (STCC, ticket sizes below INR 0.1mn) has witnessed rapid growth since FY18, now contributing to >50% of total disbursal volumes in FY21, as per CRIF Highmark. While the personal loans outstanding have grown at 25% CAGR from FY19 to FY21, the volume share of STCC has risen from 54% to 71% during this period.

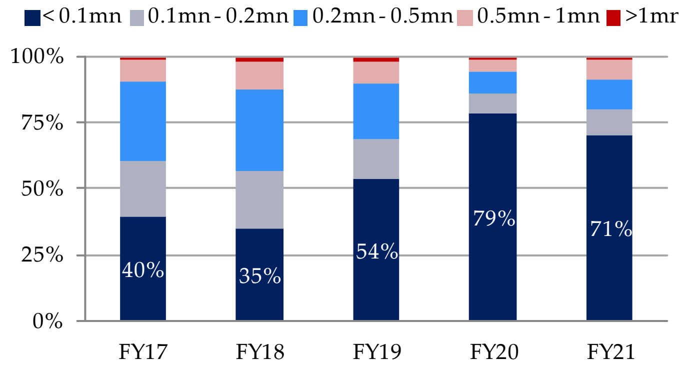
- **Deferred payment options driving high volumes:** Rising penetration of e-commerce and digital payments is now beginning to meaningfully reflect in retail credit with increasing volumes of checkout financing (BNPL, EMI financing, etc.). Beyond credit cards and traditional EMI financing options by incumbents, challenger FinTechs and BigTechs, in partnership with NBFCs and banks, are increasingly offering credit at the point of sale.

Exhibit 21: Retail credit outstanding in India (FY21)



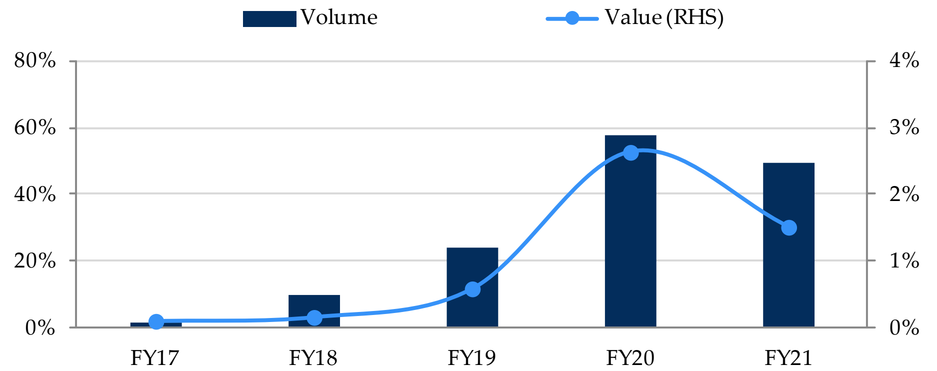
Source: CRIF High Mark, HSIE Research

Exhibit 22: Personal loan originations by ticket size (by volume)



Source: CRIF High Mark, HSIE Research

Exhibit 23: Share of personals loans < INR 10K in personal loans disbursals

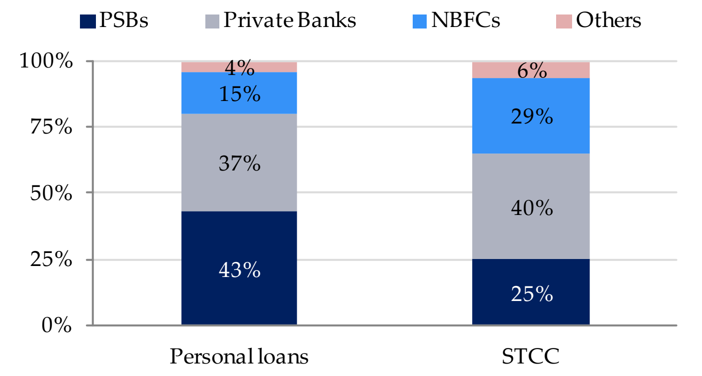


Source: CRIF High Mark, HSIE Research

- **NBFCs at the forefront of STCC disbursals:** NBFCs, driven by standalone lending and FinTech partnerships, are capturing the lion's share in STCC disbursals at 49%/66% by value and volume as of Mar-21 respectively, followed by private banks at 20%/19%. Private banks have a higher share in larger ticket sizes, where the unit economics is far more favourable.

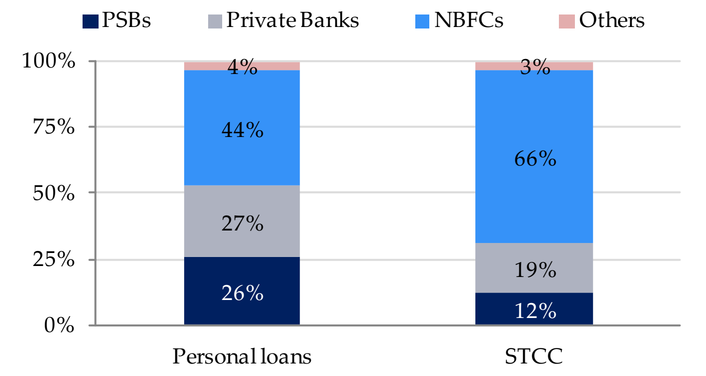
  Consumer durables financing (up to INR 50K) has been dominated by NBFCs (largely Bajaj Finance) in terms of value and volume with over >75% market share in disbursements, while private banks have focused on EMI financing through their credit card and debit card EMI offerings.

Exhibit 24: Value market share–personal loans and STCC (Mar-21)



Source: CRIF High Mark, HSIE Research

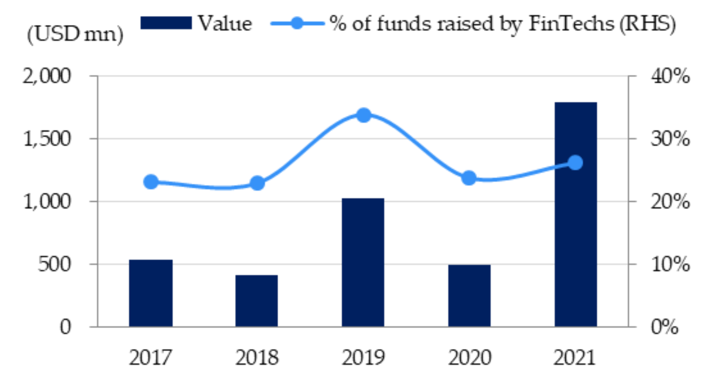
Exhibit 25: Volume market share–personal loans and STCC(Mar-21)



Source: CRIF High Mark, HSIE Research

- **CreditTech - a crowded space**: The FinTech ecosystem is currently in a sweet spot in terms of total addressable market opportunities, the problem statements being redefined, migration and distribution of profit pools, and availability of private (and increasingly public) equity capital that is chasing exponential growth. ~30% of the FinTech funding has accrued to CreditTech.

Exhibit 26: ~25-30% of FinTech Funding towards digital lending now



Source: VCCEdge, HSIE Research

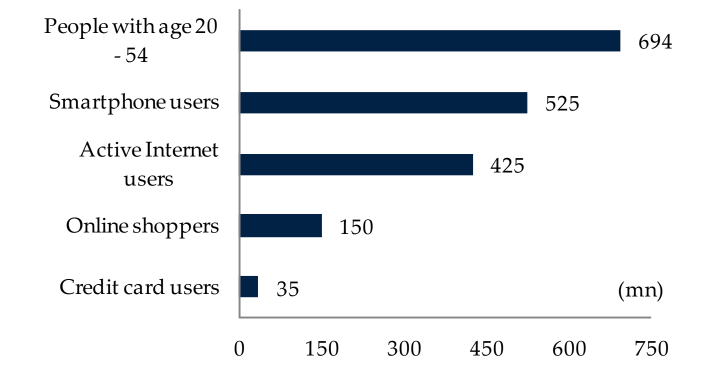
Exhibit 27: Increasing pool of BNPL and personal loans FinTechs

Source: Industry, HSIE Research

Sizing the burgeoning BNPL market

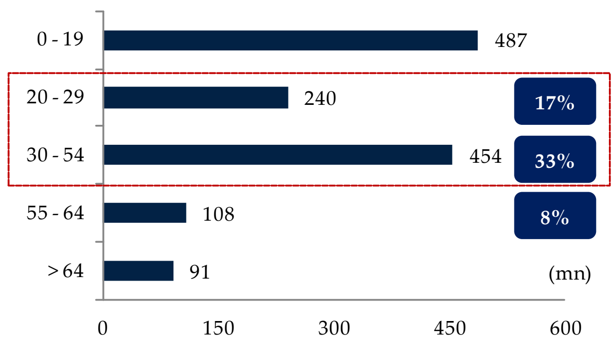
- **Low-stakes gateway to large addressable market:** The BNPL market is poised for explosive growth, led by improving penetration in customer base as well as usage categories (merchant base). The surge in BNPL FinTechs, along with rising focus by the incumbents and improving ecommerce penetration, is likely to drive the customer as well as merchant base.
- **Customer journey - cash to digital to deferred payments**: The surge in digital payments penetration is likely to provide a strong base for BNPL. A typical user's payments journey migrates from cash to P2P payments, utility payments followed by merchant payments (offline followed on online). Our conversations with industry participants suggest that deferred payments are typically the last stage of evolution in a customer's digital journey. With the proliferation in digital payments, particularly mobile payments having low ticket size (Average of INR 700) across tier 2/3 cities (~80% of PhonePe's monthly active users are from non-tier 1 cities), the digital payments continues to expand, providing a larger potential customer base for BNPL.

Exhibit 28: ~35mn are credit carded compared to ~150mn online shoppers and >500mn smartphone users



Source: Transunion CIBIL, RedSeer Report, TRAI, World Bank, HSIE Research

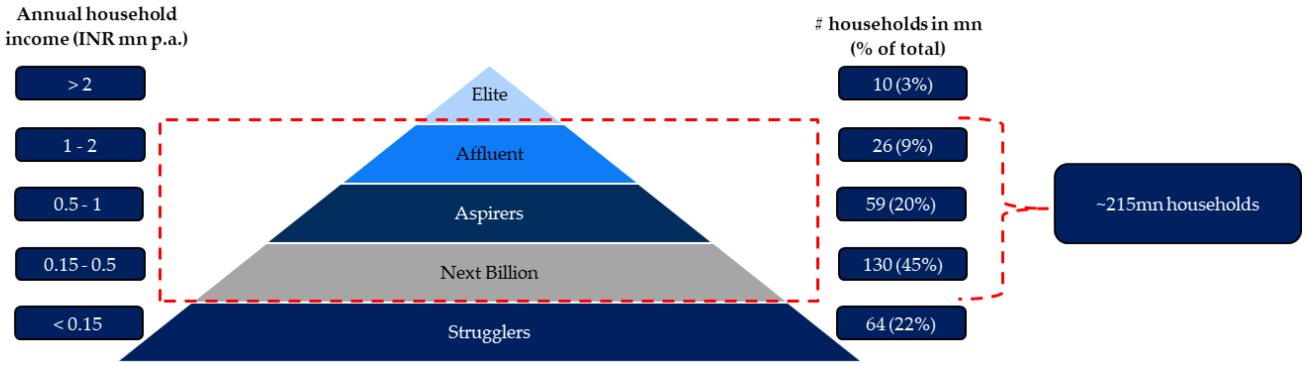
Exhibit 29: India's demographic distribution - ~700mn in the target segment of 20-54 years



Source: World Bank, HSIE Research | Note: Numbers in blue boxes denote % of total population

- **Creditworthy yet un-tapped - unit economics evolving:** Multiple reports across the industry categorically demonstrate the creditworthy market in India. As per a BCG publication on India's spending patterns, one-third of the households earned >INR41K per month, while ~78% households earned >INR12.5K per month. With the average BNPL spends per month in the range ~INR2-3K, the addressable market is disproportionately large.

Exhibit 30: Target segment at ~215mn households (CY2019)

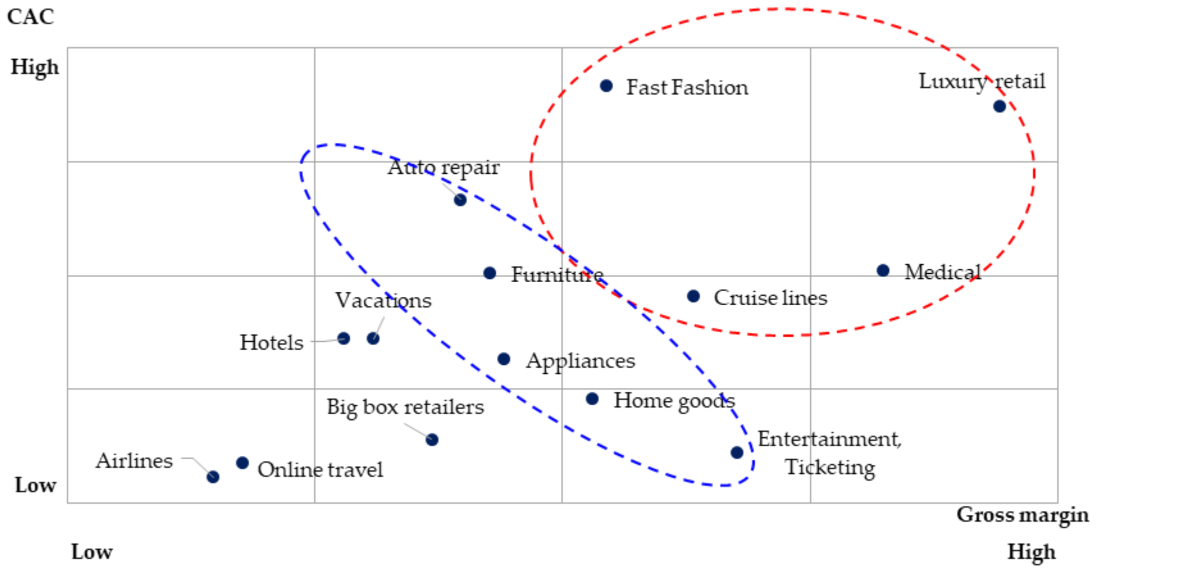


Source: BCG report – How India spends, shops and saves in the new reality?, HSIE Research

- **Increasing organised retail penetration provides large addressable TAM:** Organised retail (offline + ecommerce) is poised to grow to USD 380bn and constitute ~28-30% of overall retail market by FY26 from ~15% in FY21, driven by increasing digital penetration and consumer preference towards better shopping experiences and pricing. Increasing penetration of organised retail provides a larger addressable market for BNPL players and provides relatively easy scalability as well (through tie-ups with payment aggregators, card networks, stores franchises etc.) compared to general trade segment.

- **Merchant subvention–finding the sweet spot:** Merchant categories with high gross margins and high cost of customer acquisition are more likely to provide higher subvention for POS financing, as per McKinsey Merchant POS financing Survey. The cost of acquisition varies for merchants across channels such as social media platforms, ecommerce marketplaces, etc., and could be as high as in double digit percentage as well. While BNPL's value proposition in terms of increased sales velocity, higher average order value etc. could be applicable to the entire merchant landscape, merchant categories in the "high and medium willingness to pay" bracket are likely to provide higher merchant subvention to the BNPL players.

Exhibit 31: Merchants with high margins and high CAC likely to provide high subvention for EMI financing



Source: McKinsey Merchant POS Financing Survey, HSIE Research |

Exhibit 32: BNPL disbursals poised to reach USD 56bn by FY26

	Units	FY21	FY26E	CAGR	Comments
India's population	mn	1,380	1,577	3%	
Smartphone users	mn	550	800	8%	
% of total population	%	40%	51%		
No of online shoppers	mn	150	400	22%	Rising penetration of e-commerce
% of smartphone users	%	27%	50%		
No of unique BNPL users	mn	10	100	58%	Improving penetration of deferred payments on online/offline space
% BNPL penetration in online shoppers	%	7%	25%		
Disbursals per user per month	INR' 000	2.2	3.5	10%	Increase in use cases with widening merchant base
BNPL disbursals	INR bn	260	4,187	74%	
BNPL disbursals	USD bn	3.5	55.8		

Source: World Bank, TRAI, RedSeer Report, Paytm DRHP, Industry, HSIE Research

- **5% of P2M payments by FY26:** BNPL, as a mode of P2M payments, is likely to contribute ~5% of total P2M payments by FY26. While the pace of growth in the BNPL segment is staggering, mobile P2M payments (UPI) have been growing at a staggering pace with widespread adoption amongst customers and merchants. Going forward, the increasing pool of digitally paying customers is likely to become the addressable target segment for BNPL.

Exhibit 33: BNPL disbursals to constitute ~5% of P2M payments by FY26E

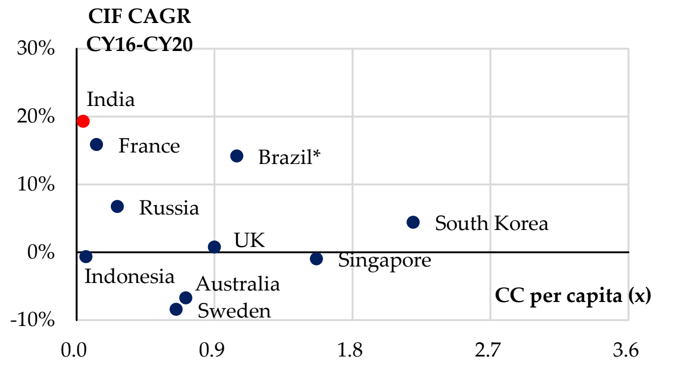
	Units	FY21	FY26E	CAGR
BNPL disbursals	INR bn	260	4,187	74%
P2M payments	INR bn	22,984	91,585	32%
As % of P2M payments	%	1%	5%	

Source: RBI, NPCI, CRIF High Mark, Industry, HSIE Research

BNPL–a global phenomenon

- **Making inroads into well-carded countries**: BNPL's usage has surged in well-penetrated credit card markets such as Australia, US, UK, Sweden, etc. Similar to India, the adoption has been higher among the millennials and Gen-Z with lower usage history with credit cards. Several firms have achieved economies of scale and also tapped in the public equity markets with a demonstrated business model.

Exhibit 34: Highly penetrated credit cards market-with saturation in growth



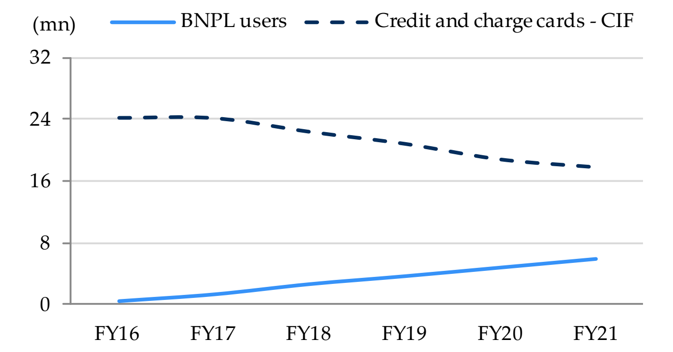
Source: BIS, HSIE Research | Note: * Data for CY19

Exhibit 35: Surge in GMV (TPV) of leading global BNPL players

Company	Year ending	Units	CY18*	CY20*	CAGR
Klarna	Dec	USD bn	29.0	53.0	35%
Affirm	Jun	USD bn	2.6	8.3	78%
AfterPay	Jun	USD bn	3.7	15.8	107%
Zip	Jun	AUD bn	1.1	5.8	130%
Sezzle	Dec	USD bn	0.0	0.9	426%

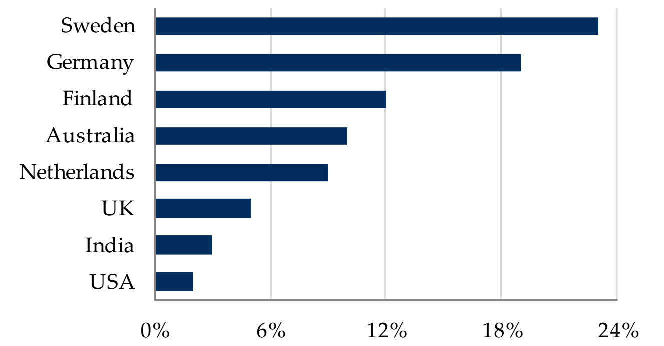
Source: Company, HSIE Research | Note: * FY19 and FY21 for AfterPay, Affirm and Sezzle

Exhibit 36: Surge in BNPL users in Australia, compared to credit cards issuances



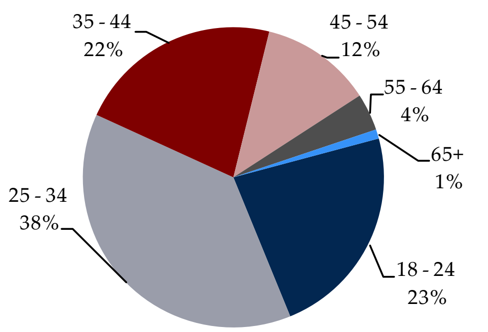
Source: RBA, ASIC, HSIE Research | Note: * BNPL users for FY21 include only top 2 players

Exhibit 37: BNPL already constitutes >10% of ecom payments in select countries (CY20)



Source: WorldPay Global Payments Report 2020, HSIE Research

Exhibit 38: Users below 35 years contributed to ~60% of BNPL transactions in FY19 (Y/E June)



Source: ASIC, HSIE Research

Exhibit 39: ~60% of people in age group 18-34 had used a BNPL product in US according to a Survey

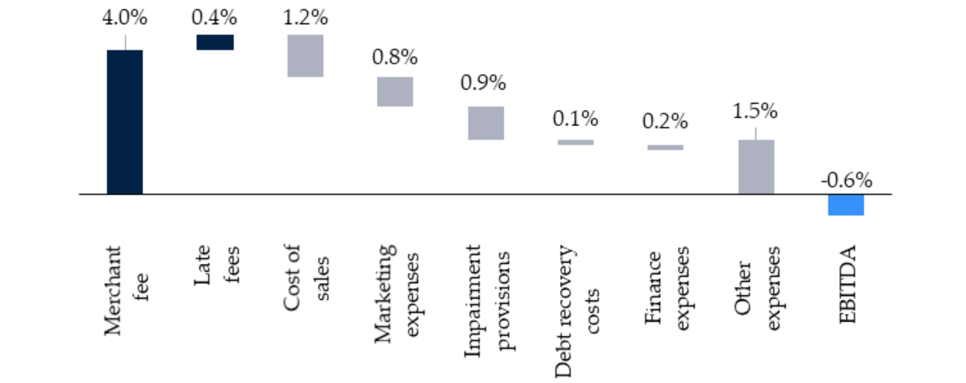
Age (in years)	Jul-20	Mar-21
18 - 24	38%	61%
25 - 34	47%	60%
35 - 44	50%	61%
45 - 54	42%	53%
Over 54	21%	41%

Source: The Ascent Survey – July-20 and Mar-21, HSIE Research

- **Unit economics gradually evolving with economies of scale:** Several leading BNPL companies such as AfterPay, Affirm, Klarna, etc., on the back of astronomical surge in GMV, have witnessed improving unit economics.

  For AfterPay, high merchant service fees remains the most important revenue driver, with small contribution from the late fees from the customer (~10-15% of revenues). The company is now gradually diversifying into other products such as bank accounts in partnership with banks (Westpac) for higher customer engagement and driving profitability. However, the profitability remains elusive as the marketing and promotion expenses, along with higher tech and employee expenses are yet to normalise.

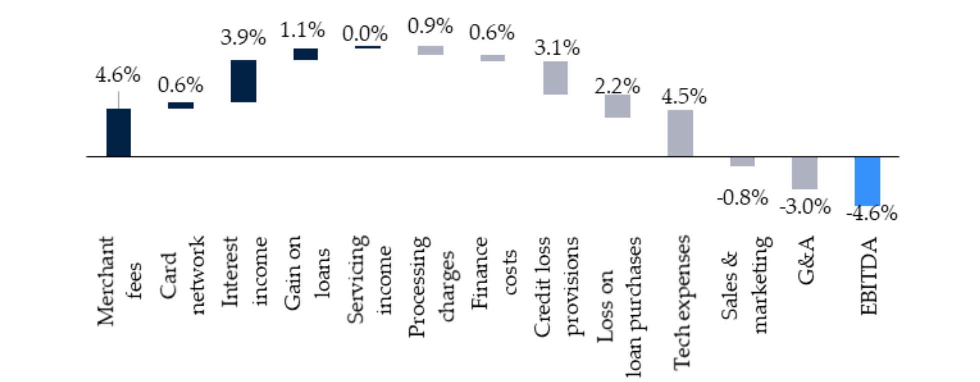
Exhibit 40: AfterPay unit economics (as % of GMV) – FY21 (Y/E June)



Source: Company, HSIE Research

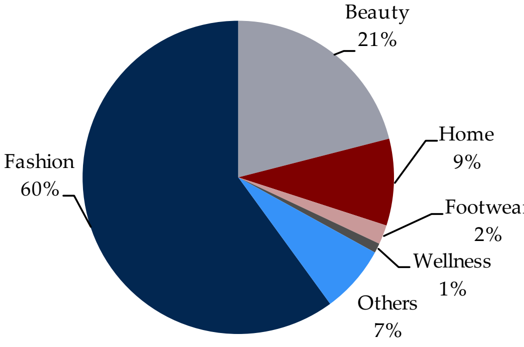
- **Affirm–diversifying revenue streams beyond merchant fees:** Companies such as Affirm have begun to diversify their revenue streams beyond merchant fees in order to achieve profitability. Affirm is now issuing virtual debit cards that generate interchange fee and buying out loan portfolio from the banking partners. However, the profitability is elusive for Affirm as well, with credit costs and tech expenses being the biggest cost drivers.

Exhibit 41: Affirm unit economics (as% of GMV) – FY21 (Y/E June)



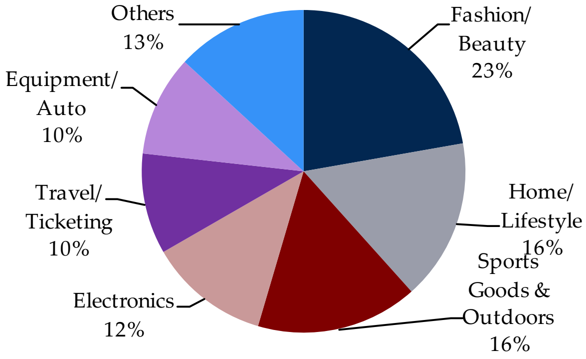
Source: Company, HSIE Research

Exhibit 42: Fashion contributed to ~60% of GMV for CY20 for ClearPay (AfterPay – UK)



Source: Company, HSIE Research

Exhibit 43: Fashion, Home/lifestyle and Sports goods contributed top categories of BNPL usage for Affirm (Q3CY21)



Source: Company, HSIE Research

- **Valuations driven by GMV, network effect:** Several BNPL players have already tapped into public markets in order to raise capital for the furious pace of growth. While the conventional metrics are not applicable due to negative earnings, the leading BNPL players are trading at ~9-12x FY23 EV/sales and ~1-3x their current GMV. The valuation premium for larger players is likely driven by growth as well increasing scale that gradually brings in network effect for larger players.

Exhibit 44: Global listed BNPL companies trading at ~0.3-2.5x GMV

Company	Country	MCap (USD mn)	Sales CAGR F21 - F23	EBITDA margin		EV/Sales (x)		EV/GMV (x)
				F21	F23	F22	F23	
AfterPay	Australia, USA, UK	15,726	58%	11%	13%	14.4	9.4	1.0
Affirm	USA	22,790	50%	-7%	-8%	17.1	11.6	2.6
Zip	Australia, USA, UK	1,610	54%	-37%	4%	5.4	3.9	0.6
OpenPay	Australia, USA, UK	61	88%	-175%	-10%	1.5	0.8	0.2
Sezzle	USA, Canada	401	48%	-46%	-24%	2.1	1.5	0.2
Splitit	USA	91	86%	-173%	29%	4.0	2.2	0.3

Source: Company, Bloomberg, HSIE Research | Note: Market capitalization as on 06-Jan-22

Exhibit 45: Some of the leading BNPL players globally

Company	Country	Year	GMV	Active customers	Active merchants	PAT
Units			USD bn	mn	'000	mn (local currency)
Klarna	Sweden	CY20	53.0	87.0	250.0	(129)
AfterPay	Australia	FY21	15.8	16.0	100.0	(159)
Zip	Australia	FY21	4.1	7.3	51.3	(166)
OpenPay	Australia	FY21	0.2	0.5	3.8	(63)
Affirm	USA	FY21	8.3	7.1	29.0	(431)
Sezzle*	USA	9MCY21	1.6	3.2	44.4	(41)
Splitit*	USA	9MCY21	0.9	2.2	26.6	(32)

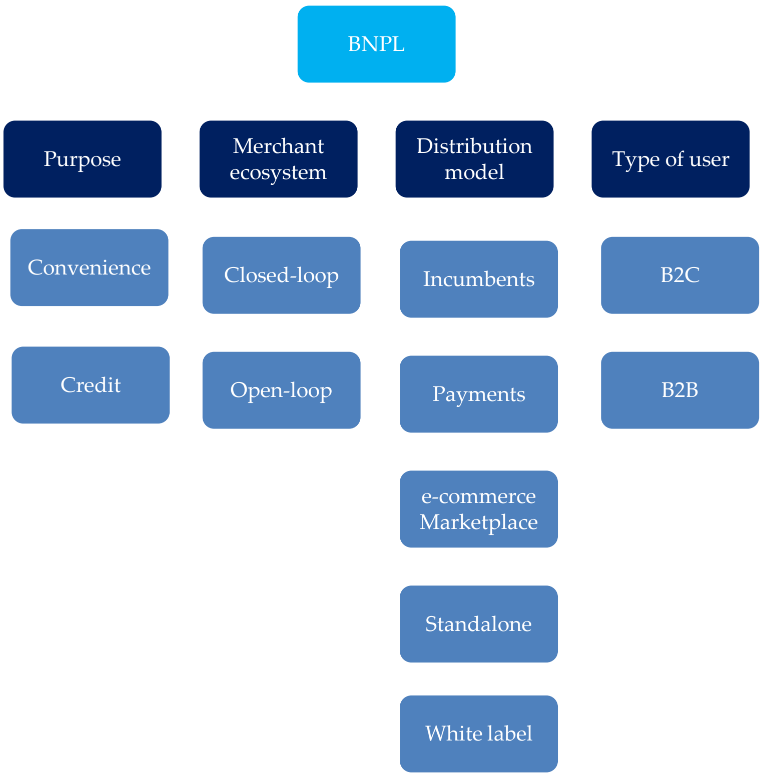
Source: Company, HSIE Research | Note: * GMV annualized | FY21 – year ending June

Different BNPL models at play

- The proliferation of BNPL in India's payments ecosystem has been fairly diverse, with players following different models. These models could be classified based on multiple parameters: purpose, target segment, merchant ecosystem, distribution model, user type, and product categories. As the ecosystem evolves, some of these models could integrate with one another or the unviable ones are likely to get weeded out.

  For the purpose of this report, BNPL is defined as the deferred payment option available at checkout (online/offline) including interest-free credit period (15d-45d), no-cost-EMI (Pay-in-3/4) and EMI financing. However, we exclude personal loans/cash advances offered by a few BNPL players from this definition.

Exhibit 46: Emerging BNPL business models



Source: Industry, HSIE Research

1. **Purpose-led - Credit models outperform**: BNPL players offer different modes of deferred payments, which could be classified under **Convenience** (15-30d interest free credit period, with bullet repayment at the end of the period) or **Credit** (3 months - 18 months interest-bearing/interest-free EMIs). Convenience features are typically used to onboard NTB/NTC customers with relatively smaller credit limits (~INR2K – INR10K). With sufficient payments track-record, the customer can be migrated to credit model, providing higher credit limits and longer-tenure loans.

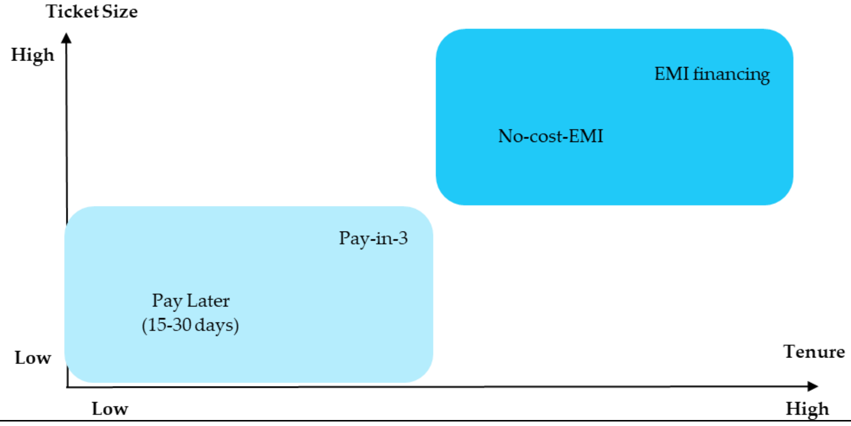
Exhibit 47: BNPL model – convenience vs. credit

	Convenience	Credit
Variants	• Pay Later: Repay in full after n days (no interest) • Pay-in-3: Repay in 3 equal instalments with no interest	• No-cost-EMI: Repay the full amount in EMIs with no interest • EMI financing: Repay at approved interest rate
Tenure	15-45 days	3 months – 18 months
Monthly spends	Small (~INR 2K – 10K)	Higher (~10K – 100K)
Customer profile	NTB/NTC/ETC/ETB	ETC/ETB
Revenue streams	• Merchant - MDR • Customer - Late fees	• Merchant - Subvention • Customer - Interest income
Delinquencies	High	Low
Bureau reporting	Depends	Yes

Source: Industry, HSIE Research

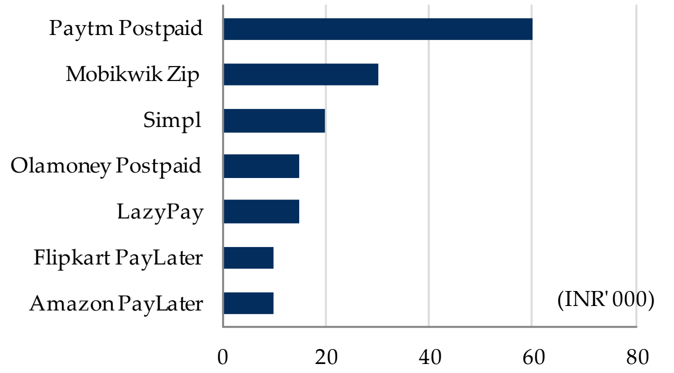
Several BNPL players are transitioning towards a hybrid model, with Convenience model being used as a customer acquisition gateway and for developing customer credit history, while the Credit model provides the major upswing in revenue and profitability.

Exhibit 48: Various BNPL models



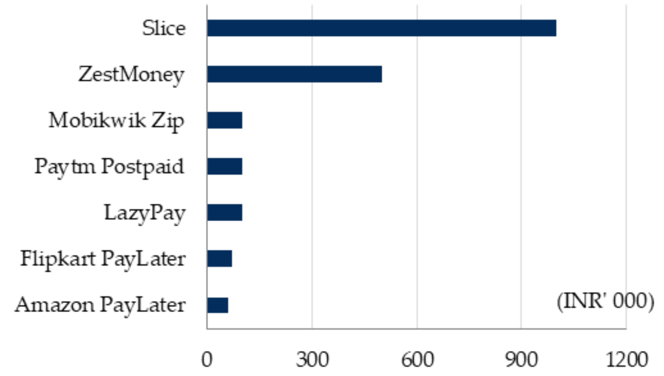
Source: Industry, HSIE Research

Exhibit 49: Lower credit limits for PayLater products (excludes EMI credit limits)



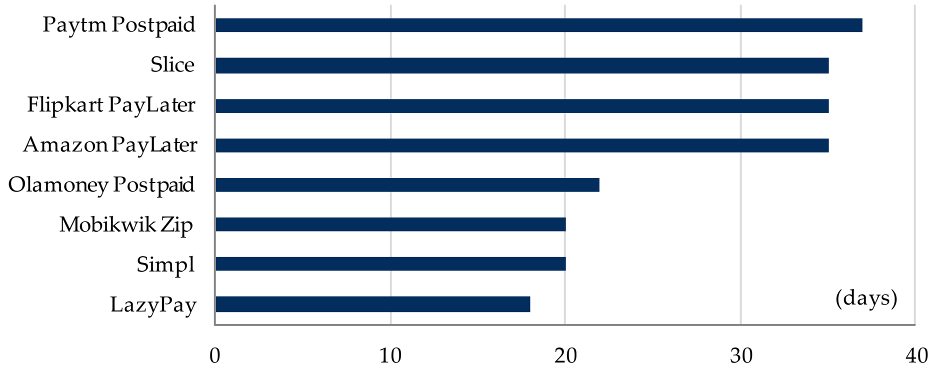
Source: Company, HSIE Research

Exhibit 50: Higher credit limits for EMI loans



Source: Company, HSIE Research

Exhibit 51: Interest-free credit period for PayLater product



Source: Company, HSIE Research

2. **Merchant ecosystem-led - Proprietary model the way to go**: BNPL players either tap into the open-loop merchant ecosystems already in place such as cards rails (Slice, debit card EMI etc.) and UPI rails, or create a closed-loop ecosystem through integration with the merchants. The open-loop network, although easier to adopt and scale, provides little competitive moats to the BNPL player, in terms of customer stickiness, as well as easily replicable by other players. The merchant fees, consequently, is lower compared to the closed-loop ecosystem.

Exhibit 52: BNPL model–open loop vs. closed loop

	Open-loop	Closed-loop
Payment rails	Cards switch, UPI	Wallets, merchant, Payment aggregators integration
MDR	Lower	Relatively higher
Customer stickiness	Low	High
Scalability	Easy	Difficult
Examples	Credit cards, Slice, LazyPay, ICICI PayLater	ZestMoney, Simpl, Paytm, FreeCharge PayLater

Source: Industry, HSIE Research

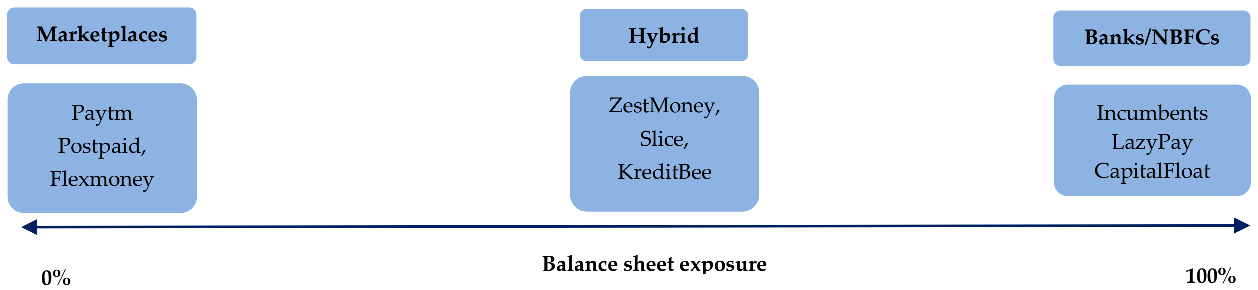
3. **Distribution-led - Incumbents could hold an advantage**: On a distribution basis, BNPL models can be classified as incumbent-led, payment companies, ecommerce marketplaces, standalone and white label service providers. Each of these models is different in terms of the target customer acquisitions, merchant ecosystem, etc. While incumbents, payment companies, and ecommerce marketplace players tap into their captive customer franchises, standalone FinTechs rely completely on open-market sourcing.

Exhibit 53: BNPL–based on distribution model

	Incumbents	Payments	Ecommerce Marketplace	Standalone	White Label
Service provider	Banks/NBFCs	Wallet (payments) provider	Marketplace	FinTechs	FinTechs
Customer profile	Mostly ETB	ETB	ETB/NTC	NTB/NTC	NA
Merchant ecosystem	Open/Closed loop	Closed loop	Closed loop	Open/Closed loop	Open loop
Balance Sheet	Own	Own/Partnership	Own/Partnership	Own/Partnership	NA
Delinquencies	Low	Medium to High	Medium to High	High	NA
Examples	ICICI PayLater, HDFC Bank FlexiPay	Paytm Postpaid, Mobikwik PayLater	Amazon PayLater, Flipkart PayLater	ZestMoney, Simpl, ePayLater	PineLabs

Source: Industry, HSIE Research

Exhibit 54: BNPL–based on distribution model



Source: Industry, HSIE Research

Most BNPL players are essentially tech platforms and 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.

4. **User type - B2B BNPL emerges as a blue sky**: While the BNPL models are predominantly focused on retail (B2C), B2B BNPL is also emerging a deferred payment mode for wholesale customers (B2B).

   B2B BNPL provides deferred payment options for small businesses/SMEs at select merchants for wholesale purchases such as inventory etc. Typically, the BNPL player provides credit to the vendors at marketplaces such as Zomato, Flipkart etc., with the marketplace acting as a quasi-counterparty to the credit line offered to the vendor. This model allows the BNPL player for granular credit assessment and higher collection efficiency.

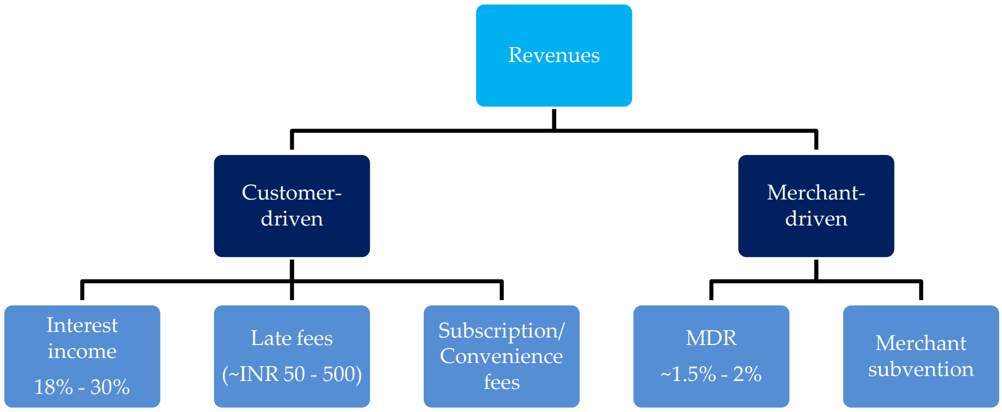
Exhibit 55: BNPL model–B2C vs. B2B

	B2C	B2B
Customer profile	Retail customers	Wholesale clients
Monthly Spends	Low	High
Revenue streams	Customer and merchant driven	Merchant-driven
Use cases	High	Low
Delinquencies	High	Medium
Counterparty risk	Retail customer	Typically Corporate
Examples	ZestMoney, Amazon PayLater	Rupifi, ePayLater

Revenue streams–limited but growing

- 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 products.

Exhibit 56: BNPL revenue streams



Source: Industry, HSIE Research

1. **Interest income**: 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.

Exhibit 57: Interest rates on EMI loans offered by BNPL players

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

Source: Company, HSIE Research

2. **Late payment charges**: Most BNPL players charge late fees based on the bill amount and the overdue period. Although the charges are lower compared to that of credit cards on absolute basis, late fees as percentage of spends is on the higher side. With the absence of a revolve credit option, most BNPL players temporarily freeze the accounts until the dues are cleared.

   A high share of late fees in the revenue mix is an indicator of a sub-optimal portfolio and not sustainable in the long run.

Exhibit 58: Late fees for BNPL players

	Simpl	LazyPay	Olamoney Postpaid	Paytm Postpaid	Slice	Amazon PayLater	Flipkart PayLater	Credit cards
Late fees	INR 12 - 118	INR 59 - 590	IN 50 - 500	INR 10 - 500	INR 0 - 100 per day	INR 100 - 590	INR 60 - 600	INR 1,000
Spends threshold for highest late fees	500	25,000	5,000	5,000	20,000	20,000	5,000	50,000
% of spends	**23.6%**	**2.4%**	**10.0%**	**10.0%**	**2.5%**	**3.0%**	**12.0%**	**2.0%**

Source: Industry, HSIE Research | Note: AXSB credit cards late fees taken for reference

3. **Subscription/convenience fees**: A few select BNPL players charge their customers a subscription or convenience fee as well. Mobikwik charges a one-time activation fee of INR 99, while Dhani app charges INR 199 for every month of usage. Paytm Postpaid charges a convenience fee of ~1-3%, depending on the BNPL variant (Lite/Delite/Elite). With most of the peers providing BNPL services without fee, charging subscription fees diminishes the value proposition to the customer to some extent.

   Select BNPL players charge convenience fees to consumers for EMI loans as well, based on tenure and ticket size. However, substantial portion of EMI loans through FinTech BNPL players levy no processing fees, unlike card-based EMI loans (up to ~2%).

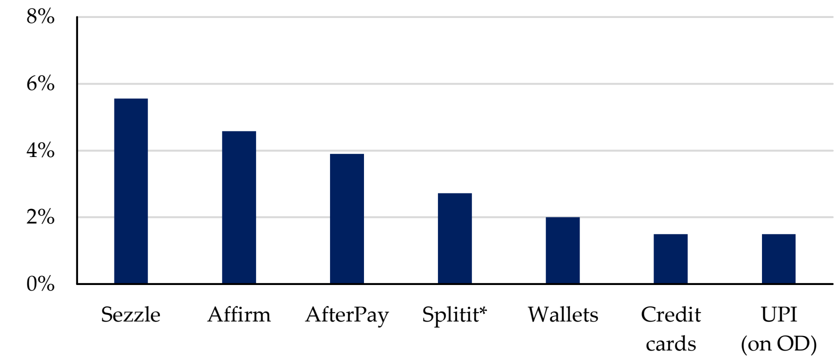
Exhibit 59: Subscription/convenience fee by a few BNPL players

Company	Customer base	Charges	Description
Flipkart PayLater	~3 mn	INR 10 per bill	Charges for monthly bill above INR 1,000
Paytm Postpaid	~3 mn	1% – 3% of spends + GST	Convenience fee based on spends
Mobikwik	~1 mn	INR 99 + GST	One-time activation fee
Dhani	1.3mn	INR 199 – 200 per month + GST	Monthly subscription fee

Source: Company, Industry, HSIE Research | Note: Active customers base for Paytm Postpaid; No. of OneFreedom Card paying subscribers for Dhani as on Sep-21

4. **Merchant fees–the holy grail**: Merchant fees, in the form of MDR and merchant subvention, is perhaps the most important revenue driver for BNPL players. Merchants' propensity to pay higher service fees is typically a function of their gross margins and opportunity cost in terms of customer acquisition (Exhibit 31). Bulk of the merchant subvention is for the three to nine months tenure EMI loans for higher ticket sizes.

Exhibit 60: Merchant service fees (% of spends) for various BNPL players (FY21 – Y/E June)

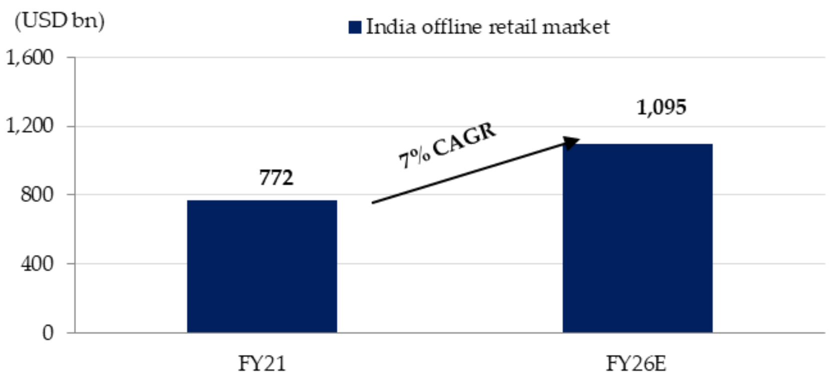


Source: Company, HSIE Research | Note: * Data for CY20; Interchange fees for Credit cards issuers in India and UPI (on OD)

- **Offline BNPL - incumbents dominate**: Offline retail still constitutes >90% of the ~USD 0.8trn Indian retail market and is poised to reach USD 1.1trn by FY26. The traditional offline BNPL segment has been dominated by banks through credit cards (~40% of total spends on POS, Credit card EMI), debit card EMI and NBFCs such as Bajaj Finance (EMI card network).

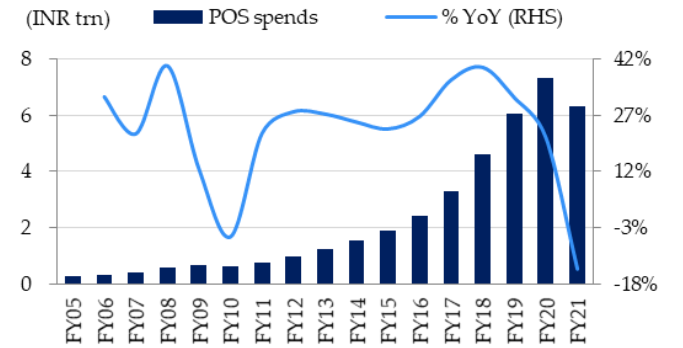
  However, except credit cards spends, bulk of the traditional offline BNPL has been through EMI financing with higher ticket size (above INR 5K).

Exhibit 61: India's offline retail market-large TAM



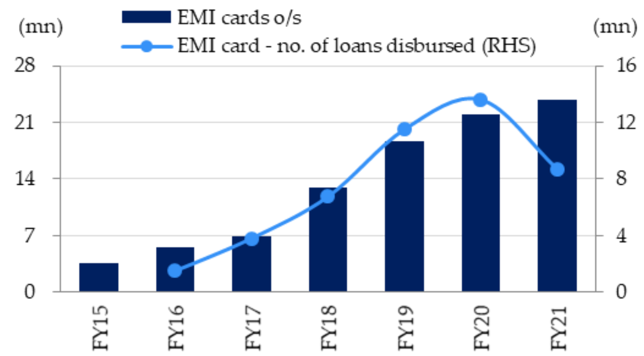
Source: Bain & Company report, HSIE Research

Exhibit 62: Credit card spends – going strong (except FY21)



Source: RBI, HSIE Research

Exhibit 63: Bajaj Finance's EMI card network and volume of loans disbursed through EMI card



Source: Company, HSIE Research

- **FinTechs - Scratching the surface, multiple models at play**: FinTech BNPLs are gradually tapping into the large offline retail market as well. Although the TAM in offline retail market is significantly high, the ease of penetration is much lower compared to online commerce. Most FinTechs are tapping into either the open-loop ecosystems such as cards network (Slice, UniCard) or UPI (LazyPay) to scale up their acceptance network. A few payments-based BNPL players such as Paytm and Mobikwik are tapping into their captive merchant network for offline payments, although the merchant penetration within their own ecosystem remains low (Paytm at ~3% and Mobikwik at <1%).

  Scalability in the offline segment is likely to remain a challenge, particularly for closed-loop ecosystems with heavy investments required in establishing and integrating with the merchant network, while the open-loop ecosystem provides lower customer stickiness.

Exhibit 64: BNPL offerings in offline space

POS	UPI	QR - Wallets	Payment Aggregators	Standalone
•FinTechs issue prepaid cards (with OD) accepted at all POS terminals •Open-loop ecosystem •E.g. Slice, Unicard, PostPe etc.	•Credit on UPI through PPI/OD account •Provides access to large QR-code acceptance network •ICICI Pay Later, LazyPay	•Based on wallet ecosystem for payments •Higher MDR compared to other modes of payments •E.g. Paytm, Mobikwik	•Integration with POS service providers such as PineLabs, Ezetap, MSwipe etc. •E.g. ZestMoney	•Closed loop - establishing network with merchants •BAF - Over 0.1mn touchpoints, INR 126 bn loans o/s (B2B sales finance)

Source: Industry, Company, HSIE Research

Profitability-too much to conquer

- **BNPL model RoA-too early to assess:** 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.

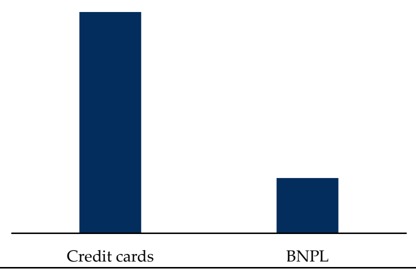
  We assess the profitability of various BNPL models with the assumption that the BNPL players have achieved economies of scale.

- **Low merchant fees, high cost of capital–a big drag on earnings:** 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).

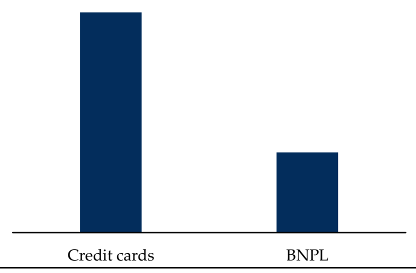
- **CAC, credit costs-key cost drivers:** Customer acquisition costs and credit costs are the key cost drivers for a BNPL player. While the customer acquisition costs are significantly lower compared to credit cards, the per-user spends and revenue potential is also lower. With higher share of NTC customers, along with lower thresholds for eligibility criteria and limited recourse with digital collections (physical collections become cost prohibitive at small ticket size), the delinquencies are likely to remain high until the BNPL player reaches a critical mass and refines the credit filter engine with multiple iterations. Having said that, the delinquencies are likely to remain higher compared to credit cards.

Exhibit 65: BNPL vs. credit cards economics

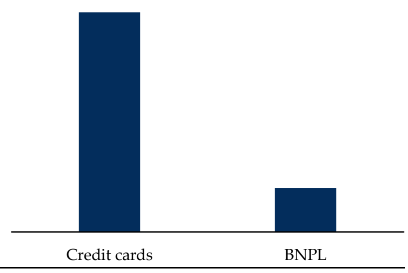
Customer acquisition cost – lower compared to credit cards



Spends per customer – BNPL vs. credit cards



Average ticket size – Credit cards vs. BNPL



Source: Industry, HSIE Research

- **Transitioning towards a sustainable RoA a long journey**: Our assessment of the profitability of various BNPL models indicates the journey to a superior profitability would be a long and arduous one. Due to a brief tenure (~3-4 months), the receivables outstanding would be a fraction of the total spends and, hence, earnings per user would be a better metric to monitor instead of RoA.

  We have assumed MDR at ~1.5%, cost of capital at ~11%, APR for EMI loans at ~24% and merchant subvention for no-cost-EMI loans at ~3.5%.

Exhibit 66: Assessing profitability of BNPL players

(% of spends)	Vanilla BNPL	EMI mix BNPL	No-cost EMI	EMI financing	Credit cards	Key assumptions
Interest earned	0.0%	1.9%	0.0%	3.8%	3.7%	@ 24% EIR
Interest expended	0.9%	0.9%	1.6%	1.7%	0.9%	Cost of funds @ 11%
Net interest income	**-0.9%**	**1.0%**	**-1.6%**	**2.1%**	**2.8%**	
Fee income	2.3%	2.2%	5.3%	1.8%	3.7%	MDR @ 1.5%; Late fees – INR 250 per instance
Total income	1.4%	3.2%	3.7%	3.8%	6.5%	
Operating expenses	1.2%	1.1%	1.2%	1.2%	3.8%	Low opex for BNPL with improving scale
Pre-provisioning profit	0.2%	2.0%	2.5%	2.6%	2.8%	
Non-tax provisions	3.3%	2.3%	1.9%	1.9%	1.5%	Elevated credit costs for BNPL, particularly vanilla BNPL
Profit before tax	-3.1%	-0.3%	0.6%	0.7%	1.2%	
Tax expenditure	-0.8%	-0.1%	0.2%	0.2%	0.4%	@ 25% effective tax rate
Profit after tax	**-2.3%**	**-0.2%**	**0.5%**	**0.5%**	**0.9%**	

Source: Company, Industry, HSIE Research

Note:

1. Average of SBI Cards performance during FY19 – FY21 considered for credit cards;

2. Mechant subvention @ 3.5% for no-cost-EMI financing; 50% EMI share for EMI mix BNPL model;

3. Credit costs @ 3.3% for vanilla BNPL, 1.9% for EMI financing;

4. Other income includes MDR plus late fees – 15% instances with average fee of INR 250;

5. Monthly spends of INR 5K for BNPL

Exhibit 67: Income statement of several BNPL players indicates profitability is still a while away (FY20)

(INR mn)	Simpl	ZestMoney	PayU Finance	Slice	Capital Float
Net interest income	(48)	(61)	101	65	778
Other income	105	755	348	326	619
Total income	57	694	449	392	1,397
Operating expenses	401	2,503	927	372	1,612
Pre-provisioning profit	(343)	(1,810)	(478)	20	(216)
Non-tax provisions	153	0	258	29	1,071
Profit before tax	(497)	(1,810)	(737)	(10)	(1,286)
Tax expenditure	0	0	0	2	(0)
Profit after tax	(497)	(1,810)	(737)	(12)	(1,286)

Source: VCC Edge, HSIE Research | *Note: ZestMoney – Camden Town Technologies Private Limited; Simpl – Get Simpl Technologies Private Limited, Slice – Garagepreneurs Interent Private Limited (Consolidated), Capital Float – CapFloat Financial Services Private Limited*

- **Diversifying the business model imperative**: We believe a healthy mix of convenience and credit is imperative for driving the profitability of a BNPL portfolio. While the convenience model helps in acquiring and engaging customers on the platform, the credit piece offers a strong revenue model either in the form of interest income (from the customer) or subvention (from the merchant).

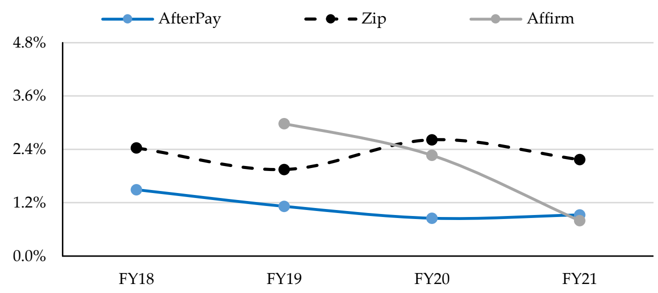
  The model is similar to that of credit cards, where an optimum mix of revolving and EMI portfolio is essential, along with transactor portfolio to drive superior profitability (RoA and earnings per card).

Exhibit 68: Credit costs as a percentage of revenues

	FY17	FY18	FY19	FY20
Capital Float	18%	29%	55%	53%
Mobikwik	NA	NA	54%	67%
PayU Finance	NA	NA	44%	57%
Simpl	NA	NA	139%	152%
Slice	NA	59%	26%	8%
ZestMoney	NA	175%	106%	98%
SBICARD	12%	17%	16%	23%

Source: VCC Edge, Company, HSIE Research | Mobikwik: Only BNPL segment considered

Exhibit 69: Credit costs as a percentage of GMV



Source: Company, HSIE Research

What makes a robust BNPL franchise?

- **BNPL models evolving; key ingredients likely to remain constant:** We have assessed the various FinTech BNPL models on our proprietary HSIE-BNPL Quotient framework. The framework encapsulates six key parameters: scale, customer value proposition, key revenue drivers, customer engagement levels, cross-sell opportunities, and risk management.

  A robust BNPL franchise, in our view, should have deep competitive moats with a large merchant network (preferably closed-loop), with healthy customer value proposition and an optimum mix of convenience and credit products to drive overall profitability. The franchise should also have the ability to onboard NTC customers enabling to target a large potential customer base; however, its credit filtering algorithms and dynamic risk management should keep the credit costs below the threshold level.

- **Incumbents vs. FinTech BNPLs - different models, different objectives:** While incumbents have their own BNPL offerings as well, they are mostly targeted at ETB customers with focus on improving customer stickiness and provide further fillip to profitability. Hence, we benchmark these BNPL players in two different categories.

- **BNPL players scaling up:** BNPL players in India are currently in the growth phase, scaling up their customer and merchant base, along with driving up their engagement levels. This is driving the higher burn-rates despite low CAC for a BNPL customer and higher delinquencies, becoming a big drag on profitability. As the BNPL players reach a critical mass, we expect the operating losses to recede and unit economics to stabilise.

Exhibit 70: HSIE-BNPL Quotient framework – FinTechs

Category	Parameters	Simpl	ZestMoney	LazyPay	Slice	Amazon PayLater	Flipkart PayLater	Paytm Postpaid	Mobikwik Zip	Olamoney Postpaid
Scale	# Customers	●	◕	◑	◔	◔	◔	◔	○	○
	# Merchants	○	◑	◑	◑	●	◔	◑	○	○
	Breadth of merchants	○	●	◑	●	◔	◔	◑	○	○
Customer value proposition	Interest-free credit period*	▮▯▯▯		▮▯▯▯	▮▮▮▮	▮▮▮▮	▮▮▮▮	▮▮▮▮	▮▯▯▯	▮▯▯▯
	Subscription fee	x	x	x	x	x	✓	✓	✓	x
	Credit limit**	▮▯▯▯	▮▮▮▮	▮▯▯▯	▮▮▮▮	▮▯▯▯	▮▯▯▯	▮▯▯▯	▮▯▯▯	▮▯▯▯
Revenue drivers	MDR	▮▮▮▮	▮▮▮▮	▮▮▮▯	▮▯▯▯	▮▮▮▯	▮▮▮▯	▮▮▮▮	▮▮▮▮	▮▮▯▯
	Interest income (EMI loans)	x	✓	✓	✓	✓	✓	✓	✓	x
	Late fees (Max)	▮▮▯▯	▮▯▯▯	▮▮▮▮	▮▮▮▮	▮▮▮▮	▮▮▮▮	▮▮▮▮	▮▯▯▯	▮▮▮▮
Engagement levels	Spends/active user/month	◑	●	◔	●	◔	◔	◑	◔	○
	# Transactions per month	◕	◑	●	●	◔	◔	●	◑	○
Cross-sell	EMI EIR %	x	▮▮▯▯	▮▮▮▯	▮▮▮▯	▮▮▮▯	▮▯▯▯	▮▮▮▮	▮▮▯▯	x
	Other products***	x	✓	✓	✓	x	x	✓	✓	x
Risk management	Collection intensity	○	●	○	●	◑	◑	◑	◑	○
	ETB/NTB	NTB	NTB	NTB	NTB	ETB	ETB	ETB	ETB	ETB

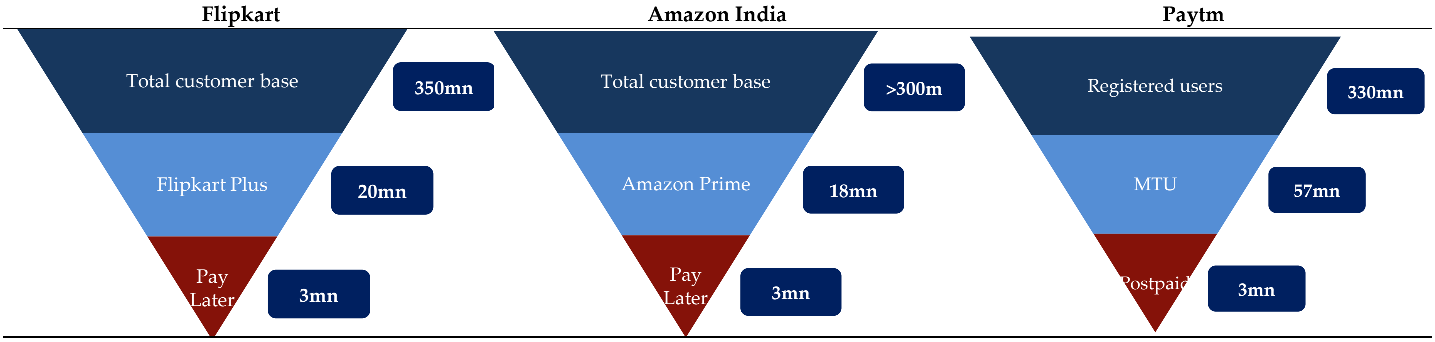
Source: Company, Industry, HSIE Research | Note: Full dark circle denotes highest, white circle denotes least; ETB denotes captive customer base; * Interest-free credit period considered only for PayLater products; ** Credit limit for EMI loans; *** Other products include personal loans, cash withdrawals, insurance etc.; Collection intensity includes different modes of collections for delinquent customers

- **ZestMoney evolving faster than peers:** As per our framework, ZestMoney (Camden Town Technologies) seems to be scoring higher than peers in becoming a robust BNPL franchise. The company has begun to gain scale, while diversifying into interest-generating EMIs, personal loans, insurance etc. Slice, a card-based BNPL, also seems to be making healthy inroads into the segment, emerging as a direct competitor to credit cards, with the advantages of a FinTech.

- **E-commerce-led BNPLs scaling gradually:** While the ecommerce platform-led BNPLs such as Amazon PayLater, Flipkart PayLater etc. have significant advantages in terms of a large captive customer base, customer traction on the platform and agility similar to FinTechs, the scalability has been lower than our expectations. For example, Flipkart PayLater customer base is still at ~15% of the Flipkart Plus customer base and ~1% of Flipkart's customer base.

- **FinTechs - payments to lending journey a reality check:** Several FinTech players had ventured into payments as a steppingstone to financial services, with the objective of acquired customers and their transaction data acting as the pool for cross-selling other financial products (with incremental near-zero CAC). While a few have ventured into lending as well through BNPL such as Mobikwik, BharatPe, Paytm etc., the journey has met with little success so far in terms of scaling up the portfolio and achieving profitability along expected lines.

Exhibit 71: Cross-sell for payments and ecommerce firms: Large TAM, low penetration so far



Source: Company, HSIE Research | Paytm statistics as on 30-Sep-21 (Postpaid includes only active users); Flipkart statistics as on 30-Jun-21; Amazon Prime subscribers statistics as on Jun-21

- **Card-based BNPLs–confluence of cards and FinTech BNPL:** Card-based BNPL players such as Slice, UniCard etc. are leveraging the open-loop card rails with a product that is a mix of a BNPL and credit card. While the open-loop merchant ecosystem provides little competitive moats with merchants, the familiarity of the card product has been able to drive healthy metrics for players such as Slice in terms of spends per active card (~INR10K per month), transaction frequency (>4 transactions per month), etc.

Regulatory arbitrage waning

- **Diminishing regulatory arbitrage seems inevitable:** Increasing scrutiny of BNPL models in India and globally by the regulators could have repercussions in terms of higher friction in the seamless customer experience as well as higher costs of compliance impacting the profitability. However, the increasing pace of digital adoption is likely to sustain some of these competitive moats for FinTech BNPL with respect to customer experience as well as opex.

- **Customer onboarding:** The stringent KYC norms laid down by the RBI typically increase the compliance costs that reflect in higher TAT for onboarding new customers and higher associated costs (CAC). While the incumbents have to adhere to these norms, several BNPL players onboard customers with either minimum KYC (only proof of identity) or through OTP-based e-KYC, which is currently allowed by RBI for credit limit up to INR 60K during a financial year.

  Increasing parity in terms of KYC norms is likely to increase associated costs and higher TAT for the BNPL players. However, the increasing digital adoption with CKYC, Aadhaar offline KYC etc. is likely to lower the customer onboarding costs for BNPL players as well as incumbents.

Exhibit 72: Regulatory norms-FinTech BNPL

	Lending - Own/Lending partner	Reporting to credit bureau	KYC – PayLater	Income proof
Credit cards	Own	✓	Full KYC	✓
BNPL #1	Own, Lending partners	✓	Full KYC	✓
BNPL #2	Own	×	Min KYC	×
BNPL #3	Own	✓	Min KYC	×
BNPL #4	Own, Lending partners	×	Full KYC	✓
BNPL #5	Lending partners	✓*	Min KYC	×
BNPL #6	Lending partners	✓*	Min KYC	×
BNPL #7	Lending partners	✓*	Full KYC	×
BNPL #8	Own	✓	Min KYC	×

Source: Industry, HSIE Research | Note:* Reporting to Credit bureaus through the lending partner for EMI loans

- **"Rent-an-NBFC" model and FLDGs:** The regulatory prohibition on FLDG (first loss default guarantee) arrangements between a bank/NBFC and a FinTech (non-regulated entity), if implemented, is likely to arrest the unbridled growth of BNPL. FLDG arrangements typically provide a comfort to the lenders with respect to credit risk of the disbursed portfolio. The absence of such arrangements are likely to lead to stringent customer selection criteria and lower credit limits, leading to lower disbursals.

  Several BNPL providers have incrementally acquired an NBFC license, through the subsidiary route, along with simultaneously entering into partnerships with banks and NBFCs. We expect BNPL players to acquire an NBFC license for balance sheet lending or witness slower pace of growth as incremental customer acquisition shifts towards better-rated customers.

- **Reporting to credit bureaus:** BNPL players, who lend on their own balance sheets and are not registered as NBFCs, are not covered under the CIC Act (Credit Information Companies Act) and, hence, do not report loan defaults to the bureaus. The primary rationale has been the volatility in the credit score due to the very small-ticket nature of such transactions, which skews the actual creditworthiness of a user. While the data-dark approach has its merits, the non-reporting of defaults to bureaus masks the credit history of borrowers from other lenders (banks and NBFCs) as well.

- **Fair disclosures:** With the absence of a regulator and a wide self-regulatory organisation, the demand for fair customer disclosures such as upfront disclosures of all the charges and risks involved is muted.

- **RBI's discussion paper a precursor to impending regulations:** The RBI's working committee report on digital lending paves the way for the RBI's impending regulatory framework on digital lending (including BNPL), in our view. While there is likely to be a negative near-term impact on pace of disbursals, the proposed norms create a healthy regulatory environment for such digital lenders. The recommendations suggest bringing digital lending (including BNPL) under the credit and regulatory net, ensuring proper reporting of credit to bureaus, authentic lending apps, and proper utilisation of co-lending mechanism instead of FLDG mechanism.

  Small-ticket unsecured credit proliferation (BNPL), if left unregulated, could be a reminder of the 2010 AP micro-lending crisis, which had serious implications for the entire MFI industry.

Exhibit 73: Key recommendations by RBI's working committee on digital lending

Existing norms	Proposed regulations	Impact
FLDG between lenders and FinTechs	FLDG only among regulated entities (Banks, NBFCs) with upper cap at ~15-20%	More FinTechs to adopt an NBFC license (co-lending model)
BNPL not classified under short-term consumer credit	Bringing BNPL under the ambit of short-term consumer credit	Enabling bureau reporting to assess leverage per customer
KYC norms and Data privacy	Ensuring full KYC of customers, with proper policies in place for customer data protection	Higher CAC, TAT for customer onboarding
Lack of comprehensive disclosures regarding fees and penal charges, interest rates etc.	Enhanced disclosures regarding APR, fees, late charges etc.	Enhanced customer awareness leading to lower frauds etc.
No certification of digital lending Apps	Constitution of DIGITA – independent agency, to authorise and certify legal apps	Weeding out of illegal/untrust-worthy lending app from market providing more credibility
Lack of a regulatory body for oversight	Constitution of an SRO (Self-regulating organization)	
Algorithms for credit assessment	Auditing of credit filter algorithms	
Neobanks not regulated	Bringing neobanks under the ambit of regulation by RBI	

Source: RBI, HSIE Research

Exhibit 74: BNPL's seamless experience may witness some friction from enhanced regulations

Onboarding during checkout	•Full KYC requirements may increase friction •No FLDG arrangement may lead to lower approval rates
Extremely low TAT	•Full KYC requirements may increase TAT
One-click checkout	•Introduction of additional factor of authentication will take away the one-click experience •Increased friction will bring it nearly at par with cards
End-to-end digital product	•NA
Low fees from customer	•Fair and upfront disclosures may keep the customer fees low for a while •Business viability may necessitate leving charges at some point of time

Source: HSIE Research

- **Seamless experience may witness some speed bumpers going ahead:** While the user experience in terms of convenience and ease of usage of BNPL is far superior to that of credit cards, the enhanced regulations on BNPL may narrow the gap between the two modes of payments. As can be seen from exhibit above, all the key features of a superior user experience of BNPL except end-to-end digitisation is likely to witness disruption to some extent, if and when the regulations are enforced.

- **Globally, BNPL gradually coming under scrutiny:** After a relatively free run with high regulatory arbitrage, BNPL providers globally are increasingly coming under scrutiny from the regulators. Regulators across countries such as Australia, UK, US, Sweden and European Union are increasingly contemplating bringing BNPL under the ambit of consumer credit, thus narrowing down the regulatory arbitrage with the incumbents. The primary concerns remain consumer protection from debt traps, opacity of disclosures and bringing parity with respect to traditional lenders.

Exhibit 75: FinTech BNPLs – Regulations around the globe

USA

- **Mar-20**: The California Department of Business Oversight charged Afterpay for making illegal loans (engaged in the business of a finance lender without obtaining a required license) (similar settlement with Sezzle in Jan-20 and QuadPay in Apr-20)
- **Dec-21**: CFPB (Consumer Financial Protection Bureau) has sought information from 5 leading BNPL players regarding the risks and benefits of BNPL. The Bureau is primarily concerned about **accumulating debt, regulatory arbitrage** and **data harvesting**

Australia

- Regulated as credit under the ASIC act 2001
- **Mar-21:** AFIA announced "Code of Practice" for BNPL players - setting best practices for the sector and strengthening consumer protection
- **Oct-21:** RBA allows merchants on BNPL platforms to pass on surcharge for their services
- **Oct-21:** Design and distribution obligations to apply to BNPL players requiring them to identify in advance the target consumer segment and to direct distribution to that target market

Sweden

- **May-20**: Amendment to Swedish Payment Services Act requires payment service providers to present debit-based payments modes before the credit-based payments and the credit-based payment mode cannot be the pre-selected mode of payment
- **July-21**: Swedish FSA investigating BNPL firm Klarna for potential breach of bank secrecy laws in connection with an IT incident in May (Klarna's customers were able to see other customers' data for ~30 minutes)

UK

- **Feb-21**: Woolard review report, published by the FCA, strongly recommended the need to regulate all BNPL products to protect consumers (improving product awareness, higher affordability assessments) as well as to ensure its sustainability
- **Oct-21**: Consultation paper released by HM Treasury on the extent of regulation of BNPL by the FCA

European Union

- **Jun-21**: European Commission has proposed to revise Consumer credit Directive to bring short-tenure interest-free credit such as BNPL under its ambit. Implications could include tighter rules around upfront disclosures on various charges, consumer adveritising and credit assessment.

Source: RBA, ASIC, FCA, CFPB, AFIA, DFPI, HSIE Research

Incumbents and BNPL–threat vs. opportunity

- **Incumbents gravitating gradually towards BNPL:** Incumbent banks have traditionally been providing BNPL offerings in the form of EMI financing (including no-cost-EMI) through credit cards and debit cards EMI. A few NBFCs such as Bajaj Finance (most formidable) and Home Credit Finance have been very active in EMI financing.

  With the advent and surge of BNPL, leading private banks are upping their game with their own BNPL offerings, broadly similar to FinTech BNPL offerings. HDFC Bank's FlexiPay, ICICI Bank's PayLater and Cardless EMI, Axis Bank's FreeCharge PayLater, Kotak Mahindra Bank's Smart EMI and IDFC First Bank's Easy EMI card are aimed to provide seamless payments experience without a debit or credit card.

Exhibit 76: Incumbents' credit-based payments

Credit Cards - EMI & Pay Later	Debit cards EMI	Cardless EMI/BNPL PayLater
•PayLater: Interest-free period up to 50 days •EMI: No-cost EMI and Interest-rate EMI (~12-24%) •Offline (POS enabled) and online merchants •ETB customers •Receivables (FY21): INR 1.7trn	•No-cost-EMI and Interest rate EMI (~12-18%) •Offline (POS enabled) and online merchants •Pe-approved ETB customers •Offered by most banks	•Pay Later: Interest-free period up to 15 - 45 days •No-cost-EMI and at-cost-EMI at POS (offline and online) •NTB and ETB customers •Offered by very few banks only currently

Source: RBI, Company, HSIE Research

- **Focus remains on ETB customers, profitability:** While the incumbents' non-card-based BNPL offerings are similar to FinTech BNPL offerings, they are kept limited mostly to ETB customers. While cross-sell to an ETB customer improves the profitability with low CAC and low delinquencies (transaction history, right-of-lien etc.) along with increasing customer stickiness, it doesn't serve the purpose of widening the customer funnel for the bank through new customer acquisitions on the asset side.

Exhibit 77: Incumbents' BNPL offerings

	HDFC Bank FlexiPay	ICICI Bank PayLater	Axis Bank FreeCharge PayLater	ICICI Cardless EMI	Kotak Smart EMI
Interest-free credit period (days)	15	45	30	NA	NA
Launched in	2018	Nov-18	Q4FY21	Nov-20	Aug-21
Payment Rails	Payment aggregators	UPI	Wallet	Payment aggregators	Payment aggregators
Credit Limit (INR' 000)	1 - 60	20	10	10 – 1,000	1,500
EMI tenure (months)	1 - 3	NA	NA	3 - 15	6 - 24
Eligibility	Pre-approved CA and SA customers	ETB	NTB, ETB	Pre-approved ETB customers	NTB, ETB
Interest rate – EMI loans	~28%	NA	NA	10% - 22%	0% - 30%
Processing fees	0	0	0	0	INR 99 - 2,999
Late fees	3% per month	INR 250 + 3% per month	INR 10 per day	INR 400 + 2% per month	INR 750 + 3% per month

Source: Company, HSIE Research | Note: HDFC Securities is a subsidiary of HDFC Bank

- **Partnerships with FinTechs for indirect lending:** Incumbents have been participating in the BNPL segment through direct offerings to customers as well as indirectly through partnership with FinTechs. Most FinTech BNPL players have entered into partnership with the incumbents, whereby the disbursements, particularly EMI loans (no-cost-EMI and at-cost EMI), are carried out by the incumbents, with the FinTech BNPL earning a sourcing fee.

Exhibit 78: Lending partners for BNPL providers

BNPL	Lending partners
amazon pay Later	IDFC FIRST Bank; CAPITAL FLOAT
Flipkart Pay Later	IDFC FIRST Bank
Flexmoney	IDFC FIRST Bank; HDFC BANK; kotak; ICICI Bank; HOME CREDIT; FEDERAL BANK
MONEYTAP	HDB FINANCIAL SERVICES; RBL BANK; Fullerton India; CREDIT SAISON INDIA; DMI FINANCE
MobiKwik ZIP	IDFC FIRST Bank; DMI FINANCE; InCred; Fullerton India
paytm POSTPAID	ADITYA BIRLA FINANCE; CLIX
RUPIFI	AXIS BANK; Muthoot Finance; TVS CREDIT
slice	NORTHERN ARC; DMI FINANCE; aphelion; FAI₹CENT; vivriti CAPITAL
zest EMI FOR EVERYONE	TATA CAPITAL; ADITYA BIRLA FINANCE; CSB Bank; CREDIT SAISON INDIA; DCB BANK

Source: Company, HSIE Research | Note: The list of lending partners is not exhaustive

Exhibit 79: Implications for incumbents

Segment	Threat/opportunity	Incumbents	Implications
Credit cards	Direct competitor to Credit card	All credit card issuers	
Customer funnel	Widening the customer funnel through NTB customer acquisitions	AXSB, KMB acquiring NTB customers through BNPL offerings	Increased digitisation to reduce friction and provide seamless experience to customers
ETB customer stickiness	Improving customer stickiness (PPC) through BNPL	HDFCB, ICICIBC, KMB, AXSB, IDFCFIRST have BNPL offerings as of now	Driving profitability with minimal CAC and high IRR
Partnerships	Portfolio/earnings growth	IDFCFIRST, Leading private banks	Growth in disbursals and revenue, access to NTB customers

Source: HSIE Research

Implications for credit cards I Collaborators or Competitors

- **Credit cards - the most exhaustive form of BNPL:** Despite multiple business models of various BNPL players, credit cards, by far, remain the most exhaustive form of BNPL in terms of its value proposition to the customer. A longer interest-free credit period, revolving credit facility, along with EMI facilities make it a lucrative deferred-payment option. Moreover, the cashbacks/rewards such as lounge access, reward points, club memberships etc. further widen the gap in terms of offerings.

Exhibit 80: Credit cards vs. FinTech BNPL

	Credit cards	BNPL
Customer offerings		
Interest-free credit period	Up to 50 days	Up to 15 – 30 days
Credit limit	High	Low for PayLater products
Revolving credit facility	~42% APR	×
EMI loans interest rates	0% - 20% APR	0% - 32% APR
Rewards/cashbacks	Average of ~1% cashback	Limited
Cash advances	~30% APR	×
Merchant network	Offline + Online	Mostly online
International acceptance	✓	×
Balance Transfer	✓	×
Complementary benefits	Lounge access, club memberships etc.	NA
Fees & Charges		
Subscription fee	INR 0 – 10,000	Mostly nil
Late fees	~INR 250 - 500	~INR 100 – 250
MDR (merchant)	~2%	~2%
Cash withdrawal charges	~2 – 2.5%	NA
Balance transfer charges	~1%	NA

Source: Industry, HSIE Research I Note: The average numbers are taken, the offerings vary from company to company I Revolving credit facility currently only offered by LazyPay

As the above exhibit illustrates, credit cards value proposition to a customer is far more exhaustive than FinTech BNPL. While BNPL models are still evolving and may encapsulate more offerings, going ahead, it is likely to further shrink the unit economics and viability of the product as well.

The key argument against credit cards has been the spiralling of debt trap and very high revolving credit interest rates. However, the credit card issuers filtering criteria in terms of income assessment and calibrated credit limits seek to keep the delinquent customers portfolio under check.

- **BNPL scores higher on convenience**: As discussed in the earlier sections, a seamless user experience has been one of the key drivers for massive surge in BPNL. Despite the increasing digital adoption and digitisation initiatives by incumbents, credit cards usage is less seamless compared to BNPL. However, the narrowing down of regulatory arbitrage is likely to close the gap to an extent.

Exhibit 81: User experience for credit cards and FinTech BNPL

	Credit cards	BNPL
KYC	Full KYC	Min. KYC/Full KYC
End-to-end digital	× (except for a few cases)	✓
TAT	High	Low (few minutes)
One-click checkout	×	✓

Source: Industry, HSIE Research

- **Credit cards issuers' FinTechs partnerships accelerating growth:** Leveraging the strengths of FinTechs, the incumbents are partnering with FinTechs/consumer techs on issuances as well as acceptance side to grow the credit cards ecosystem.

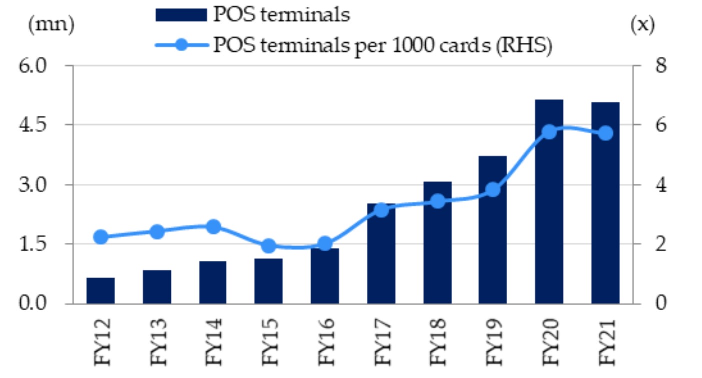
  On issuances side, several credit card issuers have partnered with FinTechs with a large captive customer base to launch co-branded credit cards with curated offerings on their platforms (ICICI Bank-Amazon, Axis Bank-Flipkart, HDFC Bank-Paytm). The partnerships aid the FinTechs in increasing customer stickiness and throughput on their platform while the incumbents are able to grow their profitable credit cards pool, with the advantage of transaction history of the customer (although there is no direct data sharing), leading to higher conversion rates, lower delinquencies, and higher digitisation in the customer onboarding journey.

Exhibit 82: Incumbents and FinTechs' partnerships in credit cards ecosystem

Bank	FinTech/BigTech	Customer base (mn) - FinTech	Comments
Issuances			
ICICI Bank	Amazon	>300mn	>2mn cards issued
Axis Bank	Flipkart	350mn	>1.4mn cards issued
HDFC Bank	Paytm	333mn	Launched in Nov'21
Federal Bank	OneCard	NA	Launched in Sep'21
RBL Bank	MoneyTap	NA	
SBICARD	Paytm	333mn	
Acceptance			
Axis Bank	BharatPe	7mn	Launched in Aug'21
HDFC Bank	Paytm	21mn	Launched in Sep'21

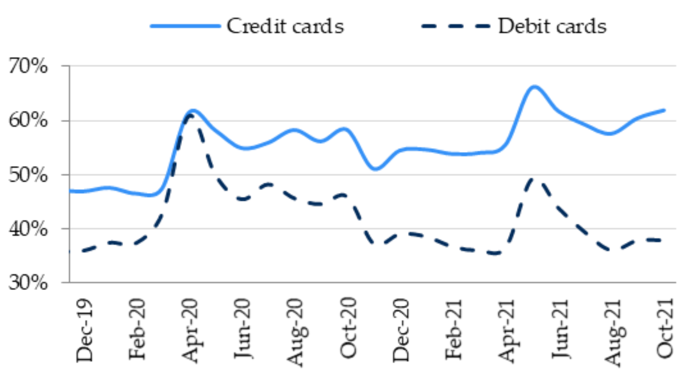
Source: Industry, HSIE Research | Merchant base in case of acceptance partnerships

Exhibit 83: POS terminals penetration improving



Source: RBI, HSIE Research

Exhibit 84: ecom share in card spends



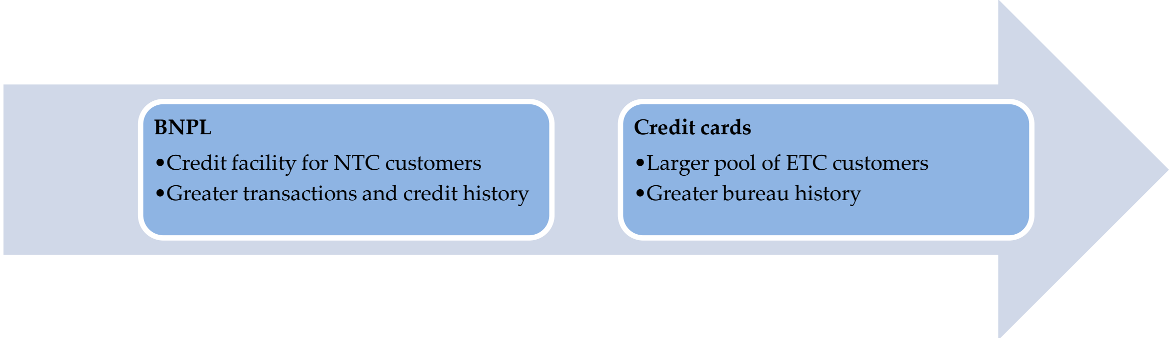
Source: RBI, HSIE Research

- **Mutually exclusive or mutually beneficial:** While BNPL is perceived to be a challenger to credit cards, the glaring differences in terms of target customer segment and value proposition indicate the two products are likely to coexist. With miniscule penetration of credit cards (0.004 cards per capita) and BNPL (~10mn users), the addressable market opportunity for both the products remains large.

  Most of the credit card issuers focus on the salaried, ETB/ETC customer segment (share of NTC at 18%), within the age group of 26-50 years. BNPL, on the other hand, focus on Gen Z and millennials segment, NTC segment, and lower credit limits.

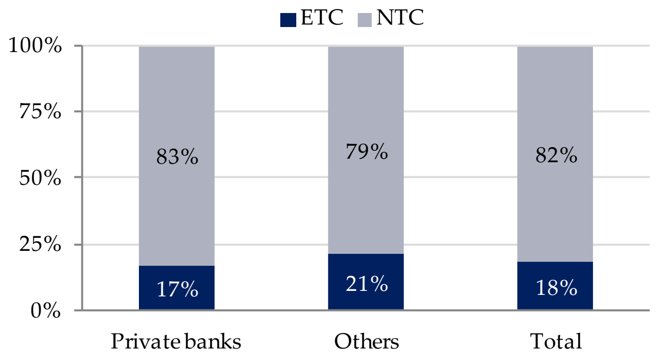
If the regulator brings BNPL under the ambit of consumer credit, it is likely to provide greater credit history and data for the NTC segment, which further expands the target customer segment for the credit card issuers.

Exhibit 85: BNPL customer pool–a credit tested pool for credit cards issuers



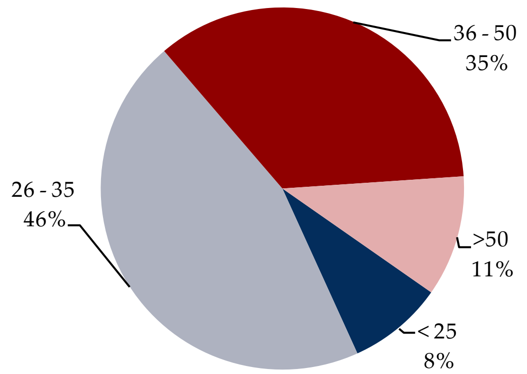
Source: HSIE Research

Exhibit 86: ETC share in new customer acquisitions–credit card (FY21)



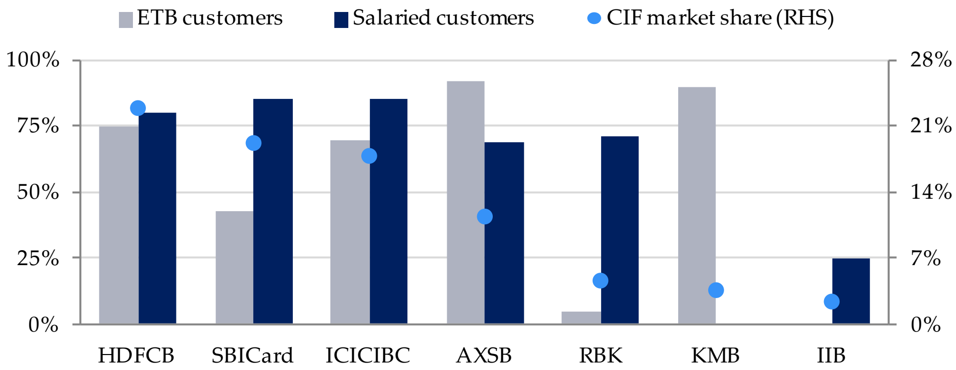
Source: CRIF High Mark, HSIE Research

Exhibit 87: Customer age profile–credit card users (Mar-21)



Source: CRIF High Mark, HSIE Research

Exhibit 88: Incumbents' credit card portfolio comprises largely ETB salaried customers (Sep-21)



Source: Company, HSIE Research | Note: HDFC Securities is a subsidiary of HDFC Bank; KMB: Salaried customer mix unavailable, IIB's ETB customer mix unavailable

- **Indian incumbents seem well-placed compared to global peers:** Incumbents globally have gradually begun to counter the rising competition from BNPL players by either tweaking their existing product offerings, launching their own variant of BNPL product or through acquisitions (VISA, Mastercard). Compared to global peers, Indian lenders, particularly leading private banks, seem better placed in thwarting the BNPL threat.

Exhibit 89: New product offerings by incumbents globally

Country	Incumbent	Product	Launched in	Features
USA	JPMorgan Chase	Credit card - My Chase Plan	Nov-20	My Chase Plan - convert spends above USD 100 into EMIs at flat monthly fee (3 - 18 months)
USA	American Express	Credit card - Pay It Plan It	Aug-17	Pay It Plan It - option to convert spends above US$ 100 into EMIs for 3-24 months at 0% interest and flat monthly fee
USA	Citi	Credit card - Flex Pay	Aug-20	Flex Pay - convert spends into EMIs at applicable interest rates
USA	Goldman Sachs	MarcusPay	Apr-20	Instalment loan product – convert spends into EMI at 11% - 26%, with no fees
Australia	National Australia Bank	Straightup Card	Sep-20	Credit card with features similar to BNPL
Australia	CitiGroup	Spot	Aug-21	Pay-in-4 option (over 2 months) at all MasterCard merchants
Australia	CitiGroup	Credit card	Jan-21	Instalment loan at checkout on online retailer Kogan.com
Australia	Commonwealth Bank of Australia	BNPL	Mar-21	Pay-in-4 options for ETB customers with credit limit of US$ 1K at all MasterCard merchants
Australia	Commonwealth Bank of Australia	CommBank Neo - no interest payment card	Sep-20	Pay Later options for credit limit up to US$ 3K with fixed monthly fee
UK	Monzo	Flex	Sep-21	Pay-in-3 at 0% interest or with 19% APR over 9/12 months
USA	CapitalOne	To be announced		

Source: Company, HSIE Research

Exhibit 90: Incumbents partnerships with BNPL firms

Country	Incumbent	BNPL/FinTech	Features
USA	Cross River Bank	Affirm	Cross River Bank provides Instalment loans on Affirm platform
USA	Barclays	Amount (White-label BNPL provider)	Barclays will provide point-of-sale financing through Amount's POS financing platform
USA	VISA	ChargeAfter	POS financing option for VISA cardholders
USA	Mastercard	Vyze	POS financing option for Mastercard cardholders
USA	Goldman Sachs	Apple	Apple Pay Later- Pay-in-4 and longer-tenure instalment plans with Goldman Sachs as the lender (To be launched)
Australia	Commonwealth Bank of Australia	Klarna	Klarna's offerings embedded into the Bank's consumer app
UK	Barclays	Amazon	"Instalments" - EMI offerings for spends above GBP 100 on Amazon.co.UK over 3 to 48 months at 11% interest rate

Source: Company, HSIE Research

Key risks

- **Regulatory risk**: The recent report by RBI's working committee on digital lending has several implications for BNPL players, if implemented by the regulator. While it is a positive step in terms of regulating the product (lending to be done only through RBI-regulated entities, no FLDGs with non-NBFCs etc.), the near-term implications could be muted disbursals growth.

- **Credit costs-risk models**: While the BNPL players are mostly focused on achieving scale in its ecosystem, the risk management by keeping delinquencies under check remains one of the major impediments in achieving high profitability. With limited revenue drivers from merchant side (MDR), the unit economics is yet to evolve completely.

- **Slowdown in retail consumption:** India's credit growth has been driven by the consumption sector for several years as the industry credit growth remained muted (lack of Capex cycle). Any slowdown in the consumption growth could lead to lower consumer financing and, hence, impact the unit economics (and subsequently business viability) of the BNPL players in the near term.

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