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JAG Team Insights

BNPL – Not your Grandparents' Installment Plan

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Throughout the years the financial world has used a variety of acronyms and confusing words to make certain topics look more attractive or complicated than they really are. The latest one is "BNPL". BNPL stands for Buy Now Pay Later, and it has become a major focus within the payments industry. Companies offering BNPL options to their customers have been able to double or even triple their sales this year. Even though the market has awarded these companies extremely high valuations, there is opportunity to invest in adjacent companies taking advantage of the trend.

During the pandemic, with the impossibility of leaving our homes, shopping online became the norm and the use of BNPL services grew exponentially as we looked to finance our purchases. As the name states, BNPL offers consumers the ability to make a purchase and figure out how to pay for it later. While making a purchase, at time of checkout, consumers are given the option to pay with a BNPL service. Typically, they are offered to pay in four interest-free installments that are due every two weeks, which is when most people receive their paychecks. Longer installment periods are usually offered at an interest rate.

The use of installment payment plans to pay for goods dates back centuries. BNPL is by no means new or revolutionary, but it offers convenience and flexibility at a lower or no cost that credit cards and banks have failed to offer.

BNPL companies charge merchants a small transaction fee and a discount rate of 3-6% of purchase value, a number comparable to the one credit cards charge. Some companies don't charge a late payment fee to consumers, while those who do typically cap fees at a low percentage of the purchase.

What is the impact of BNPL on the different actors in the payment ecosystem?

- Merchants: **Positive.** The data indicates that when merchants start offering BNPL, there is a significant increase in conversion rate, frequency of purchases, and in ticket size. Some of the BNPL companies have their own platforms that they use to refer consumers to merchants and drive incremental traffic.
- Consumers: **Positive.** Consumers can access credit immediately at no interest expense with no need to fill out applications and wait for approval. They also gain the flexibility to select the time period they want to repay the loan. BNPL companies even provide virtual cards that can be used with merchants that are not yet enrolled.
- Credit Card Issuers and Banks: **Negative.** As a result of increased use of BNPL services, credit card applications have slowed down. Given lower credit card outstanding balances, interest income earned by banks has fallen.
- Payment Networks: **Negative.** Examples of payment networks include Mastercard and Visa. BNPL purchases are being funded evenly between bank checking accounts (processed by ACH) and debit cards, where networking fees are less than half from those from credit cards.

Despite recent volatility in the payments space, we feel there is a robust opportunity for companies that disrupt the payment ecosystem and continue to drive further adoption by both merchants and consumers. Current valuations would place BNPL companies over some of the most expensive technology companies. For this reason, we have tended to look for adjacent companies who are benefitting from the trend, such as PayPal. PayPal is not typically recognized as a pure BNPL player but given their large merchant base they decided to introduce a BNPL service. 'Pay in 4' became PayPal's most successful product launch ever which drove them to offer more credit and personal consumer products and services. Square recently validated the attractiveness and value proposition of BNPL by acquiring Afterpay for a staggering price tag of $29 billion!

JAG's investment approach helps us identify great companies that can capitalize on durable sector and industry-specific trends and opportunities. We welcome your comments and questions any time!

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