White paper

Buy Now Pay Later

Reducing the "Time to yes" but at what cost?

A guide to good practice and key success factors for deferred and split payment schemes

algoan

Letter from the Editor

The BNPL market is booming, sparked by the explosion of e-commerce in the past year.

Mostly and widely used from the largest retailers, split and deferred payment schemes have not been extremely exposed until now, being offered to consumers through so-called ‘traditional’ banking institutions. To the greatest delight of customers, BNPL is becoming available for any kind of online retailers and offline merchants. This trend has led to the rapid emergence of some key players across Europe like Klarna, Afterpay (Clearpay) and Scalapay. In France, some rising stars like Alma and Pledg are also promising. While customer experiences differ and merchant integration is more or less agile depending on their API's capacities, the aim remains the same – Offer new consumers payment solutions on 3–12 instalments, extending even up to 48 monthly payments for new BNPL newcomers.

BNPL is now largely used by all types of customer profiles and age groups, and is offered on many different shopping carts. By 2025, 12% of e-commerce spending in Europe will be on BNPL, i.e. more than €295 billion, and will unreservedly cannibalise the secured consumer loans market, of which it already held 10% in 2020. Northern Europe is leading this exponential growth, like Germany, with BNPL revenues already accounting for 19% of the e-commerce GMV, compared to 2-4% for the still cautious Southern European countries. Lacking disruptive players, enhanced regulation and tech innovation, France remains a difficult market to tackle for the BNPL giants, but for how long?

Despite the BNPL tide, risk remains! In the Time to yes race, lenders need to better understand how to manage the risk. While it is crucial that the process is smooth, secured and instantaneous, it also needs to be risk-free.

Consumers in search of ‘easy deals' and motivated by spontaneous purchases (fashion, digital, sneakwear) are faced with ever more fluid paths and attractive payment offerings.

Open Banking fully addresses the issues of risk, fraud and higher converting customer experiences for all payment types. Immediate access to a customer’s bank data after authorisation provides all the information needed to make a decision. The customer's actual banking data, rather than the often exaggerated declarative information, makes it possible to avoid difficult financial situations that quickly lead to consumer overindebtedness while also protecting e-tailers from risks of non-payment or fraud.

For the last three years, Algoan has been promoting a more inclusive access to credit, fairer and with better risk management .

In order to highlight the huge opportunity that BNPL presents for e-commerce and to measure the importance of the right benefits balance between both consumers and merchants, we’re proud of our new study focusing on how to secure the BNPL stickiness!

François Gutierrez

Associate Director &
Chief Revenue Officer, *Algoan*

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In the race for Time to yes, it is necessary to offer fluid but safe, fast but risk free purchasing process.

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Contents

About us

Algoan is a French Fintech that is revolutionising the credit industry in Europe through the power of Open Banking.

Lending origination, debt consolidation, debt collection,... Algoan innovates at all stages of the credit life cycle through proprietary, cutting-edge technology developed by a team of around 40 professionals, techs, UX and data scientists.

With its Credit Decisioning Open Banking solutions (a decision engine based on the secure sharing of borrower's banking data), providing a real-time decision, acceptance rates and risk management are greatly improved.

Algoan's solutions result in a more accurate risk analysis than traditional methods and make it possible to accept a large number of good borrower profiles that are usually rejected, with a controlled risk (GINI score of up to 80%).

In the context of Buy Now Pay Later, *Algoan* enables immediate analysis of the consumer's financial health, thus protecting the consumer from overindebtedness and the payment service provider from non-payment.

With the participation of

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Part 1

BNPL, the new consumer credit?

What is BNPL?

Buy Now Pay Later (BNPL), or split payment, refers to a set of 'credit' products distributed at the time of an online or physical purchase.

There are three main types of products, which differ in terms of their methods, the way in which they are used and their regulatory framework: payment made in 3 or 4 instalments, deferred payment and payment made in more than four instalments.

These products are most often integrated into e-Commerce buying journeys and offered on a B2B2C basis. The principle is that the lender advances the purchase amount to the merchant before being reimbursed by the customer in several instalments. However, BNPL products are also available in shops and B2C.

Payment in 3 or 4 instalments

As the name suggests, this type of credit involves repayment by the customer in 3 or 4 instalments, usually at the rate of one per month (the first may be at the time of purchase). In all cases, repayment is made within 90 days to not fall within the Loi Lagarde scope, which imposes additional requirements in terms of checking the customer's creditworthiness. On the contrary, payment in 3 or 4 instalments involves a straightforward customer experience and eligibility checks without any supporting documentation. Acceptance rates are also very high, 80%–95% depending on the provider.

Among BNPL's products, payment in 3 or 4 instalments is currently the most popular with a worth of €6 billion.

Deferred payment, or Pay Later

This product allows a customer to defer payment, generally by between a fortnight and a month. It is still relatively uncommon in France, worth a total of €100 million (source: *Association Française des Sociétés Financières*). It entails a higher risk for the lender, who must collect the entire amount in one go and does not benefit from the first instalment payment at the time of purchase.

Pay Later corresponds to a different usage to paying in 3 or 4 instalments: it is particularly useful for end-of-month purchases before pay day, or for customers who like to test a product before buying it.
As with payment in 3 or 4 instalments, deferred payment is not subject to the Loi Lagarde.

Payment in more than 4 instalments

Unlike the two previous products, which are payment facilities, payment made in more than four instalments is a consumer credit regulated by the Loi Lagarde. This requires more cumbersome procedures, with requests for supporting documents and checks on the customer's creditworthiness. It also corresponds to higher than average spendings.

For these products, lenders generally charge interest rates of between 1.5%–4%, which are often handled by the merchant.

1,5% - 4%

The range of rates generally charged by lenders for payment in more than 4 instalments.

A fast-growing market...

First introduced in the early 2010s, Buy Now Pay Later has been growing rapidly for about five years. According to estimates by key industry players, it could reach €10 billion by the end of 2021, compared to €6 billion in 2019. For the founder of Alma, a fintech specialising in BNPL, the potential credit amount could be as much as €60 to €70 billion.

The development of BNPL was first sparked by the implementation of the Loi Lagarde in 2010. This applies to consumer loans of between €200 and €75,000 that last more than three months, and aims to strengthen the level of information and protection for borrowers. In concrete terms, the Loi Lagarde obliges credit institutions to check the solvency of the applicant, and to ask them for various supporting documents for loans above €3,000 (identity, address, income, as well as a 'fiche de dialogue', a form completed by the lender and the borrower to check the feasibility of the project).
This has obviously made customer experience and the credit granting process more cumbersome, and has prompted new players to come up with new credit products of less than three months that fall outside the scope of the regulation.

Beyond this regulatory windfall, BNPL is a response to a number of customer and merchant expectations, particularly in terms of online (see the results of our study in Part 2).

For retailers, especially online retailers, the range of payment methods offered is crucial to optimise the purchasing process: the ease of use and reliability of the payment method have a strong influence on conversion rates, while the offer of credit also increases the average basket size. While BNPL's solutions are generally more expensive for merchants than credit cards, they can achieve better performance on various KPIs.
The health crisis, which caused the closure of physical shops for several months and encouraged the French to embrace shopping online, has further reinforced this trend. Developing online sales has suddenly become a key issue for many merchants, who see in BNPL a quick and efficient way to stimulate sales.

... and highly competitive

Different types of players at the payment/credit axis are now competing in the BNPL market:

- Credit specialists from the retail sector - *Oney*, the former *Auchan* group bought by the *BPCE* group, and *Floa Bank*, a subsidiary of the *Casino* group and *Crédit Mutuel* - are among the pioneers and market leaders;
- Historic credit specialists such as *Cetelem*, *Cofidis*, *Sofinco*, *Franfinance* etc., subsidiaries of major French banks;
- Fintechs, some of which have experienced impressive growth in recent years. In France, *Alma* raised €49m in 2021, while internationally, the Swedish unicorn *Klarna*, which has become a real giant in the sector, is now valued at $46bn. These companies have generally entered the market via small traders, offering them easily integrated solutions, and are now attacking larger players;
- Some banks and payment system providers such as *PayPal*, which tend to offer B2B services.

Due to the absence of a credit bureau and respective regulation, the French market is still mainly addressed by French companies. Nevertheless, the desire of some major e-tailers to expand in France could push some foreign players to enter the market.

In addition, traditional consumer credit organisations could consider strengthening their position in the BNPL market. While some have been slow to make the switch, preferring to focus on their existing products and avoid the risk of cannibalisation, the continuing decline in revolving credit (from 31 billion outstanding credit in 2008 to 18 billion in 2021) and the generally unfavourable consumer credit environment (low interest rates, increased household debt) could, on the contrary, encourage them to look for new growth drivers.

Examples of buying journey

Online B2B2C

Purchasing process

The customer completes their online purchase and validates their basket

Subscription to the service

- The customer chooses to pay in three instalments
- The customer fills in a short identification form (name, surname, postal address, telephone number and email address, etc.)
- The customer validates the contractual information and subscribes to the service

Eligibility check

- The lending institution checks the eligibility of the client (for example, based on their contact details, product type, FICP file)
- The institution makes an authorisation request on the amount of the first instalment or the total amount (less risk but more refusals)

First payment

- If eligible, the customer pays the first installment (plus any fees)
- The lender pays the merchant the purchase amount (less any fees)

Payment of instalments

The customer pays instalments 2, 3, etc. according to the schedule provided at the time of subscription.

There are also in-store B2B2C paths, where the customer usually has to make a payment request at the checkout and fill in a form.

B2B (credit as a service)

Subscription to the service

- On their banking application, the customer subscribes to the split payment service (e.g., *Lydia*, *Floa Bank*)
- Two possible options: automatic triggering of the split payment above a certain threshold, or activation by the customer
- An eligibility check is carried out by the bank on the basis of the customer's history

Making a purchase

The customer makes a purchase online or in a physical store

Spreading the payment

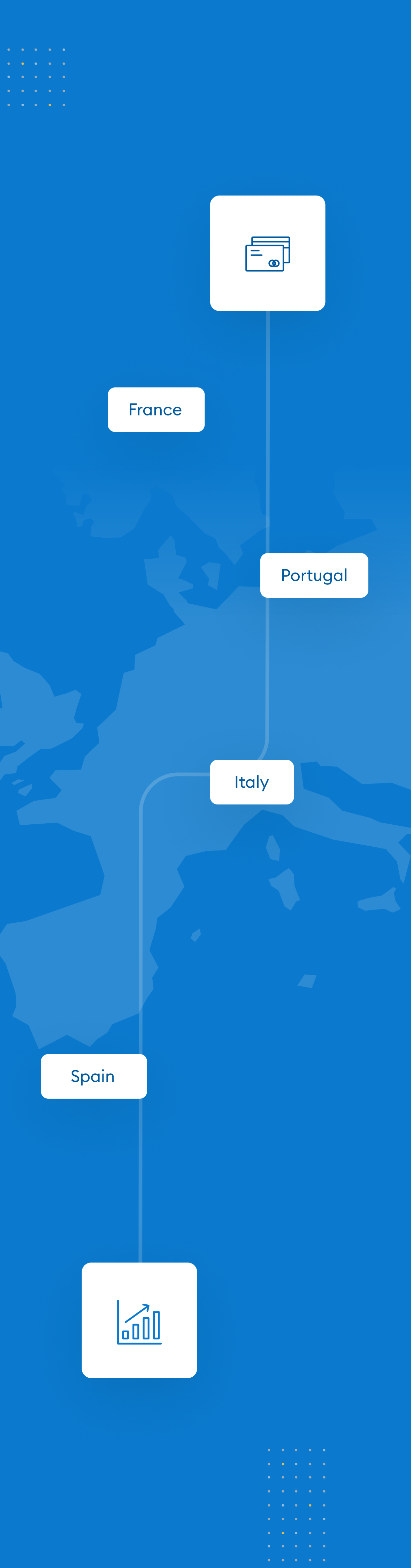
- In their application, the customer decides to pay in instalments (if this is not done automatically)
- The bank then credits the customer with the purchase amount (minus any fees and the first repayment instalment)

Payment of the 2nd and 3rd instalments

The customer pays instalments 2, 3, etc. according to the subscription schedule.

Part 2

Our study: BNPL usage in Southern Europe



Adoption of BNPL in Southern Europe

A delay that reveals opportunities to be seized

Compared to its Nordic neighbours, Southern Europe is still in the early days of Buy Now Pay Later. In 2020, the share of e-commerce revenues generated by BNPL was 23% for Sweden and 19% for Germany.
Way behind, the share was 2% for Spain and Italy, and 4% for France.

In contrast to Northern Europe, which is moving towards a cashless society, Southern Europe is still attached to cash. The pandemic has nevertheless greatly accelerated the digitalisation of payments and with it, the use of split and deferred payment solutions.

In France, this delay is also due to the regulations in force for payments beyond 90 days, which are considered as specific purpose loans. These require a longer purchasing process and, possibly, supporting documents as well. This is a clear obstacle for some consumers, who abandon their purchases because they are slowed down. Others, reluctant to take out credit, also give up.

However, BNPL has already made a name for itself with consumers. The forecasts are clear: we are going to see an explosion in its use in Southern Europe.

Our study

Algoan presents the results from its 'Open Banking and BNPL' usage study, conducted with *Happydemics* between 26 February 2021–3 March 2021 among 4,401 respondents over the age of 18.
The sample was surveyed via an online self-administered questionnaire.

Details of the population surveyed:

1071 French	1011 Spanish	1083 Italian	1236 Portuguese

A population seduced by split payments

Although BNPL does not yet represent the same market share as in Germany and Scandinavia, it has already been tested and approved by a majority of the Southern European population. More than one in two French people have already used split or deferred payment when making a physical or online purchase. 40% of Spaniards and 33% of Italians have also used these payment methods. The Portuguese are more cautious, with only 25% having been tempted.

These adoption rates are explained by the late arrival of BNPL players in Southern Europe; *Klarna*, which has just announced its arrival in France, only established itself in 2020 in Spain and Italy. Portugal does not yet benefit from increased competition in the sector, which delays the implementation of these solutions.

In France, traditional banking institutions tend to compete with independent players such as *Alma* or *Pledg*, who are gaining a more agile foothold with e-tailers and merchants.

If we look more closely at usage, split payments are favoured over deferred payments.
These are used by 30% of the French, six points more than in 2020, whereas deferred payments are used by less than 20% of the population in the countries surveyed.

This facility, which allows customers to pay for their purchases in 3–12 instalments, is particularly popular with the younger generation, especially 18-34 year olds. Digital natives even view **BNPL as a decisive factor in their choice of a retailer to make a purchase**.

>50%

of French people have already used split or deferred payments.

A solution for unforeseen expenses

For all countries surveyed, split or deferred payment is first and foremost cited as beneficial in the event of unexpected expenses and as a solution to avoid an unwelcome overdraft which brings additional costs. Related to this, the possibility of purchasing in anticipation of cash flow is the second factor mentioned by respondents as being beneficial. Buyers are no longer obliged to wait until the end of the month before fulfilling their needs or desires.

BNPL is now mainly used as a means to better manage cash flow, regardless of the profile of the buyers.
A recent *Floa Bank* study conducted with *Opinionway* confirms this trend by stating that 37% of AB+ have used it in the last twelve months, compared to 24% of inactive people.

This finding seems to apply only in France. For the Spanish, Portuguese and Italians interviewed, it emerged that those who already had an outstanding consumer loan were more inclined to make a split or deferred payment than the others.

Fear of overindepttedness & hidden costs

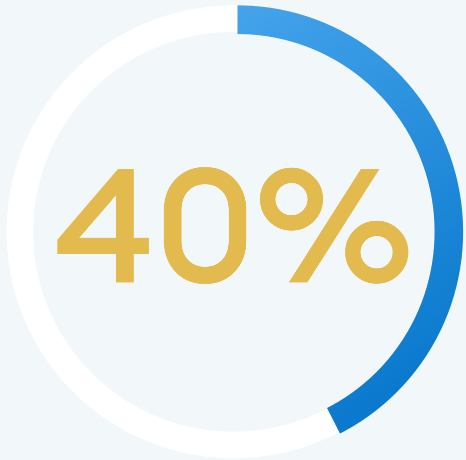
The main disadvantage cited by respondents is the risk of overindebtedness. This fear is justified since overindebtedness in France is set to rise in the second half of 2021 (May 2021 data from the *Algoan Index: an analysis of the financial health of French borrowers based on Open Banking data*).

More specifically, in France, more than half of the respondents consider that these payment facilities may result in higher than expected costs due to unanticipated additional charges.

Proof that these payment solutions are used in times of financial stress is evident in the finding that **4 out of 10 respondents (among Italians, Spaniards and French) have already received a payment refusal within a Buy Now Pay Later scheme**. Refusals for which almost half of the respondents claim not to have received a clear explanation.

Consumers are therefore largely aware of the risks generated by these means of payment. This clearly demonstrates that consumers would be open to better regulation of BNPL to limit these risks.

All the respondents said that an instant analysis of their financial situation would reassure them at the time of purchase.
The second thing that respondents said provided reassurance was the possibility of assessing their ability to repay from the merchant site. These are two needs that Open Banking can meet effectively.



of Italian, Spanish and French respondents have already had a payment refused via a BNPL scheme.

Part 3

Risk measurement & regulatory framework

BNPL & Risk management

Renamed 'Buy Now Pay Never' or 'Klarnage', the BNPL model has been plagued by a high incidence of non-payment and fraud. The frictionless purchasing process and lack of clear contractual information encourage consumers to make purchases without any real awareness of their ability to pay and/or obtain refunds.

Non-payment and fraud

Classified as a financial facility, BNPL is not subject to the same regulations as consumer credit. Indeed, a loan of less than €200, and/or repayable within a period of less than 3 months, is not subject to the regulations on consumer credit. The consumer therefore does not need to prove their financial solvency by making a purchase in a BNPL scheme.

This is an opportunity for retailers who want to increase their average shopping baskets and build customer loyalty. It is precisely in the quest for loyalty that Try Now Pay Later has been developed, using deferred payment to offer buyers the possibility of paying for their purchase later, if they are satisfied with it.

This is great news for fraudsters who get their money refunded before they have paid for the product they ordered. In turn, split payments involve many unpaid bills. Often already in a fragile financial situation, consumers overestimate their solvency and poorly anticipate their payment deadlines.
Not to mention the numerous card frauds generated by these solutions when no identity verification is put in place in the purchasing process.

So why is it so successful?

This is probably because all the risks are borne by the credit organisation and not by the e-tailers. It is therefore logical that they call for better regulation to minimise the risk.

“Time to yes”: the Holy Grail for e-tailers & the consumer!

As we have already mentioned, BNPL channels are currently frictionless, so that they can be completed as quickly as possible without letting the customer escape to a competing site. This is appreciated by consumers, and by retailers who benefit from much better conversions. However, the quest for an ever shorter Time to Yes (the time for the credit acceptance) puts aside good practices and warnings which make consumers aware of the expense they are about to incur.

The Time to no is equally important. As a safeguard, it limits future difficult situations for already vulnerable customers. This could be seen as paradoxical, but a fair balance is essential for traders and consumers. It can be found with a few simple rules:

- Leave some friction points at checkout, such as avoiding 1-click orders
- Reinforce pre-contractual information
- Clearly display the cost of credit associated with the purchase.

The BNPL/Open Banking partnership: the solution?

Some solutions exist today to identify a risk of fraud by analysing a consumer's buying journey. *OneyTrust*, for example, can detect fraudulent payment attempts from the data collected up to the point of payment.

Additionally, Open Banking plays a key role in reducing risk while maintaining a smooth and fast purchasing process. It is certainly one of the most effective applications for assessing the risk profile of borrowers by analysing, with their consent, their daily banking transactions, revealing both their budgetary situation and their financial habits.

The absence of a credit bureau in France makes it all the more important to use credit scoring solutions in purchasing processes where an advance is offered.

As mentioned earlier in the *Happydemics* survey results, consumers are aware and fearful of the potential risks of overindebtedness they face when using BNPL. Assessing their creditworthiness can undoubtedly reassure most of them, and prevent them from overestimating their ability to pay or repay.

Algoan is already working with players in the 10–12 instalments payment market, helping to protect consumers from the risk of overindebtedness and merchants from the risk of non-payment and fraud. In these cases, the adoption of Open Banking is growing in strength and heralds a potential mainstreaming of payments in 3 or 4 instalments. A possibility that will also depend on the review of the regulators.

What is the future for BNPL?

Today, split payments represent a very competitive market where it is necessary to achieve volume given the small amounts loaned. Nevertheless, several developments are expected in this market in the short and medium- term, and there will be many opportunities for competitive differentiation. The ability to adapt quickly to market shifts will therefore be a key issue for market players.

Product innovation

As we have seen, the development of Open Banking offerings will initially enable players to propose a smoother and faster customer experience while optimising credit risk. Other product innovations are also to be expected.

First of all, while split payments are currently based solely on bank cards, in the next few years we can expect to see new payment paths based on credit transfers. Although this means of payment is currently impractical for merchant payments, and therefore little used, the expected development of Instant Payment and above all the initiation of transfers will make it possible to improve the process and make it more competitive.

By making it possible to integrate transfers seamlessly into the payment process (automatic redirection to the customer's bank interface, automated entry of the beneficiary's details), the initiation of transfers, introduced by PSD2, will thus make it possible to benefit from its intrinsic advantages compared with cards: lower cost for the merchant, means of payment less prone to fraud, higher maximum payment limits for the customer, no expiry date or risk of loss of the means of payment, etc. Instant Payment will allow funds to be transferred in less than 10s, which represents a significant advantage for the merchant in terms of cash flow.

Another innovation, Request-to-Pay (or R2P), is a new European (SEPA zone) messaging service designed to make exchanges between payers and payees more fluid. In its initial version, which will come into force in June 2021, this service essentially allows a creditor to offer the payer the option of settling the transaction immediately or later. Subsequent versions of the service could natively integrate with other options, including payment in instalments, which could make it possible to develop alternative split payment paths.

Tougher regulation

The next few years may see a tightening of split payment regulation to prevent consumer overindebtedness. In the UK in particular, the regulator, the Financial Conduct Authority (FCA), has called for rapid regulation of the sector.
In France, the authorities are also keeping a close eye on the matter and could take advantage of the review of the European directive on consumer credit, which is due to begin shortly in Brussels, to introduce new requirements.

At present, the debt ratio of French households is only slightly above the average for the euro zone (at 97%), and does not reach British levels (126.2%), but it is constantly increasing and has doubled in twenty years (53% in 2000) (source: *Banque de France*).

Due to the measures taken in the early 2010s regarding revolving credit, overindebtedness has been halved in 10 years (232,000 cases in 2010, 109,000 in 2020), but could rise again due to the health and economic crisis.

In addition to overindebtedness, the authorities could also take a closer look at the rates charged by split payment companies and demand increased transparency. Some are accused of hiding the real cost of credit from their customers and of charging rates well above the borrowing rate.

Business drivers

Although the split payment market is now fairly mature, there are still several business drivers that the various players can use to strengthen their position.

Strengthen deferred payment offers,

a product that is still in its infancy on the French market and which does not entirely meet the same needs.

Develop new channels (shops, apps, etc.)

following the example of banks which are turning to offers embedded in their applications.

Develop B2B ‘credit-as-a-service’ offers

such as mini-loans of less than 3 months.
Through the *Lydia* application, *Floa Bank* distributes a loan of up to €1,500, with no need to provide proof of age, and with the funds being made available instantly on the customer's *Lydia* account.

Exploring new markets in Europe and internationally:

For e-tailers established in several countries, the ability of a partner to support them in several markets at the same time represents a differentiating asset. However, it requires a good understanding of the different local regulations. Split payment operations can also think about establishing themselves in markets outside Europe, for example in emerging countries with a strong appetite for digital channels.

Part 4

Takeaways

Integrating a BNPL solution: what are the key success factors?

Key success factors

As BNPL's various pathways are increasingly forced to follow the same requirements as consumer credit, it is important to optimise the customer experience at all stages of the application process and to integrate BNPL's offers seamlessly into the buying process.

This optimisation can be achieved at several levels:

1

Integrate the financing offer within the merchant's "buy flow",

by displaying the lowest possible monthly payment as a call price on a product page. This can be done by including the words "from €XX per month", showing the customer that they will be able to spread their payments over several instalments, while at the same time emphasising the accessibility of the offer. It is important at this stage of the process to communicate clearly in terms of the nature of the offer being taken out, i.e. financing, with all that this entails in terms of commitment and responsibility.

2

Guide the user through the application process

This can be done upstream of the process, to warn them to bring the various elements necessary to process their application properly, such as their identity document for verification (KYC) or their bank details in the context of a process involving multiple bank accounts (Open Banking module).

Despite the democratisation of Open Banking, the technology still raises some fears among consumers. Each step of the process must be explained to the customer to reassure them of the security of the solution and compliance with GDPR regulations on the processing of their personal data.

3

Partnering with experts

Open banking is strongly encouraged or even mandatory on some channels, such as the pan-European partnership between *Younited Credit* and *Microsoft* for the Xbox All Access programme. It took several phases of A/B testing to find the right wording and the right steps to best support the end customer.

4

Offer an automatic and instant decision on credit approval

With regard to long term credit (i.e. more than 90 days), **the ability to offer an automatic and instantaneous decision on credit approval** is a key part of maximising conversion rates. Once again, Open Banking can ensure this immediacy while minimising the risk of fraud and non-payment.

The use of data and customer credit scoring are also at the heart of the integration of BNPL's offerings. Aggregating bank accounts provides access to very granular and representative data on the solvency of the customer, improving the acceptance rate/cost of risk ratio, promoting financial inclusion, while drastically minimising household overindebtedness.
In the context of a pan-European solution, where credit bureaus have a strong presence, the combination of Open Banking with these makes it possible to address a part of the population that does not have a credit score with these institutions.

5

Integrating the right financial partner

Finally, the integration of a financial partner with the merchant is also causing reflection. Contrary to what one might imagine, having a redirection in a banking universe is not counterproductive in terms of the transformation rate, but allows the customer to clearly identify that they are applying for financing. Moreover, this redirection also allows for better management of the integration of third-party partners (e.g.KYC module or bank account aggregation).

Geoffroy Guigou

Co-founder & CEO, *Younited*

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The payment world is extremely demanding in terms of conversion rates, and therefore in terms of a financial institution's ability to offer high acceptance rates.
The use of Open Banking, to score the most complex files, or to analyse customer segments traditionally excluded from credit (young people, self-employed, etc.) is a relevant and effective solution.
Younited has been using it for several years in its payment processes, and we will be extending it to our new Younited Pay proposal for split payments from 1–48 months.
Its effectiveness and adoption, already massive with customers, will be key to the success of a unique offering in the market.

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