



BUY NOW, PRAY LATER

SOLVING FOR COMMERCIAL SUSTAINABILITY IN
ASIA PACIFIC'S BNPL INDUSTRY

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EXECUTIVE SUMMARY

Buoyed by years of robust economic growth and booming household consumption, the Asia-Pacific (“APAC”) region has seen rapid growth in the consumer finance market, with total consumer finance loan volumes reaching USD 5.4 trillion in 2021.

Despite strong demand, traditional consumer finance products – such as personal loans and credit cards – have faced heightened criticism from consumers and merchants alike, exhibiting problems such as high interest charges / fees and static conversion rates, respectively. Recognising these pain points, numerous alternative consumer finance solutions have emerged in recent years – the most notable one being Buy Now Pay Later (“BNPL”).

Unlike traditional consumer finance products that monetise consumers through fees and interest charges, BNPL firms primarily monetise merchant partners by charging them a merchant discount rate (“MDR”) to facilitate credit-enabled transactions. In doing so, consumers are given access to better financing and repayment terms without the need to pay interest. And regional demand for BNPL solutions is skyrocketing as a result, with total gross merchandise value (“GMV”) forecast to grow by a CAGR of over 39% from 2022-25, reaching USD 361 billion.

Nonetheless, BNPL firms currently face a plethora of challenges on several fronts, including unsustainable customer / merchant acquisition costs, NPLs, and funding costs, as well as low user retention rates. As such, most BNPLs are struggling to turn a profit, with even the largest players in developed markets (both in APAC and the West) making sizeable losses.

In fact, we estimate that the largest BNPL firms are currently running average profit margins of

-15% p.a., with more nascent players operating in emerging markets suffering from profit margins of -100% p.a. Investors are voting with their feet, with share prices of listed BNPL firms being battered in 2021.

We believe that the BNPL model, as it stands today, is in need of a fundamental rethink, and see three key routes that firms must explore to carve out a path to long-term profitability: (1) optimisation (i.e. enhancing processes across the user journey and adopting alternative funding models); (2) integration (i.e. expanding vertically across the consumer value chain to enhance user retention and drive profitability); and (3) expansion (i.e. leveraging existing credit capabilities to tap into additional revenue streams, including alternative credit products and/or B2B technology solutions).

We see significant upside potential for BNPL firms that can successfully transform their strategies and operating models. For BNPLs operating in developed APAC markets, we see a 30% uplift in revenue and 20% reduction in costs as achievable targets within a three-year timeframe. For BNPLs operating in emerging Asia, we see a corresponding revenue uplift and cost reduction of 45% and 15% respectively, over the same period.

Unless major changes are made, we anticipate that most BNPL providers in the region will continue wearing losses indefinitely and forecast combined market losses to reach USD 5.2 billion by the end of 2025, based on the industry’s current P&L trajectory.

While we envisage a more sanguine future ahead for BNPL firms that can rapidly adapt their business models, it is going to be a case of Buy Now, Pray Later, for those who fail to get it right.

SECTION 1

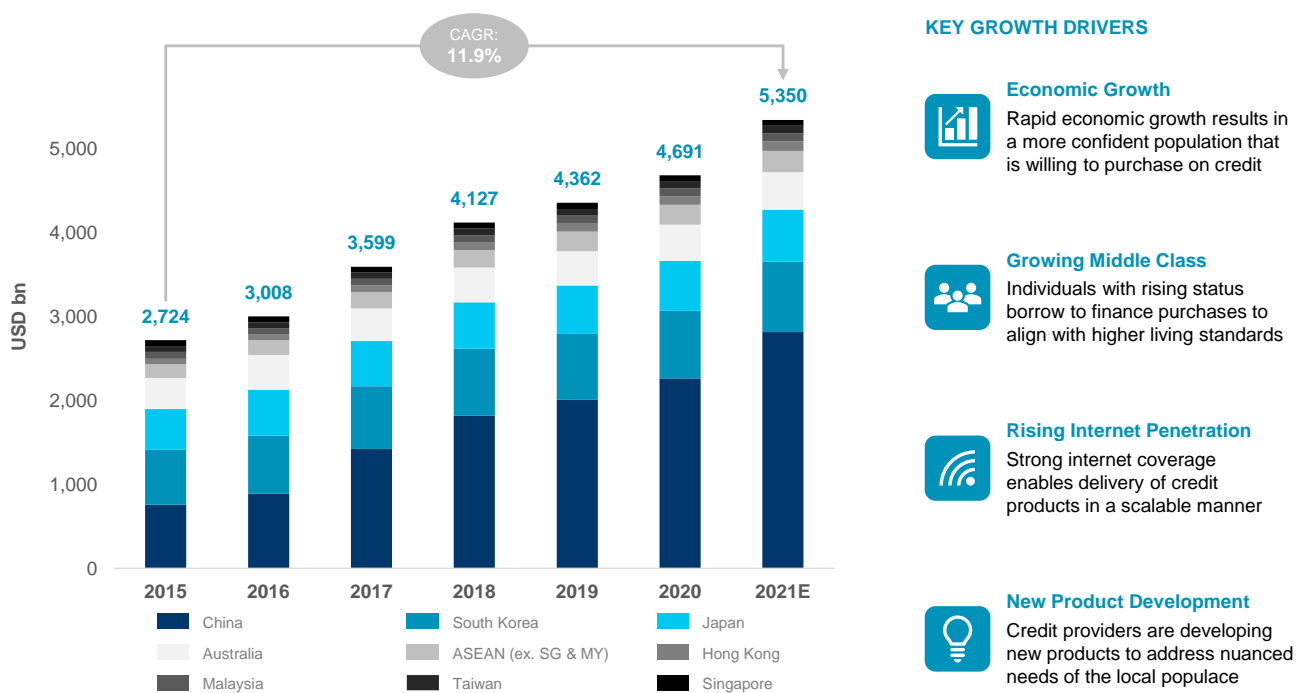
APAC CONSUMER FINANCE DYNAMICS

OVERVIEW

The APAC consumer finance market has grown rapidly in recent years, with total consumer

finance loan volumes increasing at a CAGR of 12% from USD 2.7 trillion in 2015 to USD 5.4 trillion in 2021 (see Figure 1).

FIGURE 1: APAC CONSUMER FINANCE MARKET SIZE (USD BILLION)



Source: Euromonitor, Quinlan & Associates estimates

From a geographic perspective, much of this growth has been fuelled by China and ASEAN, reflecting: (1) strong economic growth; (2) a

booming middle-class; (3) rapidly rising internet penetration rates; and (4) the launch of new consumer finance products.

CONSUMER & MERCHANT PAIN POINTS

Despite strong historical demand, traditional consumer finance products, including unsecured personal loans and credit cards, have drawn increased criticism and negative

publicity in recent years. The two key stakeholder groups – consumers (especially the younger generation) and merchants – have expressed discontent towards existing consumer finance products for a variety of reasons (see Figure 2).

FIGURE 2: CONSUMER AND MERCHANT PAIN POINTS



Source: Quinlan & Associates analysis

For consumers, adoption barriers start at the application stage, which typically requires individuals to visit physical branches to submit a range of documents (e.g. employment, income, and address proof, etc.). The review of these largely paper-based documents is extremely inefficient and may take days, if not weeks, to complete. Rejection rates are also high, especially amongst less affluent customers, given their riskier credit profiles. Even if / when applications are approved, consumers must contend with high interest rates and a range of hidden fees and charges, which worsen considerably if they are unable to meet their monthly repayment obligations.

On the merchant front, traditional consumer finance products rarely lead to revenue uplift, as many of these credit products are designed to drive neither conversion rates nor order values. Given the absence of meaningful revenue enhancement, the option to pay through traditional consumer finance products represents a cost burden for many merchants. Without concrete partnerships in place, merchants are also unable to access the large consumer base held by consumer finance companies, lowering the value proposition of such products.

BNPL

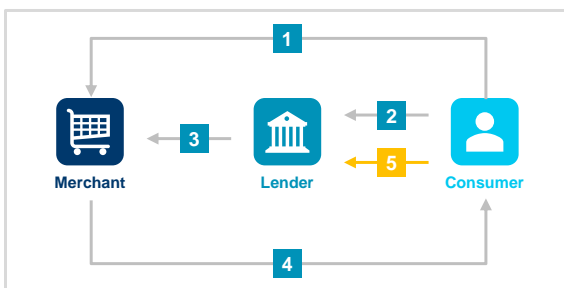
Recognising the limitations of incumbent solutions in addressing persistent consumer and merchant pain points, various alternative consumer finance solutions have emerged in recent years – the most notable of them being Buy Now Pay Later (“BNPL”).

The key difference between BNPL and traditional consumer finance products lies in their revenue model – unlike consumer finance companies that derive revenue from charging interest (and associated fees) to consumers, BNPL firms focus on monetising their merchant partnerships by charging a merchant discount rate (“MDR”) for processing new transactions (see Figure 3).

FIGURE 3: BUSINESS MODEL DIFFERENTIATORS

Traditional Consumer Finance

Business Model

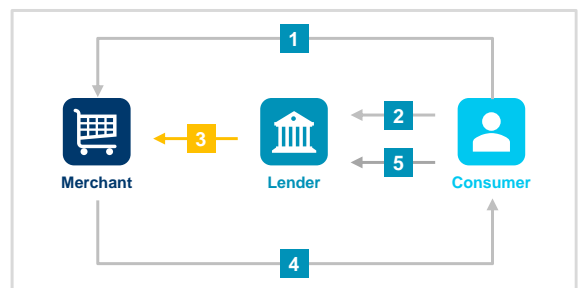


- 1 Consumer buys goods from the Merchant's catalogue
- 2 Consumer applies for credit / loan from the Lender
- 3 Lender pays the total transaction value to the Merchant
- 4 Merchant confirms payment and delivers goods to the Consumer
- 5 Consumer repays principal plus interest to the Lender, via instalments

Lenders monetise consumers via interest charges and / or processing / transaction fees

BNPL

Business Model



- 1 Consumer buys goods from the Merchant's catalogue
- 2 Consumer applies for credit from and pays down payment to the Lender
- 3 Lender pays purchase amount, with MDR deducted, to the Merchant
- 4 Merchant confirms payment and delivers goods to the Consumer
- 5 Consumer repays principal to the Lender, via instalments

Lenders monetise merchants via an MDR for driving additional marketing and sales

← Revenue Source

Source: Quinlan & Associates analysis

The BNPL model was established to provide consumers with faster and easier access to credit while allowing for more flexible repayment terms without charging interest. As such, it was seen as an ideal solution in addressing the consumer pain points associated with traditional consumer lending products.

In addition, BNPL firms run extensive marketing campaigns with many of their partner merchants to drive awareness and visibility of merchant products, increasing conversion rates and average order values (“AOVs”). In exchange for these new revenue streams, BNPL firms charge merchants an MDR – a commission for facilitating transactions.

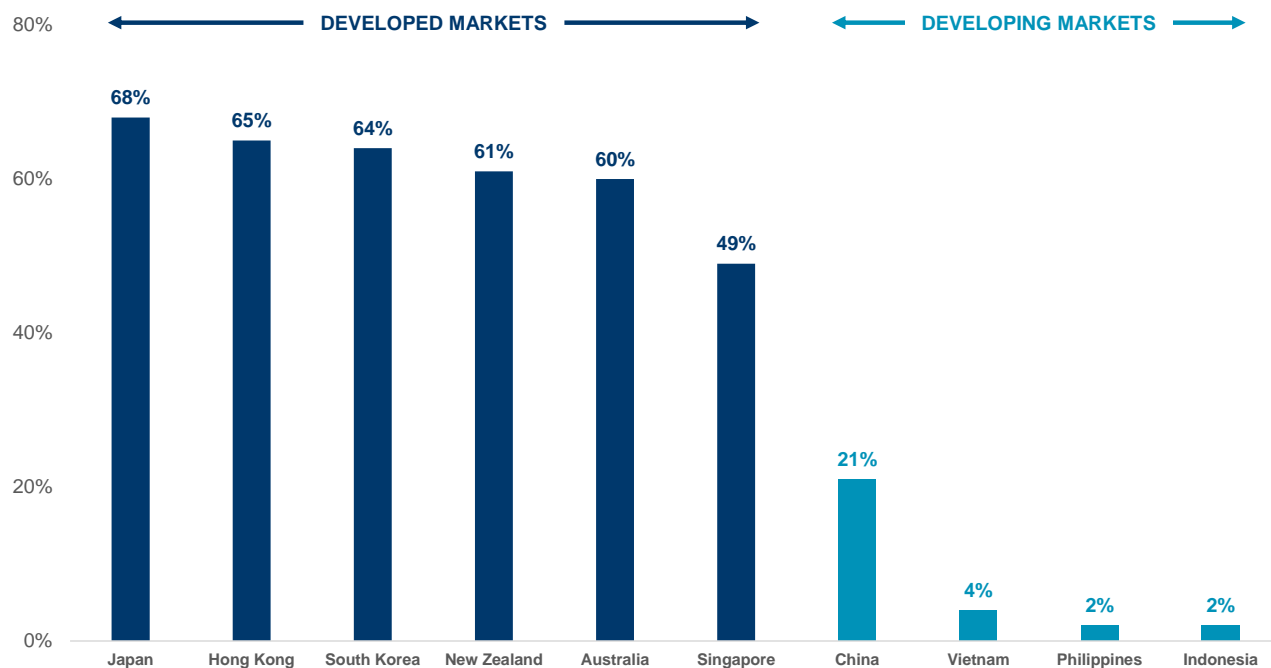
SECTION 2 THE BNPL LANDSCAPE

APAC LANDSCAPE

Recognising the explosive growth of the APAC consumer finance market and potential for competitive disruption, a flurry of new BNPL players have set up operations in the region in recent years.

It is worth noting from the outset that the dynamics of the credit industry are markedly different across the region, especially when comparing developed and developing APAC markets. For example, only 2% of the Indonesian population currently holds credit cards, compared with 68% of the populace of Japan (see Figure 4).

FIGURE 4: APAC CREDIT CARD OWNERSHIP (2020)



Source: PPRO, Statista, Quinlan & Associates analysis

Such discrepancies reflect the differences in both the proportion of the banked population and the level of financial sophistication across

each market, which have been a driving force in shaping the makeup of the BNPL competitive landscape in the region.

USER FOCUS

Due to the heterogenous nature of the APAC market, BNPL providers operating in the region offer very distinct value propositions, largely reflecting the markets in which they operate. Taking target users and merchant dimensions

into consideration, BNPL players in APAC can be broadly categorised into three key competitive clusters (see Figure 5), namely:

1. Developed market players;
2. Emerging market specialists; and
3. Supra-regional players.

FIGURE 5: APAC BNPL LANDSCAPE



Source: company disclosures, Quinlan & Associates analysis

1. DEVELOPED MARKET PLAYERS

Developed market players operate in countries where the population is highly banked, with larger disposable incomes. They also typically partner with middle- or high-end merchants. These BNPL players position themselves similarly to leading Western BNPL firms, with an extensive user base and wide merchant coverage. Launching the earliest in APAC, Australia’s Afterpay and Japan’s Paidy are prime examples of BNPLs operating in this space.

2. EMERGING MARKET SPECIALISTS

Emerging market specialists operate primarily in ASEAN countries, where most of the

population is unbanked, with lower disposable incomes. These BNPL players focus on servicing the unbanked population by partnering with low-end merchants (i.e. consumer staples). Akulaku and Kredivo, both from Indonesia, fall into this category.

3. SUPRA-REGIONAL PLAYERS

Lying in the middle are supra-regional players, typically operating in more developed Asian markets, such as Singapore and Malaysia. These firms focus predominantly on low-to-middle income consumers, targeting merchants offering consumer durables. Examples include Atome and Hoolah, both headquartered in Singapore.

SERVICE OFFERING

These three BNPL player groups can be further differentiated across several key dimensions (see Figure 6), namely:

1. Service model;
2. Merchant offering; and
3. Investors / funding source.¹

FIGURE 6: BNPL PLAYER DIFFERENTIATION

	DEVELOPED MARKET PLAYERS	SUPRA-REGIONAL PLAYERS	EMERGING MARKET SPECIALISTS				
	afterpay	paidy	atome	hølah	alokulaku	kredivo	
SERVICE MODEL	Maximum Limit	USD 1,000	USD 1,000	USD 1,300	USD 1,700	USD 300	USD 210
	Repayment Tenure (months)	2	3	2	2	3-15	1-12
	Repayment Channel	1	3	2	1	3	3
	Credit / Debit Card	✓	✓	✓	✓	✓	✓
	Bank Transfer	*	✓	*	*	✓	✓
	Digital Wallet	*	*	*	*	✓	✓
	Others	*	Cash	Apple Pay	*	*	*
	Handling Fee	*	*	*	*	1%	*
	Interest Rate	*	*	*	*	1.5%-40%	< 53.4%
Default / Late Fee	< 25%	14.6%	USD 13 - 40	USD 5 - 25	< 10%	4%-6%	
MERCHANT	Merchant Discount Rate	3%-7%	3.5%	5%	8-12%	1.7%	2.3%
	Merchant Browsing in App	✓	✓	✓	✓	✓	✓
	Purchase in App	✓	✓	*	✓	✓	*
	Offline Integration	Google/Apple Pay	PayPal	QR Code	QR Code	QR Code	QR Code
FUNDING	Key Investors	Tencent 腾讯, MUFG, ASX	MUFG, Goldman Sachs, PayPal	GADONG CAPITAL 嘉德资本, Pavilion Capital	ALLECTUS CAPITAL, ALCCORPORATION	ANT GROUP, IDG Capital, SEQUOIA	VICTORY PARK CAPITAL, reinventure
	Head-Focused	Core-Focused	Tail-Focused				
Fee from Consumers	Grey	Dark Blue	Light Blue				
Fee from Merchants	Light Blue	Dark Blue	Light Blue				
Channel Integration	Dark Blue	Light Blue	Light Blue				

Source: Crunchbase, company disclosures, annual reports, press releases, industry interviews, Quinlan & Associates analysis

¹ Note that this refers to capital for business administration, operations, and expansion; BNPL companies separately seek capital (from existing investors and / or alternative funding channels) to fund the extension of consumer credit

DEVELOPED MARKET PLAYERS

Backed by a sizeable user base, developed market and supra-regional players charge merchants relatively high MDRs when compared to emerging market specialists. Given their better-established position in the market, many are looking to enhance the experience for their end users by incorporating browsing and purchasing functions into their BNPL applications, as well as integrating with large payment services companies to provide a seamless purchase solution.

Developed market players are typically funded by established financial institutions. For example, Paidy's investors include Mitsubishi UFJ Financial Group ("MUFG"), Goldman Sachs, and PayPal. Some have also chosen to go public, such as Afterpay (which is listed on the ASX), enabling them to raise capital from public markets.

EMERGING MARKET SPECIALISTS

On the other end of the spectrum, emerging market specialists have a more aggressive offering, providing much smaller credit limits to consumers and charging lower MDRs to merchants. In addition, most do not offer pure BNPL services; instead, they usually represent a mix of BNPL and credit providers, monetising both merchants (through MDRs) and users (via interest fees).² Some players, such as Akulaku, not only impose an interest fee (based on instalment tenure), but also charge handling fees for every transaction. Moreover, as these firms typically operate in less developed markets, integration is not as mature as those operating in developed markets.

Due to their riskier nature, supra-regional players and emerging market specialists typically seek alternative funding sources, primarily from private equity and venture capital firms.

DUE TO THE HETEROGENOUS NATURE OF THE APAC MARKET, BNPL PROVIDERS OPERATING IN THE REGION OFFER VERY DISTINCT VALUE PROPOSITIONS, LARGELY REFLECTING THE MARKETS IN WHICH THEY OPERATE

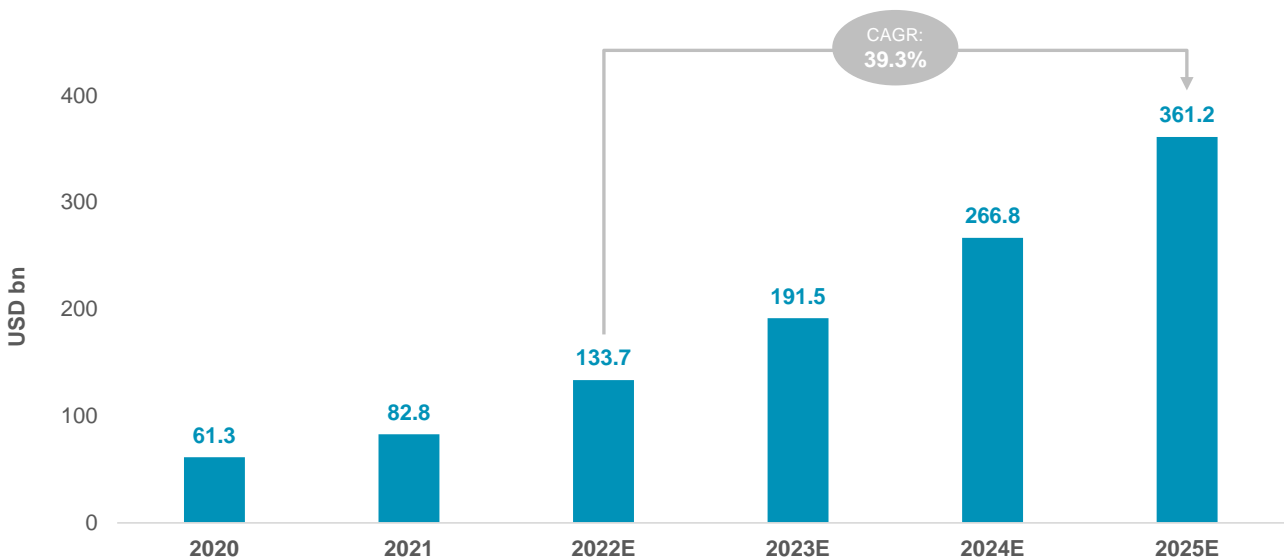
² As these firms offer credit services, they need to hold relevant licence(s) and register with the local authorities; for example, Akulaku and Kredivo have both registered with and are supervised by Otoritas Jasa Keuangan ("OJK"), the Indonesian Financial Services Authority

INDUSTRY OUTLOOK

Presenting an attractive alternative channel for consumers to access credit, the APAC BNPL industry is expected to grow rapidly in coming

years, particularly as regional economies continue to recover from the Covid-19 pandemic and domestic household consumption power continues to rise (see Figure 7).

FIGURE 7: APAC BNPL GROSS MERCHANDISE VALUE (USD BILLION)



Source: Research and Markets, Quinlan & Associates estimates

With eCommerce sales expected to rise significantly in an increasingly digitalised world, we estimate the total gross merchandise value (“GMV”) of transactions processed by APAC

BNPL firms to grow by a CAGR of 39.3% over the next three years, reaching USD 361 billion by 2025.

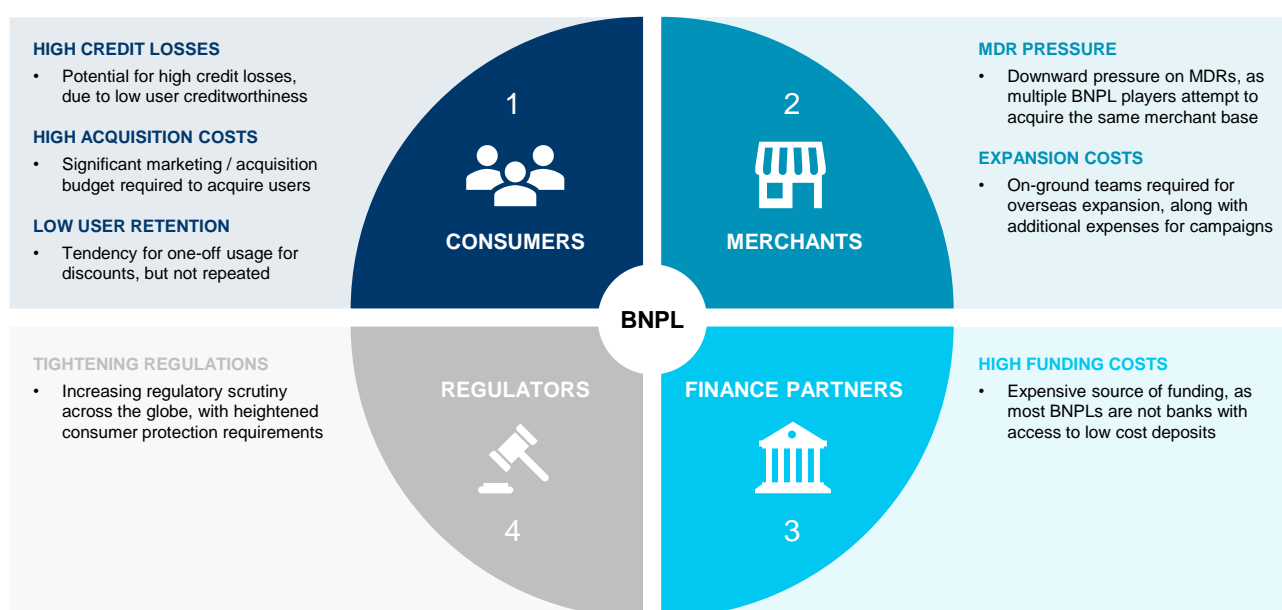
SECTION 3

INDUSTRY CHALLENGES

Despite strong industry growth, BNPL players – in developed and emerging markets alike – are facing challenges on a number of fronts, with

pressure being felt across each of their key stakeholder groups (see Figure 8).

FIGURE 8: INDUSTRY CHALLENGES



Source: Quinlan & Associates analysis

1. CONSUMERS

BNPL enables consumers to make larger-ticket purchases, providing them with greater flexibility, convenience, and control over their payment terms. It has proven to be an attractive payment alternative, especially for Millennials and Generation Z, as well as unbanked / underbanked and lower income individuals lacking access to traditional credit products.

Consumers represent a critical stakeholder group for BNPL providers, with the size of a BNPL provider’s userbase being a key indicator of their overall competitiveness, as well as a major drawcard for investors. As a result, BNPL companies are competing aggressively to acquire users, which has led to three key consumer-related challenges:

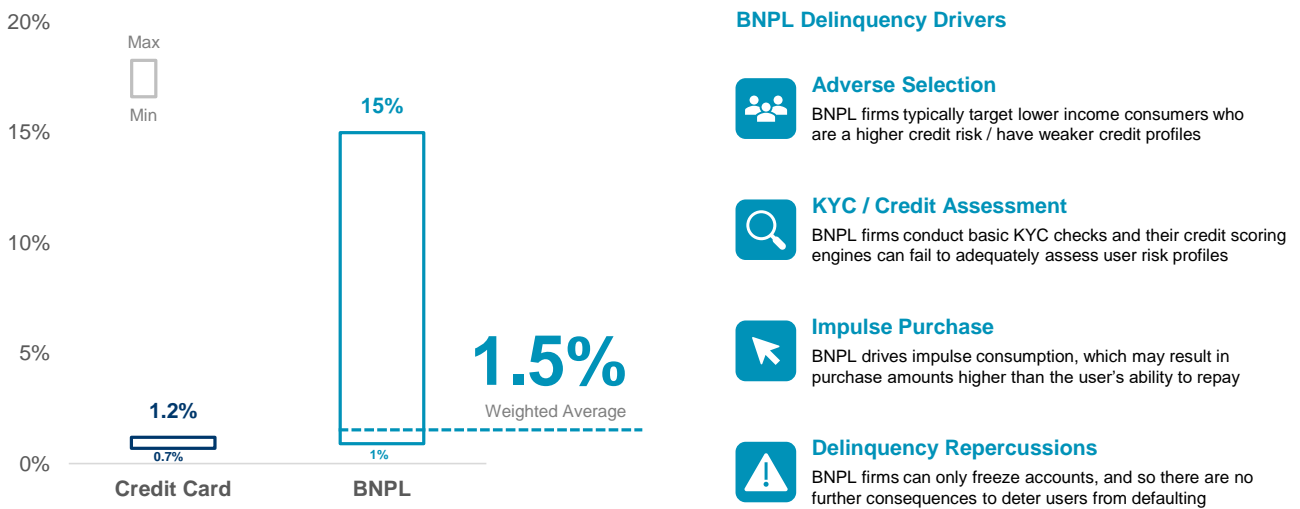
1. High credit losses;
2. High user acquisition costs; and
3. Low user retention rates.

1.1 HIGH CREDIT LOSSES

At its core, the BNPL model competes against other credit products by offering consumers easier access to financing. This inevitably

results in a degree of adverse selection, as it represents a viable alternative for consumers without access to traditional credit, reflective of their weaker credit profiles and/or higher credit risks (see Figure 9).

FIGURE 9: DELINQUENCY RATES (2021), APAC DEVELOPED MARKETS



Note: the developed markets in this figure include Australia, South Korea, and Japan
 Source: annual reports, illion, CNBC, Sydney Morning Herald, ASIC, Statista, Quinlan & Associates analysis

Indeed, the largest BNPL players in developed APAC markets suffer from an average credit loss of 1.5% of GMV, higher than average credit card delinquency rates of 0.7-1.2% in developed countries in the region.^{3,4}

Delinquency translates to lower repayment volumes, decreasing the total amount of capital available for subsequent credit extension. As a result, BNPL players need to process more transactions, using the additional revenue to cover for the capital lost (see Figure 10).

³ illion, 'Quarterly Insights', November 2021, available at: <https://www.illion.com.au/wp-content/uploads/2021/11/Quarterly-Insights-Report-Australia.pdf>

⁴ Statista, 'Non-performing loan (NPL) ratio of banks in Japan from 2012 to 2021', available at: <https://www.statista.com/statistics/1180153/japan-npl-ratio-of-all-banks/>

FIGURE 10: CREDIT LOSS COVERAGE (INDEXED)



Source: Quinlan & Associates analysis

Average MDRs for developed market players in APAC currently sit at ~5%. A GMV credit loss of 1.5% means that: (1) 30% of revenue is lost; and (2) 30% of GMV processed is “wasted”, as the revenue generated is needed to cover for the credit loss.

This issue is exacerbated by the competition for consumers, as it encourages BNPL players to move down the credit curve to expand their userbase.

The problem is amplified even further for BNPL providers operating in ASEAN. Our research indicates that some emerging market specialists in the region are experiencing average credit losses of up to 7%, such that all the revenue generated from the MDR is not enough to cover for the lost GMV. Given the lower MDRs being charged by emerging market specialists (i.e. 2-3%), we estimate BNPL providers are losing between USD 2-5 for every USD 100 of transactions processed.

1.2 HIGH USER ACQUISITION COSTS

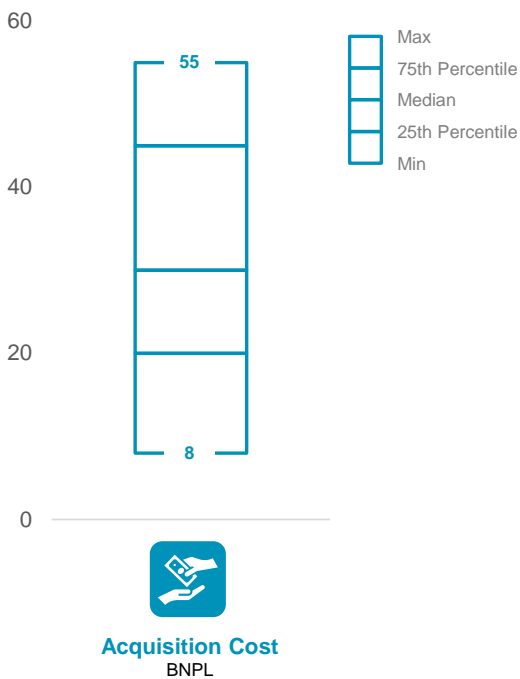
Regional BNPL providers spend considerable sums on marketing and advertising campaigns – across targeted advertisements, promotional campaigns in partnership with merchants, and the hiring of brand ambassadors – to educate

consumers, drive brand awareness, and increase conversion rates. Our research indicates that the user acquisition cost for BNPLs in the region ranges from USD 8-55 per user, depending on the BNPL firm’s lifecycle (see Figure 11).

FIGURE 11: USER ACQUISITION COSTS (2021)

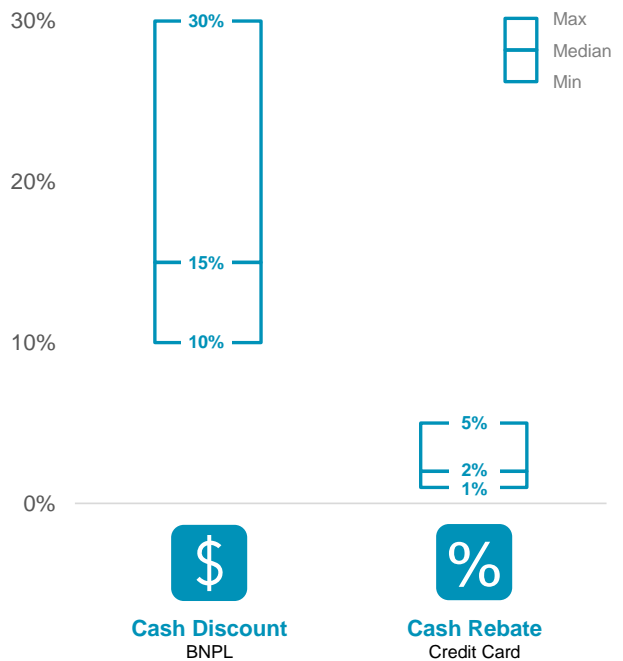
Acquisition Cost

USD per User, Avg. per Quartile



Discount Rate

%, BNPL vs. Credit Card



Source: annual reports, industry interviews, Quinlan & Associates analysis

In addition, BNPL players offer considerable discounts, often funded entirely with their own marketing budgets (especially for newer firms), to drive user acquisition. These discount rates range from 10-30% of the purchase price,

significantly higher than the 1-5% offered by most credit card providers. Moreover, as these discount rates are higher than the MDR, many BNPL players expect to make significant losses in their early years of scaling.

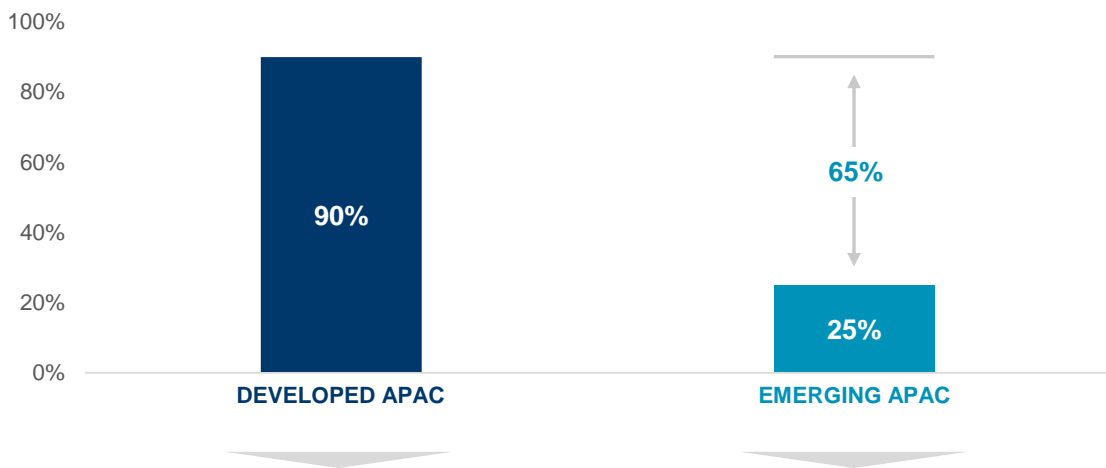
1.3 LOW USER RETENTION RATES

With significant first-time discounts, BNPL start-ups often witness rapid user acquisition, as customers capitalise on attractive deals.

However, rapid consumer uptake is not translating to meaningful retention rates for

many firms. With most BNPL firms offering a wide range of promotional discounts, it is common for consumers to regularly switch between platforms to enjoy the one-off benefits. Indeed, repeated usage represents a considerably larger portion of GMV for established BNPL players (~90%) than for new entrants (~25%) (see Figure 12).

FIGURE 12: PROPORTION OF GMV FROM REPEAT USERS



BNPL Focus

- Most BNPL companies have an established user base and focus on retaining customers through loyalty programmes and repeat usage-based discounts
- Most BNPL companies are more nascent and compete aggressively to acquire new users, typically through extensive marketing campaigns and first-time discounts

User Behaviour

- Customers are aware of the BNPL offering and many have experience using it. As such, they are more willing to use the BNPL solutions on a recurring basis
- Most customers are new to BNPL and use the service only for the initial discounts, reverting to traditional credit channels if no loyalty rewards are offered

Source: annual reports, industry interviews, Quinlan & Associates analysis

Low user retention is driven by low user engagement and weak brand loyalty. This is creating uncertainties with regards to the long-

term financial sustainability of numerous BNPL firms in the region.

2. MERCHANTS

BNPL encourages consumers to spend more, increasing both their willingness to spend and available budgets, while providing more flexible payment terms. Our interviews with BNPL providers operating in Hong Kong suggests increased retail conversion rates of 20% and a 40% uplift in average ticket sizes, representing a total revenue uplift of 70%. These figures corroborate with data points from developed markets, estimating that BNPL companies increase retail conversion rates by 20-30% and average ticket sizes by 30-50%,⁵ translating to a total revenue uplift of ~75%.

For facilitating these additional transactions, BNPL companies charge merchants a proportion of the increased revenue (through the MDR). As the core revenue source for BNPL players, merchants represent a critical stakeholder group.

BNPL companies are aggressively amassing a merchant base and, similar to their user acquisition efforts, this is leading to heightened competition, increasing costs and driving fee compression.

DESPITE STRONG INDUSTRY GROWTH, BNPL PLAYERS – IN DEVELOPED AND EMERGING MARKETS ALIKE – ARE FACING CHALLENGES ON A NUMBER OF FRONTS, WITH PRESSURE BEING FELT ACROSS EACH OF THEIR STAKEHOLDER GROUPS

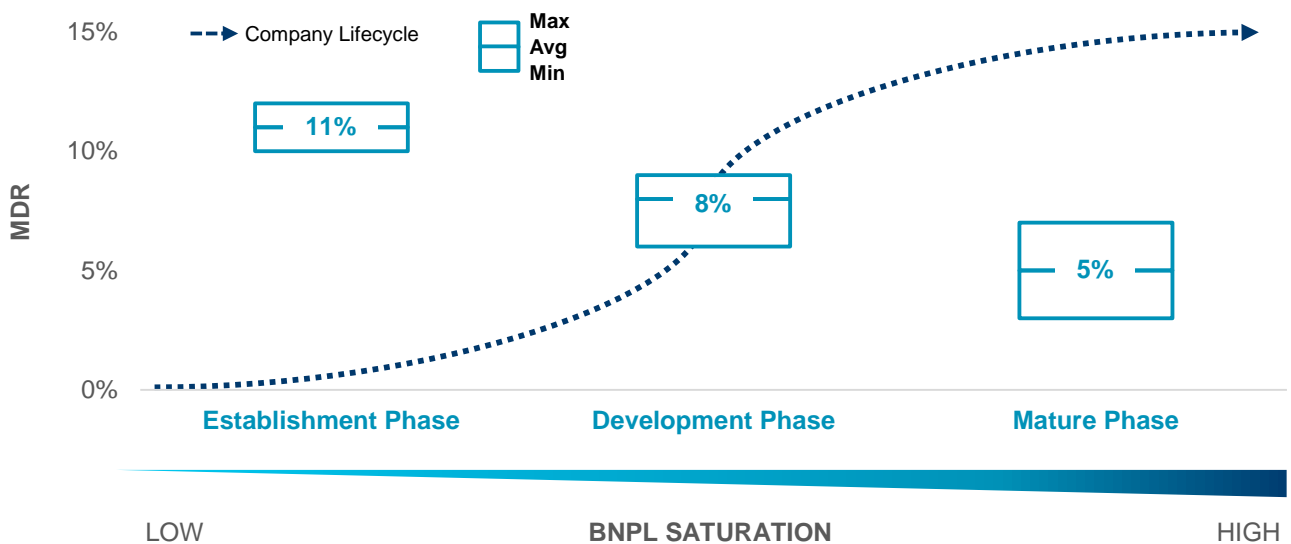
⁵ CNBC, 'Retailers bid farewell to layaway, as shoppers embrace buy now, pay later options', 25 September 2021, available at: <https://www.cnbc.com/2021/09/25/why-retailers-are-embracing-buy-now-pay-later-financing-services.html>

2.1 MDR PRESSURE

During their earlier years of operations, BNPL firms operating in developed APAC markets were able to command MDRs of up to 10-12%. However, in more recent times, as a growing number of providers have entered the industry,

merchants – especially those without exclusivity arrangements – have been presented with a wide range of alternatives. As a result, we are seeing ongoing MDR compression across many APAC markets in an effort by BNPL providers to win the merchant acquisition war (see Figure 13).

FIGURE 13: MDR TREND (%)



Source: industry interviews, Quinlan & Associates analysis

As the industry has matured, an MDR of 5% has become the “industry standard” in key developed APAC markets, such as Hong Kong and Singapore. When compared against original MDRs of 11%, GMVs have needed to more than double in order for BNPL firms to achieve previous revenue levels with their merchants.

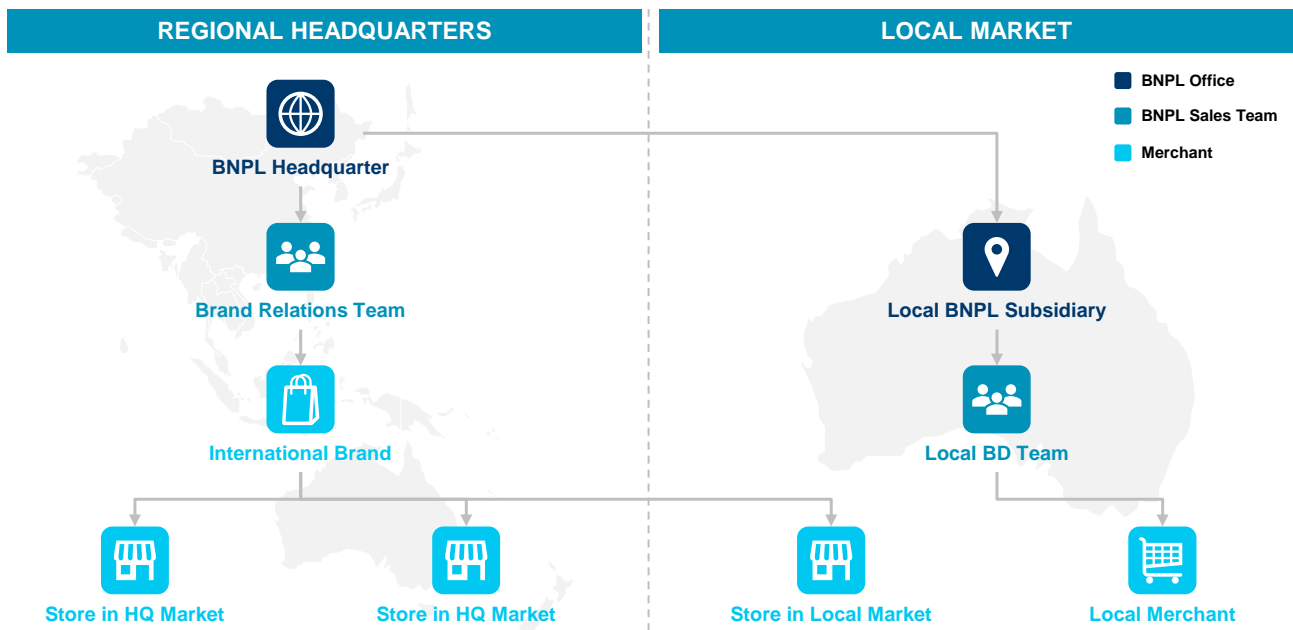
This pressure on MDRs is exacerbated by price competition from other consumer credit products. For example, credit cards and mobile payment services charge MDRs of 1-3%. In addition, these offerings are increasingly providing various discounts and cash rebates to drive merchant sales. With many substitutes competing for the same merchant base, we expect BNPL players to face ongoing MDR pressures in years to come.

2.2 MERCHANT ACQUISITION COSTS

With heightened competition creating pressure amongst BNPL players to rapidly scale, many firms have invested considerable sums building in-house business development and sales teams to support their merchant acquisition efforts.

For larger regional players, this is typically implemented through a combination of a centralised brand relations team operating from the firm’s headquarters and local sales / business development teams in each of the BNPL providers’ operating market (see Figure 14).

FIGURE 14: BUSINESS DEVELOPMENT / SALES TEAM SET-UP



Source: industry interviews, Quinlan & Associates analysis

The centralised brand relations team is responsible for establishing relationships with international / regional merchants, encouraging them to offer the BNPL solution in stores across their operating markets. Local sales / business development teams are typically organised by industry coverage verticals (especially for larger providers), with each account manager being responsible for acquiring merchant clients within a specific industry. The need to set up multiple business development teams inevitably increases operational costs, further weighing on margins.

To attract merchants, many BNPL companies in APAC offer attractive perks, such as sponsored marketing campaigns and promotional discounts. Most of the time, these are fully – or at least heavily – funded by the BNPL firms themselves, further increasing expansion-related costs. Moreover, a number of BNPL firms in the region employ sizeable brand ambassador teams that work on-site at merchant stores, whose primary responsibilities include driving brand awareness and in-store sign-ups. This has added considerably to the cost base of many firms.

3. FINANCING PARTNERS

While BNPL companies receive capital from various parties (as discussed in Section 2) – including venture capital, private equity, established financial institutions, and public markets (via an IPO) – these funds are

deployed towards business operations only (i.e. business administration, operations, and expansion). However, in addition to day-to-day operating expenses, BNPL companies need to seek capital to finance their credit extension service. This is being done via a number of channels (see Figure 15).

FIGURE 15: CREDIT EXTENSION FUNDING

FUNDING NATURE		FUNDING SOURCE				CREDIT RISK		PORTION
		Alternatives (PE / VC)	Financial Institutions	Private Investors	Mass Retail	On Bal. Sheet	Off Bal. Sheet	
Debt Financing	Investors loan money to BNPL firms, with a specified maturity and fixed interest rate (lower than the MDR charged), to be used for credit extension to end customers	✓	✓	✓		✓		██████
Equity Financing	Investors invest in BNPL companies, with an understanding that the capital will be used directly for credit extension to end customers	✓		✓		✓		██□□□□
Investment Product	BNPL companies receive funding through structured products or credit platforms, with customisable terms depending on investor risk appetite and return expectations	✓		✓	✓	✓	✓	██████□
Bank Deposits	BNPL companies can establish retail banks or retail banks can offer BNPL services, using consumer deposits as a low cost source of funding to extend credit				✓	✓		██□□□□
Partner Distribution	BNPL companies act as a distribution channel for players already operating in the consumer credit industry to access additional customers (i.e. BNPL users)		✓				✓	██□□□□

✓ Applicable
 Low ████████ High

Source: industry interviews, Quinlan & Associates analysis

3.1 ON-BALANCE SHEET FINANCING

Most capital-raising methods to support the credit extension activities of BNPL firms are on-balance sheet, whereby BNPL companies raise money from investors (moving capital onto their balance sheet) and lend the capital out to retail customers when BNPL service is provided. In this model, the BNPL companies wear the credit risk, as any defaults directly translate to a credit loss on the BNPL companies’ balance sheet.

In addition, because of the relatively risky nature of credit extension (exacerbated by

potential adverse selection in highly unbanked markets), investors expect higher returns from their investments to compensate for the risk taken. As a result, most of these funding methods are relatively expensive.

3.1.1 DEBT FINANCING

Debt financing makes up the highest proportion of capital raised for credit extension. Due to the nature of BNPL’s business model, investors expect some level of protection when providing capital for credit extension, and therefore debt financing represents the most prominent financing method.

The debt facility has an interest rate lower than the MDR charged by BNPL companies, and the differential represents the gross returns for the BNPL player. Most of these debt facilities are short-to-medium-term in nature. For example, Afterpay reported a weighted average life of 2.0 years for its debt facilities in FY 2020.⁶

3.1.2 EQUITY FINANCING

Equity financing represents the lowest proportion of funding used for credit extension. Most investors expect BNPL companies to utilise equity financing for their business operations (namely, expansion), and therefore equity capital is rarely used for credit extension.

However, during early stages of launch, BNPL companies may struggle to access debt financing from investors, given their absence of track record. As such, some firms need to rely on equity capital to conduct their credit extension functions in order to prove the efficacy of their credit scoring models. Nonetheless, once other channels to access capital become available, BNPL companies quickly switch as equity represents the most expensive form of capital.

3.1.3 INVESTMENT PRODUCT

In addition to vanilla debt and equity financing methods, BNPL companies may issue structured investment products, typically invested in by private funds and private investors. These financing products have customisable terms (e.g. fixed vs. variable returns, guaranteed minimum returns, guaranteed capital protection, credit tranches, etc.), depending on return expectations and risk appetite of the investors.

In some markets, BNPL companies may also raise capital from retail investors through credit platforms. This typically involves the use of P2P credit platforms, on which BNPL companies can list borrowing terms. BNPL companies may list multiple options, with differing maturities and interest rates, to appeal to retail investors with varying preferences. Nonetheless, as regulators worldwide continue to crack down on P2P lending credit platforms in an effort to provide greater protection to retail investors, BNPL companies are finding it increasingly difficult to raise capital from mass retail investors.

3.1.4 BANK DEPOSITS

Bank deposits represent another funding channel, though it is only utilised by a handful of players. In this model, BNPL players may set up their own banks – typically a virtual bank, given their digital nature. For example, Klarna obtained a full banking licence in Sweden in 2017 and launched a savings account service in Germany in 2020.⁷ Some BNPL players in the APAC region we have spoken to have also expressed an interest in establishing a virtual bank by acquiring an existing bank amidst the ongoing wave of virtual banking licence approvals across ASEAN markets.

Virtual banks can amass retail deposits at relatively cheap cost and redirect the capital for BNPL credit extension, earning the margin between the MDR and the savings rate. Two virtual banks in Hong Kong, Mox Bank and Livi Bank, have already launched their own BNPL service (albeit the offering being a traditional consumer loan-BNPL hybrid).

⁶ Afterpay, 'FY20 Results Presentation', 27 August 2020, available at: <https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2020/11/FY20-Results-Presentation-1-1.pdf>

⁷ eMarketer, 'Klarna's banking ambitions underscore the threat of established fintechs in the banking space', 10 February 2021, available at: <https://www.emarketer.com/content/klarna-s-banking-ambitions-underscore-threat-of-established-fintechs-banking-space>

3.2 OFF-BALANCE SHEET FINANCING

As BNPL companies operate a credit business, most on-balance sheet financing options are expensive. This is especially important in the current inflationary environment, with rates expected to rise in coming years. Consequently, with funding costs set to rise, we believe an on-balance sheet funding model will become an increasingly unattractive option for many BNPL firms.

In addition, as many BNPL players in the APAC (especially ASEAN) region target unbanked customers by acting as an alternative credit channel, adverse selection inevitably results in even higher financing costs.

As a result, BNPL players taking credit risk on their books are often viewed unfavourably by investors, particularly from a risk and valuation perspective.

As such, many BNPL firms are seeking to offload, or completely remove, credit risk from their balance sheets, in order to reposition their business as a credit distribution channel (vs. acting as a credit risk taker).

3.2.1 PARTNER DISTRIBUTION

In this model, BNPL players partner with credit institutions, such as retail banks and consumer financing companies. When a user purchases goods through BNPL, instead of the BNPL company lending money from its own accounts, the credit institution provides the credit through the BNPL service.⁸

Through this partnership, credit institutions can access additional retail customers and leverage underutilised customer deposits. BNPL companies may also provide additional services, such as customer KYC and credit profile evaluation for these credit institutions. In exchange for supporting credit extension, BNPL companies may charge a fixed fee (similar to a technology licensing / SaaS-subscription) or a commission-based fee.

More importantly, BNPL companies pivoting to this model are able to shift credit risk off their balance sheets, acting instead as a credit distribution enabler for partner institutions who ultimately wear the credit risk. As a SaaS-based model, BNPL companies can earn “risk-free” technology or commission fees instead of an MDR based on credit extension.

A number of regional BNPL players we have worked with have already begun to explore how to further transition their businesses to more of a partner distribution model in an effort to de-risk and drive their valuations.

⁸ See later section for more detail on partner distribution

4. REGULATORS

With the APAC BNPL industry developing rapidly, regulators are increasingly becoming concerned about the credit-based business model and its implications for consumer

protection. While regional regulators have been slow to respond, given the comparative infancy of the BNPL industry when compared to Western markets, we anticipate regulatory requirements across APAC will likely catch up in coming years (see Figure 16).

FIGURE 16: GLOBAL BNPL REGULATORY SNAPSHOT

	MARKET	REG. STANCE	DESCRIPTION
APAC MARKETS	Malaysia	□ □ □ □ □	• BNPL is not regulated by Bank Negara Malaysia (“BNM”), as it falls under a factoring agreement instead of lending
	Vietnam	□ □ □ □ □	• No regulatory requirements on BNPL service providers with respect to their offerings and data privacy
	Indonesia	■ □ □ □ □	• No specific laws for the industry, but BNPL companies need to comply with certain requirements for credit services
	Japan	■ □ □ □ □	• Stated an awareness of the industry but yet to draft any laws, given regulator is unsure if BNPL will continue to develop in the market
	Singapore	■ ■ □ □ □	• Increasing concerns with regards to consumers falling under unseen debt, and therefore exploring stricter regulatory requirements
	Philippines	■ ■ ■ □ □	• Comprehensive laws and regulations on credit services, with established licensing requirements and regulatory expectations
	Australia	■ ■ ■ ■ □	• Upcoming reform on payments regulation to include the imposition of more stringent supervision on BNPL providers and the industry
WESTERN MARKETS	Germany	■ ■ ■ □ □	• Proposal of a new directive on consumer credits by the European Commission, to replace the current Consumer Credit Directive
	US	■ ■ ■ ■ □	• Stringent requirements with past cases of licence rejections and fines, along with data requests for further industry evaluation
	U.K.	■ ■ ■ ■ □	• U.K. Treasury believes BNPL should no longer be exempted from consumer credit regime, and suggested further regulatory oversight

Regulatory Scrutiny: Low □ □ □ □ □ High

Source: press releases, regulatory announcements / newsletters, Quinlan & Associates analysis

In many Western markets, metrics are established for money lenders to determine if a business is categorised as a credit / loan business. These metrics are primarily based on the nature of fees charged (i.e. interest vs. non-interest) and repayment terms (including tenor and number of instalments). To remain relatively unsupervised, Western BNPL companies do not charge interest and offer limited payment periods (i.e. typically three months).

As the industry continues to grow, regulators are reviewing the need for stronger consumer protection measures, with industry-specific laws / requirements likely to be implemented in coming years. In fact, Klarna U.K. implemented a suite of changes to its service to comply with pending regulatory requirements. These include explicit wording to make clear to customers that BNPL is a credit product with penalties for missed payments, a “pay now” option in addition to its instalment payments, and a commitment to stronger credit checks.⁹

REGULATORS ARE INCREASINGLY BECOMING CONCERNED ABOUT THE BNPL MODEL AND ITS IMPLICATIONS FOR CONSUMER PROTECTION. WE ANTICIPATE REGULATORY REQUIREMENTS IN APAC TO CATCH UP TO THOSE IN WESTERN MARKETS IN COMING YEARS

⁹ Financial Times, 'Klarna overhauls UK 'buy now, pay later' service ahead of crackdown', 18 October 2021, available at: <https://www.ft.com/content/89fc33b7-4029-4ca4-82c1-04065d84fe31>

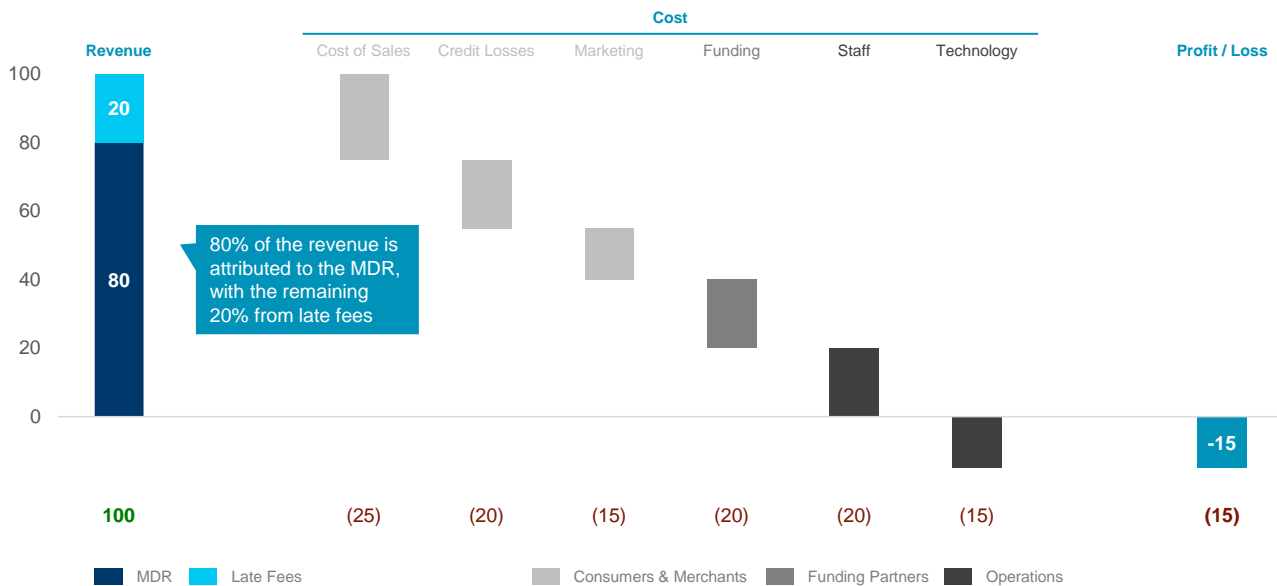
PROFITABILITY CHALLENGES

DEVELOPED MARKET PLAYERS

Suffering from pressure on multiple fronts, many BNPL firms in the region are struggling to

turn a profit. Indeed, even the most established players in developed markets (both in APAC and West) are still making sizeable losses (see Figure 17).

FIGURE 17: FINANCIAL PERFORMANCE – DEVELOPED MARKET PLAYERS



Note: values are indexed to Revenue
 Source: annual reports, industry interviews, Quinlan & Associates analysis

For established BNPL players, while the majority of revenue is driven by transaction MDRs, late fees (i.e. fee levied on consumers that fail to fully repay the instalments in time) still represent ~20% of overall revenues.

Major cost categories include cost of sales, credit losses, and marketing, driven by challenges imposed by consumers and merchants (as outlined above), with each representing 15-25% of total revenue, while

funding costs represent up to ~20% of revenue. Operational expenses, including staff wages and technology spending, represent ~35% of revenue.

Taken together, these costs total up to 115% of revenue, translating to a -15% profit margin for even the largest BNPL firms. For example, Klarna, Afterpay, and Affirm reported negative margins of 12%, 17%, and 13% respectively in their latest financial year.¹⁰

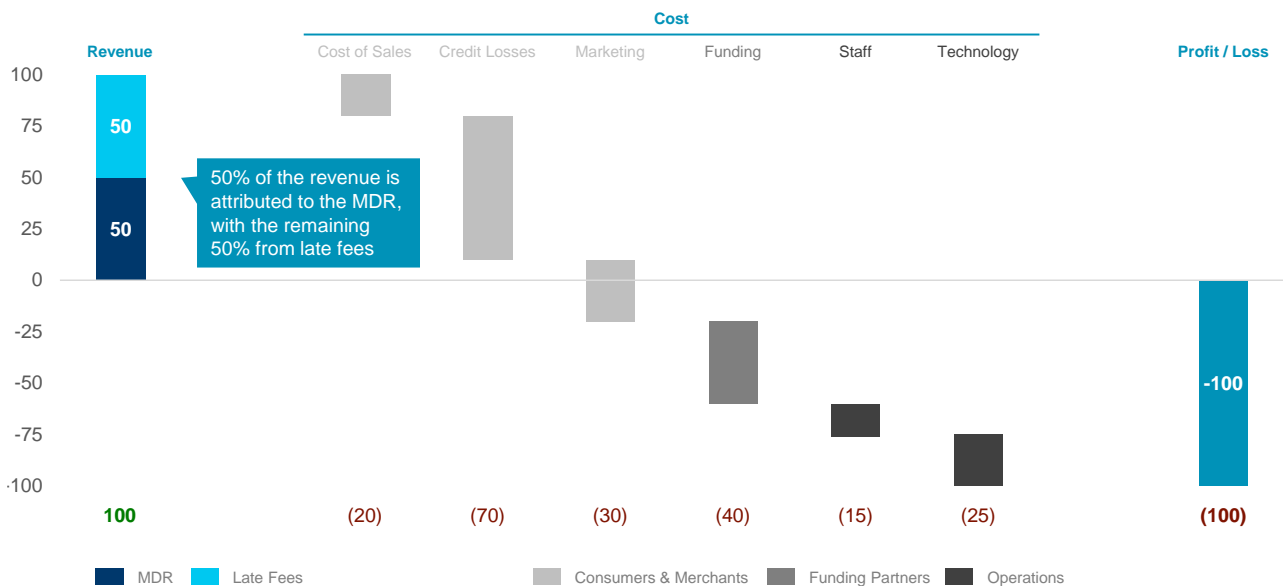
¹⁰ Note that Affirm only reported a six-month performance, from July 2020 to December 2020

EMERGING MARKET SPECIALISTS

Losses are even more pronounced for emerging market specialists operating in developing economies, particularly ASEAN.

Because of their stronger focus on long tail, unbanked / underbanked consumers, credit losses and funding costs represent a considerably larger portion of their overall cost base (see Figure 18).

FIGURE 18: FINANCIAL PERFORMANCE – EMERGING MARKET SPECIALISTS



Note: values are indexed to Revenue
Source: annual reports, industry interviews, Quinlan & Associates analysis

Given their focus on riskier customers, emerging market specialists tend to impose higher late fees, which make up a notably larger portion of their total revenue (i.e. ~50%), due to both a higher rate of missed payments and relatively higher late fees (vs BNPLs operating in developed APAC).

These BNPL companies also suffer from a higher rate of credit loss relative to developed market players. Moreover, as they are less technologically mature than more established providers, promotional campaigns are typically

scattered and conducted offline / in-store, driving up marketing costs considerably.

Funding costs for emerging market specialists are also significantly higher, as funding partners expect higher rates of return to offset the inflated credit risks associated with lending to less creditworthy consumers.

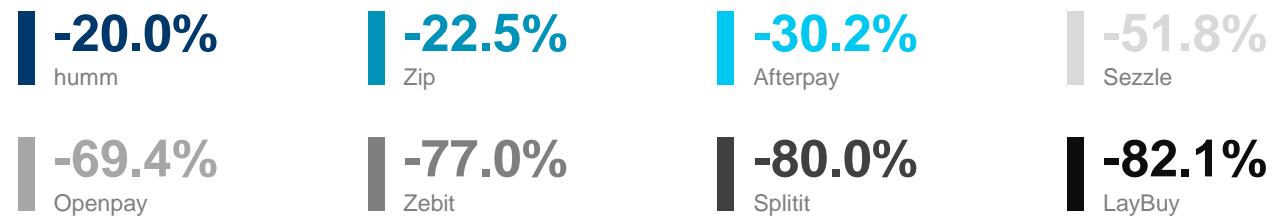
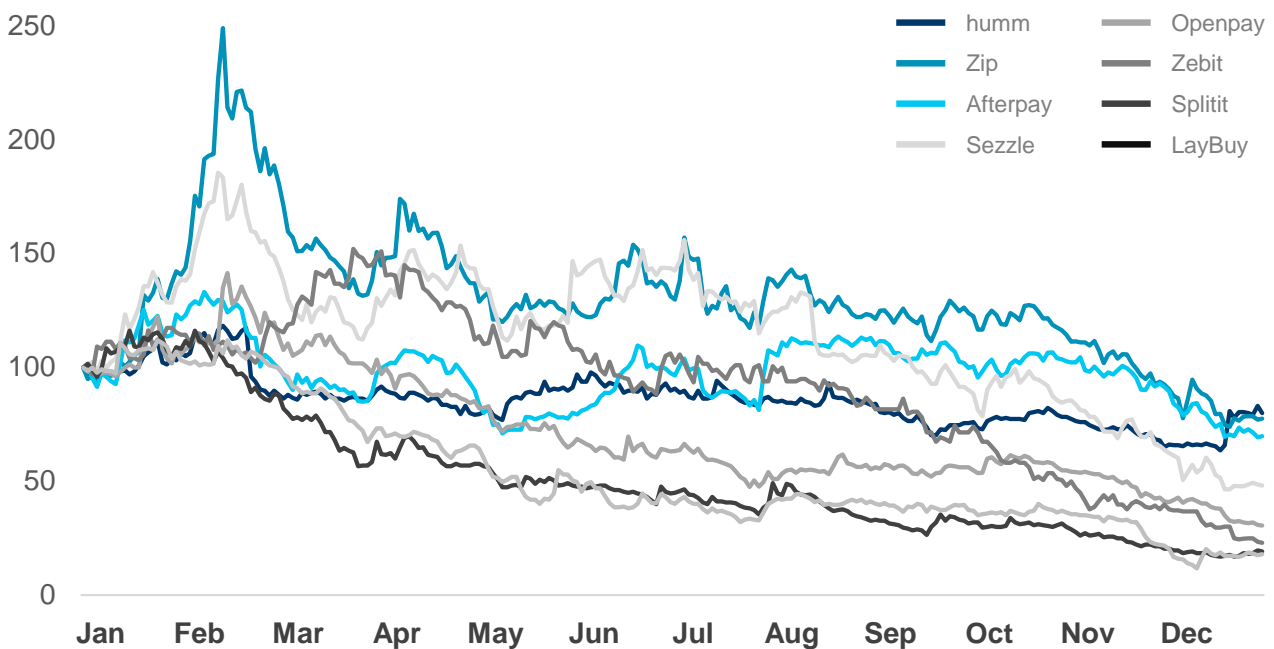
Our data shows that these costs add up to 200% of revenue for many firms operating in the region, resulting in a -100% negative profit margin per year.

STOCK PERFORMANCE

With the initial industry boom and honeymoon period for the BNPL industry coming to an end, investors are placing greater scrutiny on bottom-line financial performance. Recognising

the sustained negative profit margins (i.e. losses) being experienced by even the most mature BNPL players, valuations have tanked across the board, despite strong growth in BNPL adoption rates during the Covid-19 pandemic (see Figure 19).

FIGURE 19: 2021 STOCK PRICE PERFORMANCE (Indexed)



Source: annual reports, industry interviews, Quinlan & Associates analysis

Indeed, the eight BNPL companies listed on ASX¹¹ all suffered from a considerable decline in their stock price in 2021, with losses ranging from 20% to over 80%.

It is clear that long-term commercial sustainability has become a key concern for the investor community, and we believe it is something BNPL firms must urgently address.

¹¹ These refer to BNPL companies listed since before 1 January 2021

SECTION 4

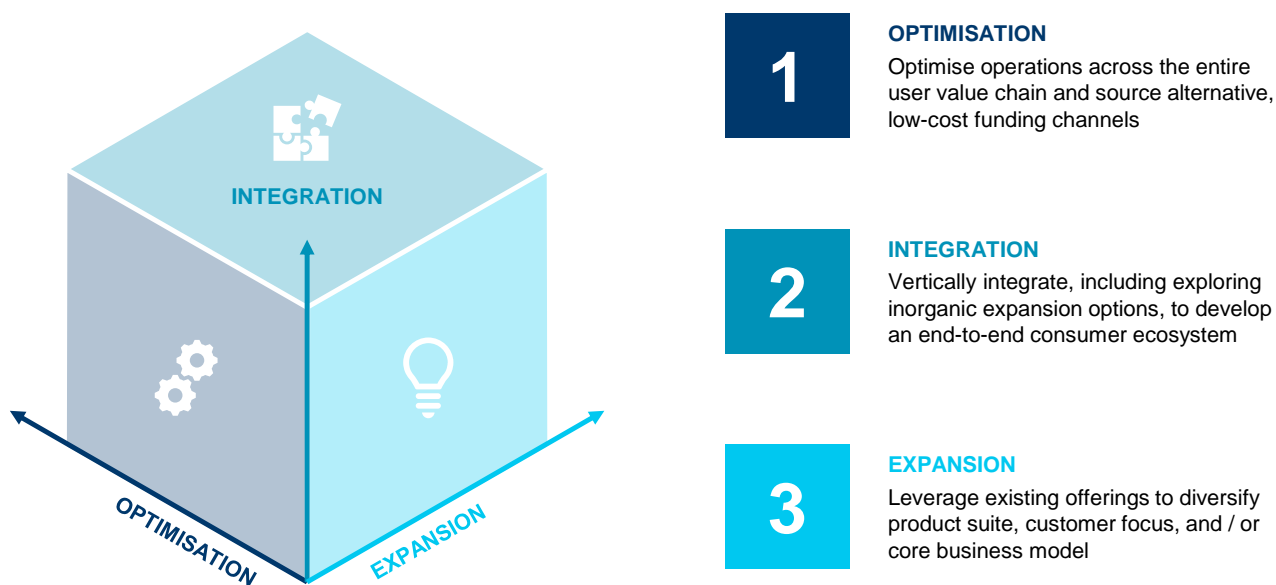
SOLVING FOR PROFITABILITY

With incumbent and start-up BNPL providers suffering from unsustainable losses (with no clear end in sight based on current trajectories) and tanking share prices, we believe it is critical for BNPL firms to fundamentally rethink their business models.

We see three key pathways that BNPL companies can explore, including:

1. Optimisation;
2. Integration; and
3. Expansion (see Figure 20).

FIGURE 20: SOLVING FOR PROFITABILITY



Source: Quinlan & Associates analysis

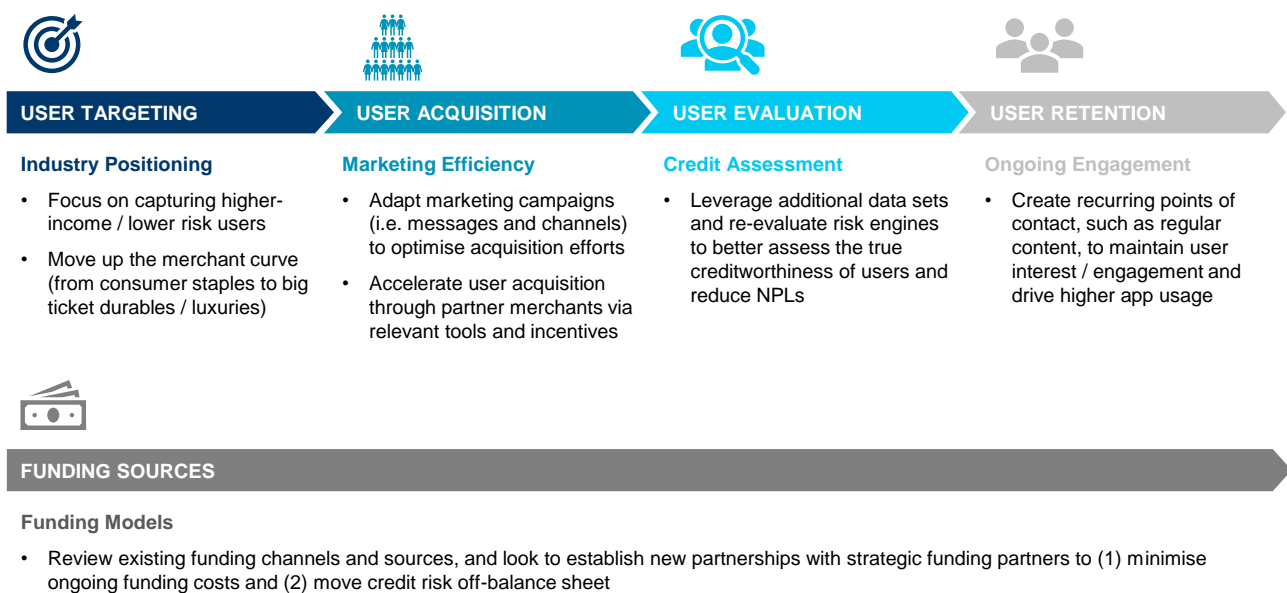
1. OPTIMISATION

While the current BNPL model represents an attractive alternative credit solution for consumers with significant growth potential, we see considerable scope for BNPL companies to

optimise their business models in an effort to improve their financial sustainability.

We see a number of areas for optimisation across the end-to-end user journey (i.e. from customer targeting to user retention), as well as in the firm's funding source (see Figure 21).

FIGURE 21: BNPL OPERATIONS OPTIMISATION



Source: industry interviews, Quinlan & Associates analysis

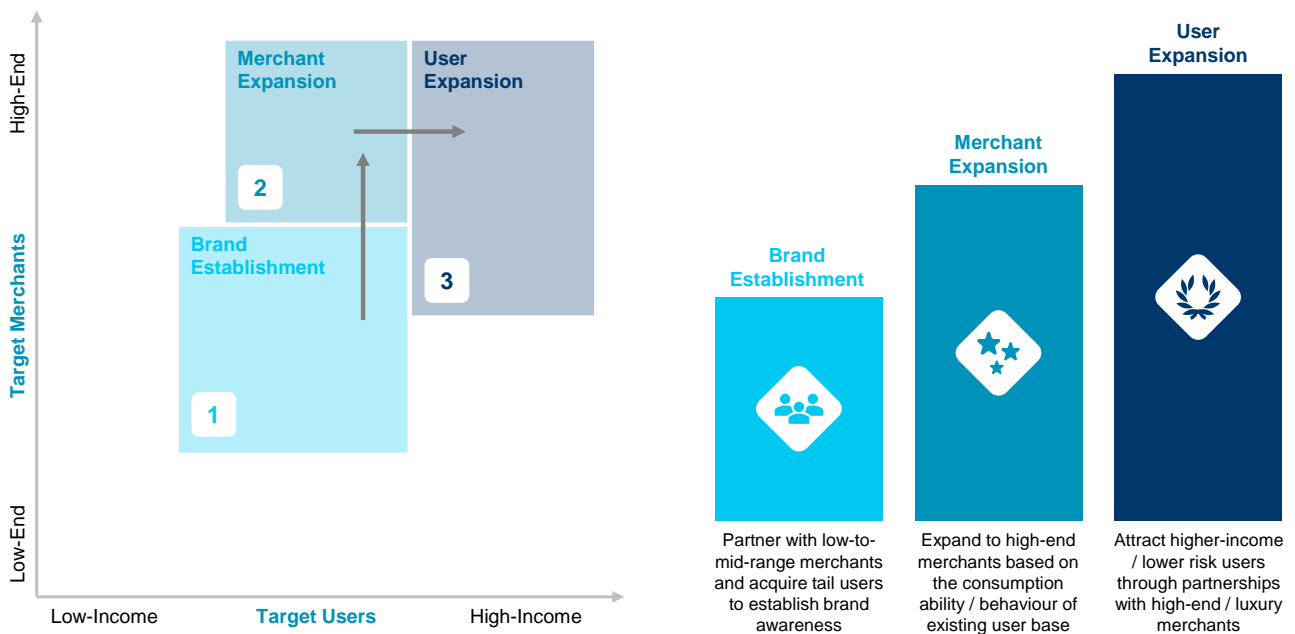
WITH BNPL PROVIDERS SUFFERING FROM UNSUSTAINABLE LOSSES AND TANKING SHARE PRICES, A FUNDAMENTAL RETHINK OF THEIR BUSINESS MODELS IS NEEDED

1.1 USER TARGETING

As BNPL companies continue to compete against each other to capture market share, additional opportunities – in terms of expanding the overall targetable user universe – need to be carefully considered. This is especially relevant for BNPL players operating unbanked / underbanked markets, given their predominant focus on servicing higher credit risk customers and lower-end merchants.

It is only logical that many BNPL providers commence operations focusing on low-to-mid range merchants and lower-income user groups, in order to establish brand awareness and market presence. However, once a robust user base has been amassed, it is important for BNPL firms to analyse user consumption behaviours in an effort to establish partnerships with relevant high-end merchants (see Figure 22).

FIGURE 22: MERCHANT POSITIONING EVOLUTION



Source: Quinlan & Associates analysis

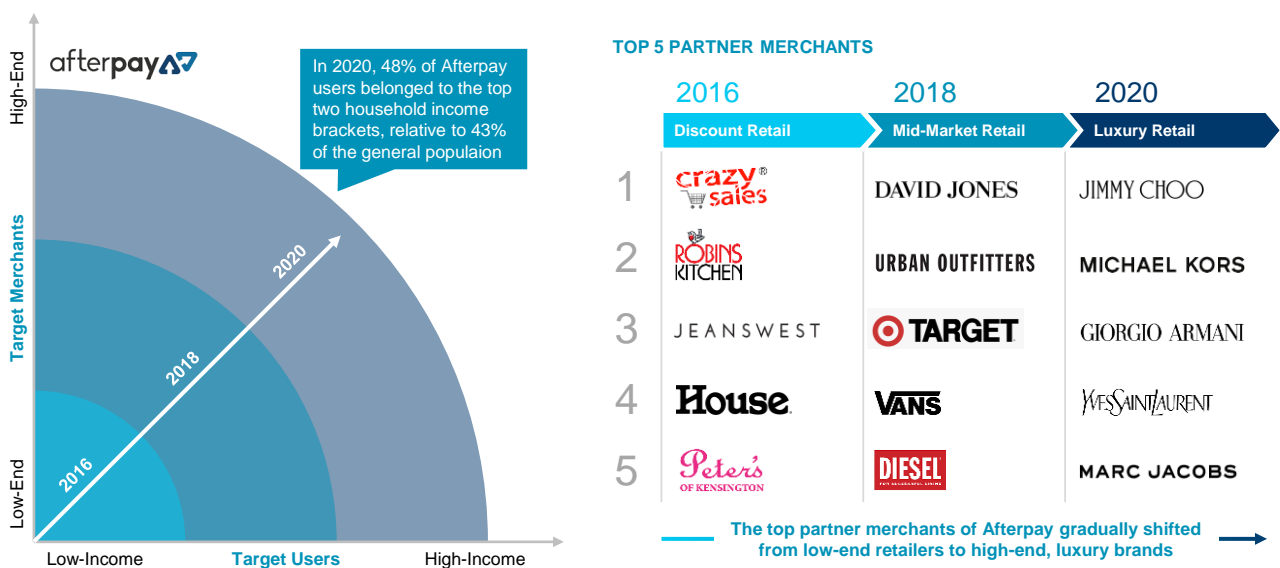
Through (exclusive) partnerships with luxury retailers, BNPL companies can facilitate premium purchases and attract higher-income user groups. This positioning pivot enables

BNPL companies to drive top-line revenue potential (from greater transaction values) at lower risk (as high-income users are likely have lower credit risk).

We see a more robust profitability profile for firms that can pivot their brand positioning and focus on higher-end merchants (and, in turn, lower risk consumers). We are already

witnessing this trend take place among Western BNPLs, with Afterpay being a prime example of a BNPL company executing a merchant positioning pivot (see Figure 23).

FIGURE 23: EVOLUTION OF AFTERPAY'S MERCHANT POSITIONING



Source: Afterpay, Accenture, Quinlan & Associates analysis

In 2016, Afterpay partnered with local, low-to-middle range merchants, such as Cotton On and Myer. Over time, the company started working with higher end luxury brands, such as Michael Kors and Armani, and its user group

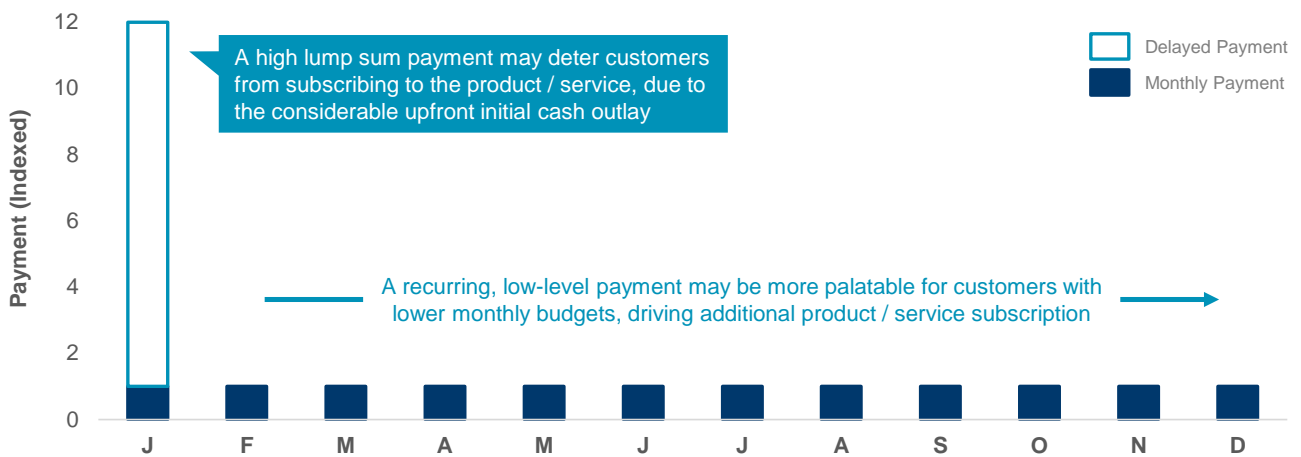
focus also shifted towards the higher-income population. Indeed, 48% of Afterpay users are from the two highest income groups in Australia in 2020.¹²

¹² Accenture, 'Afterpay Economic Impact', April 2021, available at: <https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/04/Afterpay-Economic-Impact-report-2020-Accenture.pdf>

We believe the expansion of merchant partnerships should also be considered from a broader industry / sector context. While retail merchants represent the current focus of most BNPLs, some firms are exploring partnerships with other industries. For example, BNPL companies can help facilitate the purchase of

insurance plans that require significant annual premium payments, or club / gym memberships that charge high annual subscription fees (in which BNPL companies can help transform these lump sum payment terms into monthly, instalment-based payments) (see Figure 24).

FIGURE 24: LUMP SUM-TO-MONTHLY PAYMENT TRANSFORMATION



Source: Quinlan & Associates analysis

A SUITABLE POSITIONING PIVOT ENABLES BNPL COMPANIES TO DRIVE TOP-LINE REVENUE POTENTIAL (FROM GREATER TRANSACTION VALUES) AT LOWER RISK (AS HIGH-INCOME USERS ARE LIKELY HAVE LOWER CREDIT RISK)

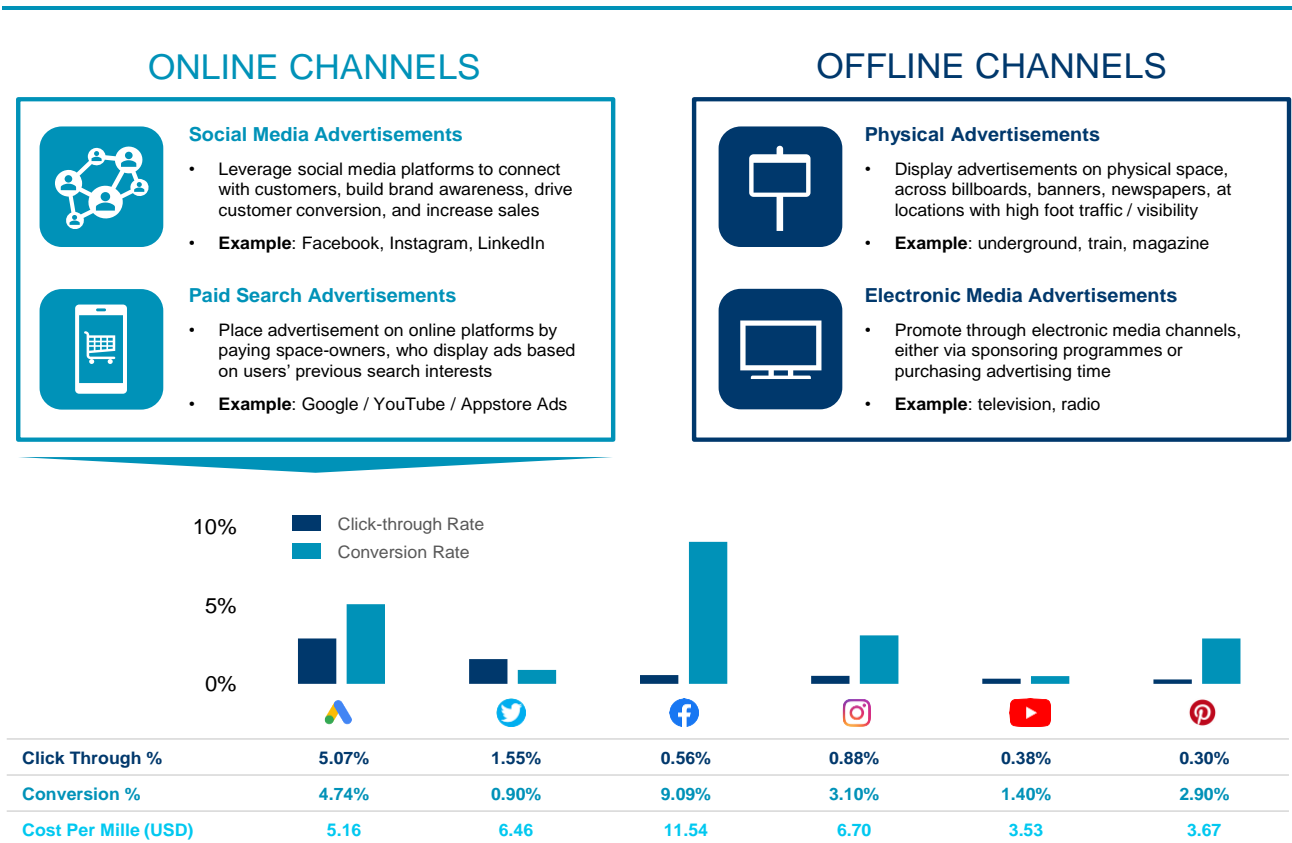
1.2 USER ACQUISITION

1.2.1 MARKETING

Marketing plays a critical role in user acquisition. To drive efficiency and reduce customer acquisition costs, BNPL companies

need a clear marketing strategy – across messages and channels. While BNPL is primarily a digital offering, consumption in Asia (particularly in emerging economies) remains heavily offline-focused. As such, both online and offline channels should be leveraged (see Figure 25).

FIGURE 25: MARKETING CHANNELS



Note: Google Ads and Facebook data are specifically for the finance industry, while others represent platform average across industries
 Source: Pixability, Wordstream, Heap, Social Media Examiner, Adstage, Webfx, Fat Stacks, 4C Insights, Quinlan & Associates analysis

Developed market players tend to focus on online channels, due to the digital nature of BNPL apps and strong presence of eCommerce players in their operating markets. These online marketing channels are typically evaluated by: (1) click through rates; (2) conversion rates; and (3) cost per mille, to understand the average acquisition cost of a new user.

In APAC (especially ASEAN) markets, where internet and eCommerce penetration rates are relatively lower, BNPL companies continue to promote their offerings through offline channels. For example, Atome placed physical advertisements across MTR (i.e. subway) stations in Hong Kong as they expanded in the city, while Afterpay launched TV commercials with Australian actress, Rebel Wilson.

1.2.2 CONVERSION

Marketing plays a critical role in user acquisition. To drive efficiency and reduce customer acquisition costs, BNPL companies need a clear marketing strategy – across both messages and channels. While marketing campaigns are effective in raising awareness of both the BNPL offering and the brands themselves, additional promotion initiatives are required to convert interested customers.

Many BNPL firms offer reward schemes on their apps. Most offer sign-up / registration rewards, including discounts and / or cash rebate rewards for new joiners. While most discounts only apply to first-time purchases, well-backed BNPL companies may offer rewards for up to three months after registration.

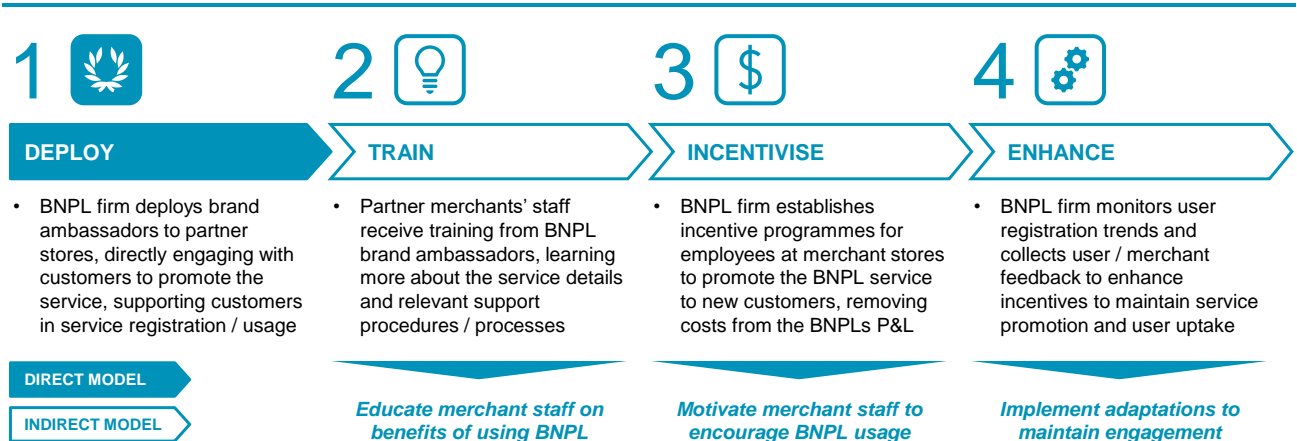
Registered users can also participate in referral schemes by sending invitation links to friends and family. When the link is used to register for an account and complete purchases (reaching a certain threshold), monetary rewards will be provided to the original user. Users can also participate in social media campaigns. For example, users could follow / like Atome’s

Facebook page and tag three friends, for a chance to win a pair of AirPods Pro. While social media campaigns do not translate to direct user acquisition, they are effective in raising awareness.

In addition to online initiatives, many BNPL firms run campaigns in brick-and-mortar stores of key partner merchants. This involves deploying on-ground staff (i.e. brand ambassadors) to physical stores to promote the BNPL offering. BNPL companies may work with partner merchants to display posters and banners across stores during major offline campaigns, to better promote the BNPL service. In exchange for the usage of store space, merchants may negotiate with the BNPL firm for monetary discounts during the period, such as waived MDR or subsidised sales campaigns.

We also see considerable scope for BNPL providers to move from their direct brand ambassador model to an indirect one, moving a considerable portion of their staffing costs off their books (see Figure 26). However, in order to be effective, any indirect distribution model needs to be carefully implemented.

FIGURE 26: OFFLINE CONVERSION CAMPAIGNS



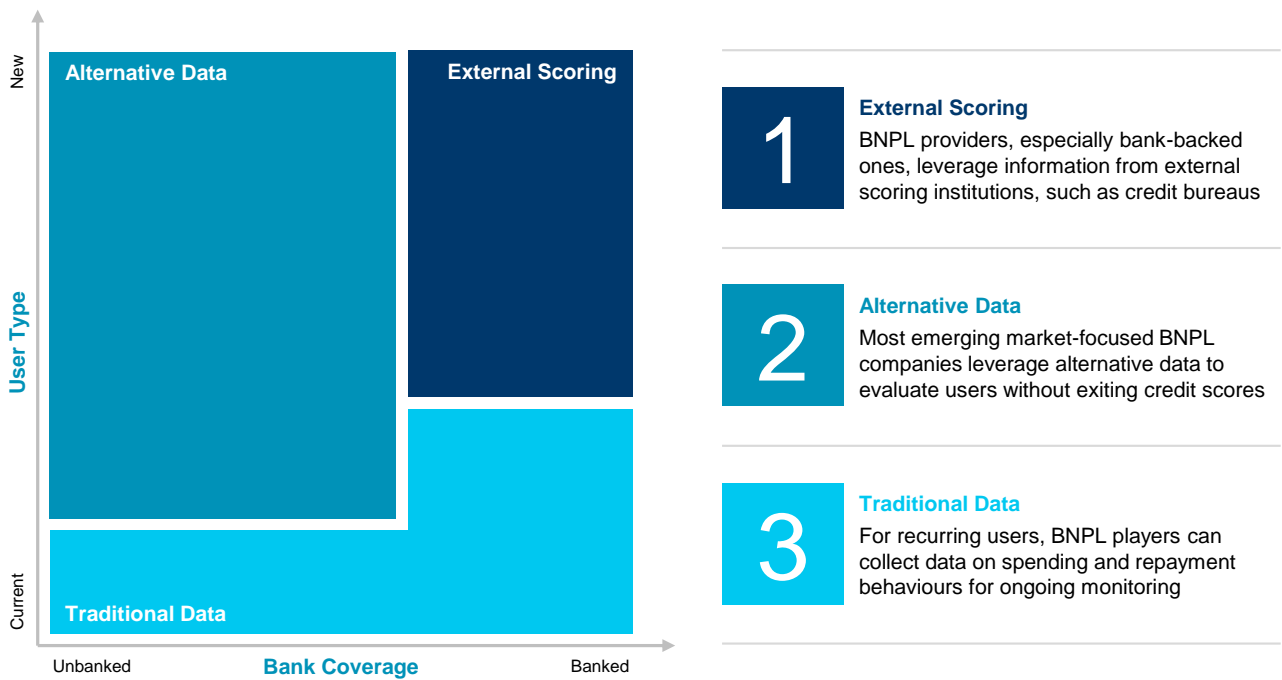
Source: Quinlan & Associates analysis

1.3 USER EVALUATION

Effectively refining the credit assessment process will enable BNPL providers to operate at a risk level that is more consistent with their tolerance / appetite.

For emerging market specialists that focus on long tail, unbanked consumers, we see considerable scope to establish alternative methodologies and algorithms to better evaluate user creditworthiness, with the use of alternative data being key (see Figure 27).

FIGURE 27: CREDIT EVALUATION



Source: Quinlan & Associates analysis

BNPL companies focusing on high-end customers or operating in developed markets can rely on external scoring providers to understand the creditworthiness of new users, including credit bureaus and independent credit scoring institutions. As consumers continue to use the BNPL app, purchasing information – including browsing history, spending patterns, and repayment records – can be collected to build holistic user profiles. As a result, the user credit score can be regularly maintained and updated through traditional data.

However, BNPL companies targeting long tail consumers (i.e. underbanked / unbanked customers) need to consider deeper use of alternative data – such as phone metadata, social media behaviour, utilities / telecom bill payments – to evaluate the creditworthiness of new users. These providers typically utilise an alternative risk engine to analyse such data.

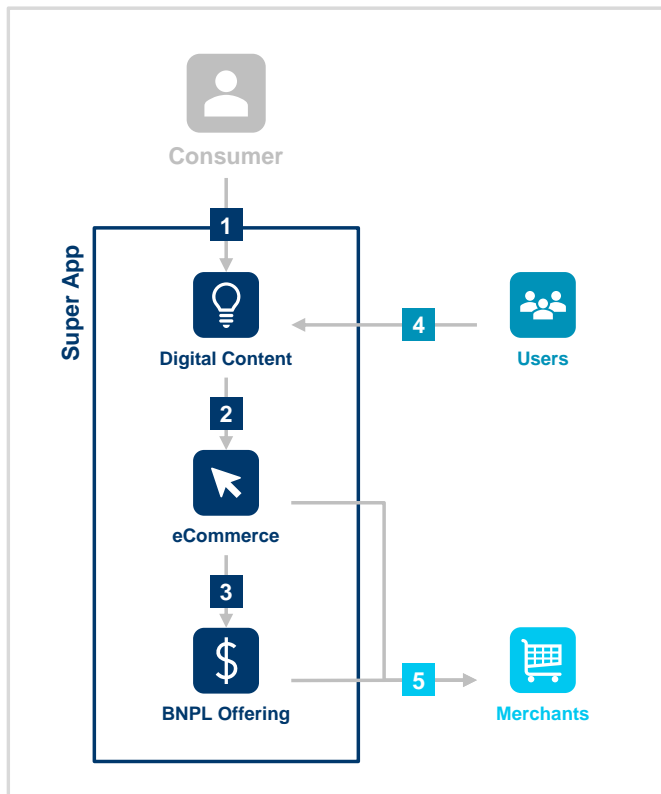
Despite this, the high non-performing loans (“NPLs”) being experienced by numerous emerging market specialists, especially in the wake of covid-19, suggests considerable room for improvement. Indeed, a regional BNPL player we spoke to saw NPLs saw during the early stages of the pandemic, reaching a peak of 19%. The efficacy of these risk engines is critical to ensuring long term sustainability and ensuring NPLs are kept to more manageable levels.

1.4 USER RETENTION

While many BNPL companies have experienced strong user acquisition in their early years, most firms fail to convert their customer base into recurring users. Indeed, many BNPL users register to enjoy the first-time discounts / benefits, with little reason to return to the app.

This challenge is experienced not only by BNPL companies, but also other retail customer-facing financial services apps. Many firms are looking to address this issue through improved user engagement and stronger integration with related services (see Figure 28).

FIGURE 28: USER ENGAGEMENT



SUPER APP

- 1 ENGAGE**
Regular, updated content to encourage consumers to access the application on a recurring basis
- 2 BROWSE**
Content engagement leads consumers to browse related products / services, driving additional consumption
- 3 PAY**
BNPL is integrated and offered as an option at check-out, minimising friction to drive consumer adoption

USERS

- 4 CREATE**
Users are encouraged to create content, either via a social media model or incentives for consumption

MERCHANTS

- 5 PARTNER**
Merchants list products on the eCommerce platform and receive payment through the BNPL offering

Source: Quinlan & Associates analysis

To drive user retention, BNPL firms can consider the development of a “super app”, either from organically or via partnerships / acquisitions. A content platform is established as the recurring access point. Content on the platform can be produced by the BNPL company itself or by other users, either as a social media platform model or incentivised through rewards / discounts on purchases on the super app. A social media platform works extremely well in driving engagement, given consumers visit social media platforms multiple times daily.

An eCommerce platform and the BNPL offering should be integrated¹³ such that consumers can directly access any products related to the content with ease and choose to pay through BNPL in a seamless manner. At its core, the aim of a super app is to attract consumers to visit the app regularly, then facilitate consumption and payment through a streamlined user journey.

The BNPL company can also use the super app as a foundation upon which to build and offer additional financial / credit products.

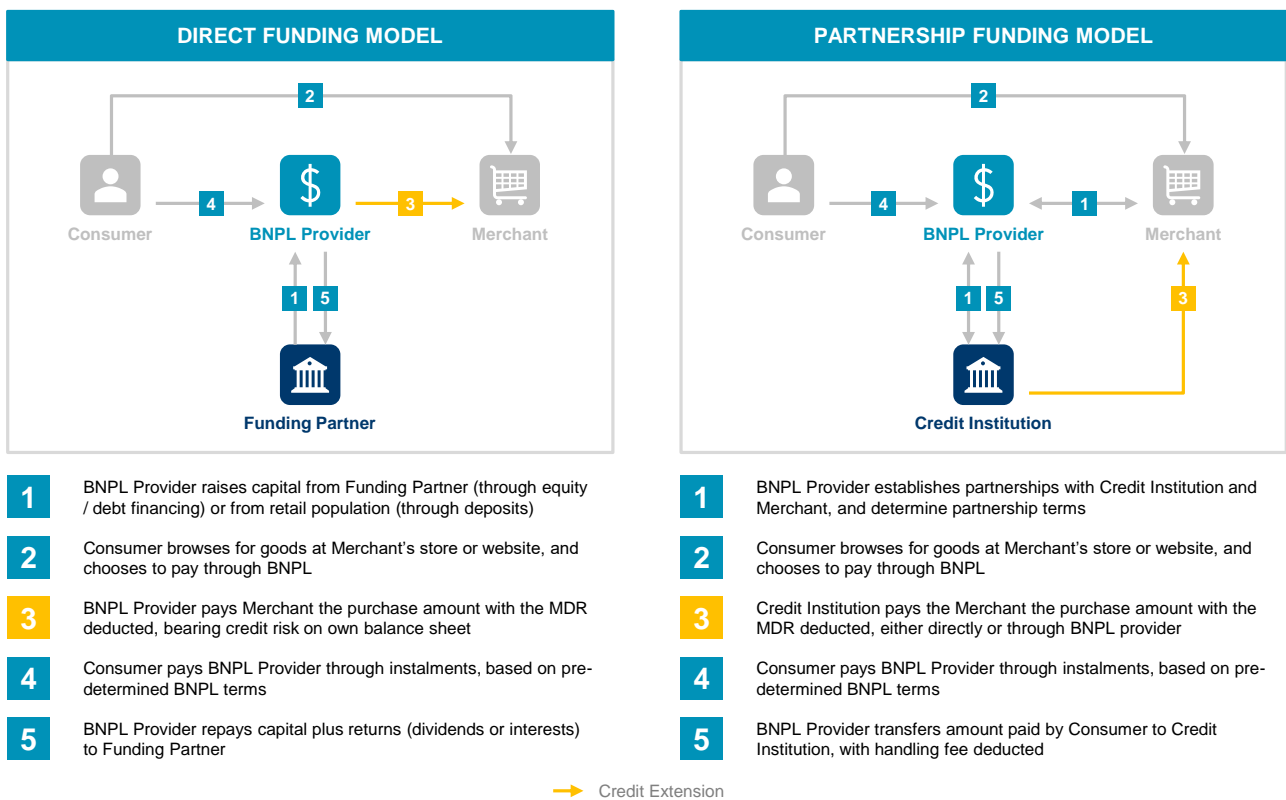
¹³ See also 2. INTEGRATION of this section

1.5 FUNDING SOURCES

The current funding model used by the majority of BNPL firms in APAC involves raising capital – typically from equity / debt financing – and extending credit using their own balance sheet.

As a result, BNPL players bear the credit risk of end-consumers and, driving up their funding costs as they exposed to NPLs. Recognising the shortfalls of this model, we see considerable scope for BNPLs to explore alternative funding models via partnerships (see Figure 29).

FIGURE 29: FUNDING MODEL



Source: Quinlan & Associates analysis

In a partnership funding model, BNPL companies work with credit institutions (e.g. banks and non-bank financial institutions) with significant cash / deposits and the appetite to extend credit to new customers. When a consumer chooses to purchase through BNPL,

the funding partner pays the merchant (either directly or through the BNPL provider) and receives MDR as revenue. The consumer repays the BNPL provider over time, who takes a fee for facilitating the transaction before handing the rest to the credit institution.

In this model, the BNPL player acts as a platform connecting consumers with credit needs to institutions that have the capacity to extend credit, shifting the credit risk off their balance sheets. This enables both the BNPL player and credit institution to capitalise on their expertise and capabilities: BNPL companies can leverage existing their relationships with consumers and merchants, and their technological infrastructure (e.g. eKYC and credit scoring solutions) while credit institutions can access new customers and make better use of their idle cash / deposits. Moving to such a model also has significant upside implications for the valuation of BNPL firms relative to their current setup.

As mentioned, given the plethora of banks in APAC and a wave of virtual / digital bank licenses being handed out by numerous regional regulators, BNPL firms can also explore setting up / acquiring a bank to source low-cost funding. However, a host of strategic, financial, and operational (namely compliance) considerations need to be evaluated on a case-by-cases basis in order to determine if such an approach has merit for the individual BNPL firm.

THE CURRENT FUNDING MODEL USED BY THE MAJORITY OF APAC BNPL FIRMS REQUIRES THEM TO BEAR THE CREDIT RISK OF END-CONSUMERS. WE SEE CONSIDERABLE SCOPE TO EXPLORE ALTERNATIVE FUNDING MODELS

2. INTEGRATION

In addition to optimisation, BNPL companies can consider opportunities to vertically integrate their offerings. This may represent a natural development opportunity, where BNPL players can leverage relevant capabilities (e.g. some

are already operating an in-app / online catalogue). By expanding / partnering through the value chain – across shopping, payment, credit (and debt collection), and fulfilment – we see scope for BNPL players to enhance user retention and drive profitability (see Figure 30).

FIGURE 30: VERTICAL INTEGRATION



Source: Quinlan & Associates analysis

2.1 ECOMMERCE (& LOGISTICS)

While eCommerce adoption in APAC (with the exception of China) currently lags Western markets, the industry is seeing rapid growth

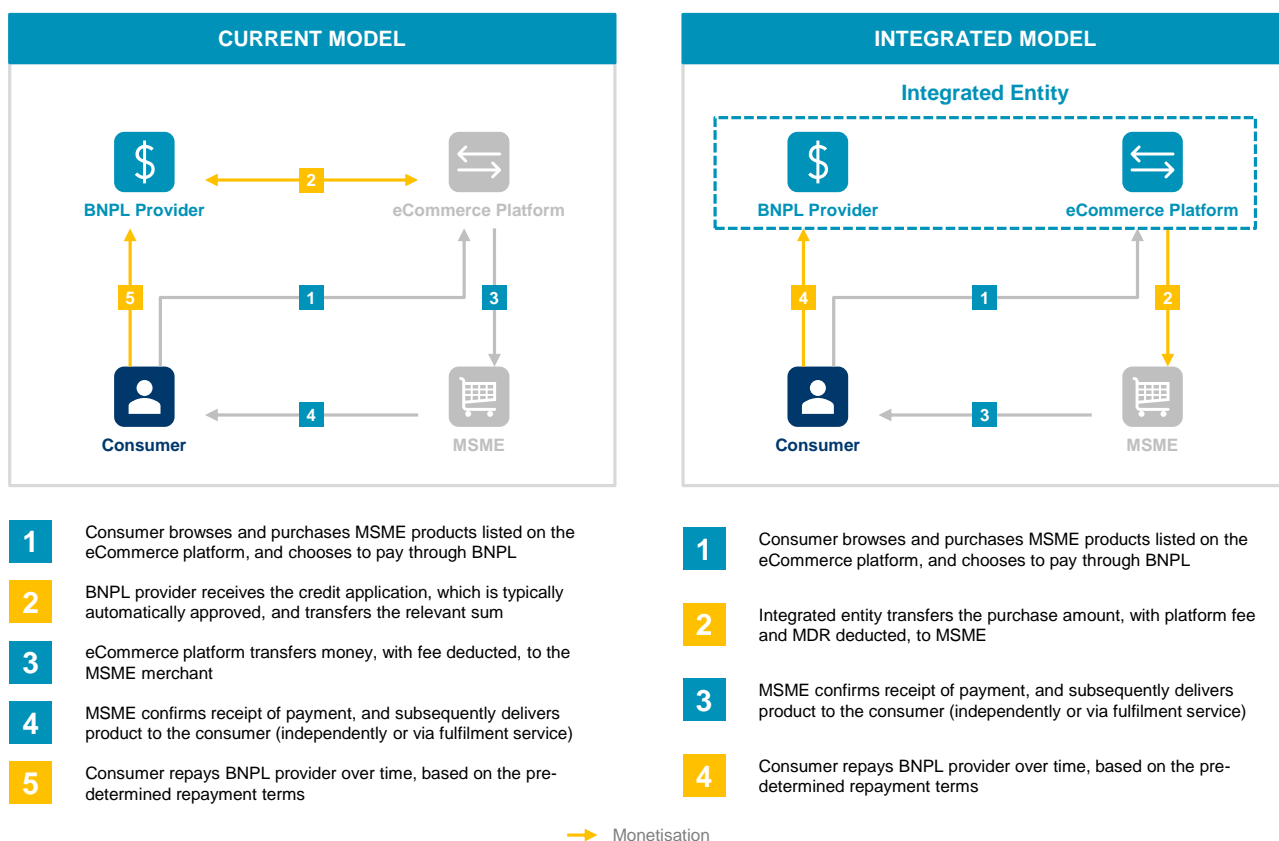
which is expected to continue in coming years. In fact, eCommerce sales in APAC are forecast to reach USD 2.8 trillion by 2025, up from USD 1.7 trillion in 2020.¹⁴

¹⁴ Forrester, '2021 Online Retail Forecast, Asia Pacific', 18 August 2021, available at: https://www.forrester.com/report/2021-online-retail-forecast-asia-pacific/RES176102?ref_search=0_1644824210337

A number of BNPL providers currently partner with eCommerce platforms to distribute credit through their platforms. In this model, BNPL companies charge an MDR to the merchants on the eCommerce platform for facilitating the transaction, while paying an additional cut to the eCommerce provider as a platform fee.

By acquiring or establishing their own eCommerce platform, BNPL companies can directly partner with their retail merchants. Not only would this increase revenue through capturing an additional platform fee (while avoiding a pay-away to existing eCommerce platforms), but it can also help to attract (and retain) more consumers due to its nature of being a “holistic shopping ecosystem” (see Figure 31).

FIGURE 31: ECOMMERCE INTEGRATION



Source: Quinlan & Associates analysis

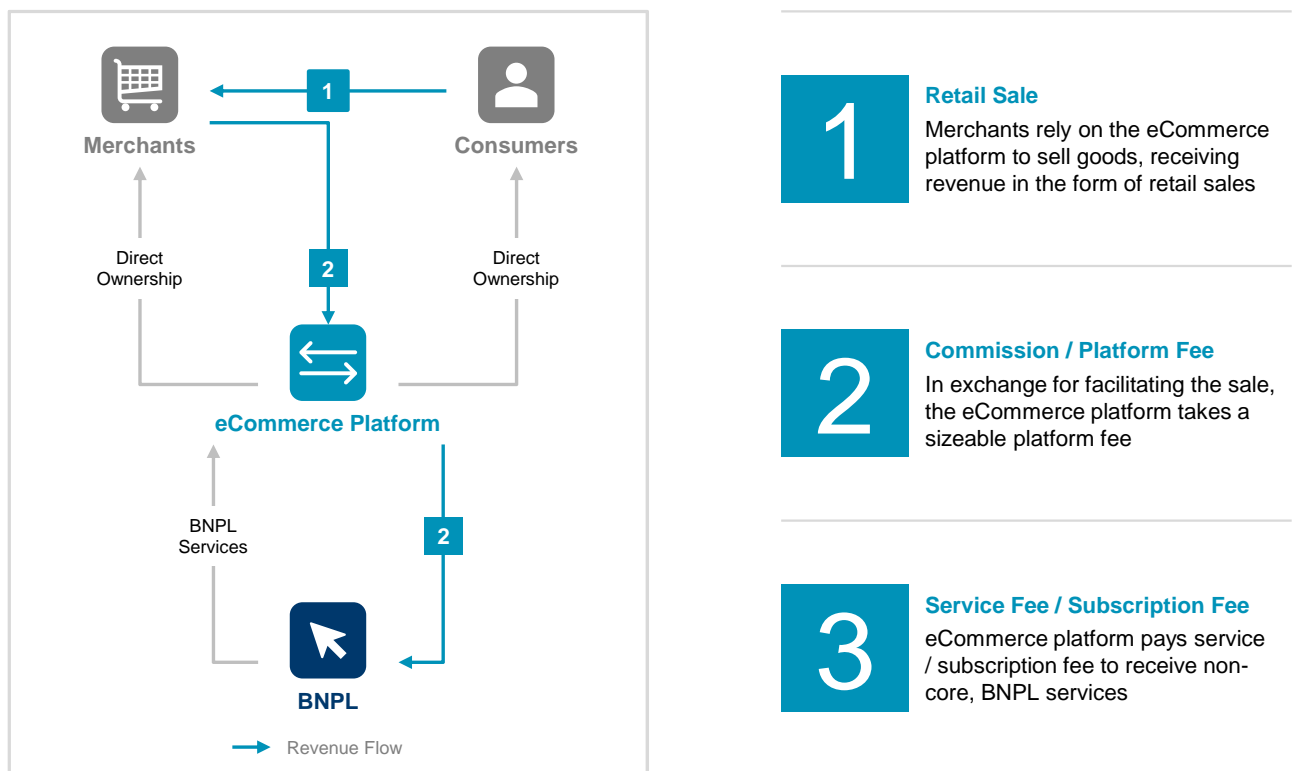
The leading BNPL player in Japan, Paidy, announced in July 2021 their plans to launch an eCommerce platform, integrating the entire

shopping journey – from browsing to borrowing and purchasing – on a single consumption application.

In today's ultra-competitive environment, the need for FinTech service providers to get as close as possible to end customers is of considerable importance. Revenue flows from the end customers to the relationship owner, and subsequently to add-on service providers,

providing the relationship owner with the greatest pricing power and the deepest understanding of customer needs. In an eCommerce-BNPL model, the eCommerce platform owns the relationships with merchants and consumers (see Figure 32).

FIGURE 32: CUSTOMER RELATIONSHIP OWNERSHIP



Source: Quinlan & Associates analysis

Owning direct relationships with consumers, eCommerce platforms can charge a significant commission / platform fee. In addition, leveraging the network of merchants and consumers, eCommerce platforms can choose from various BNPL providers, all seeking to access the platform's customer base.

eCommerce platforms can: (1) choose whether to implement a BNPL service; and (2) choose between various BNPL service vendors, generating significant pricing power. As a result, eCommerce platforms are the clear winners in the space, and add-on service providers (including BNPL players) struggle to effectively monetise customers. Direct customer ownership represents a benefit of establishing an eCommerce platform, in addition to revenue diversification.

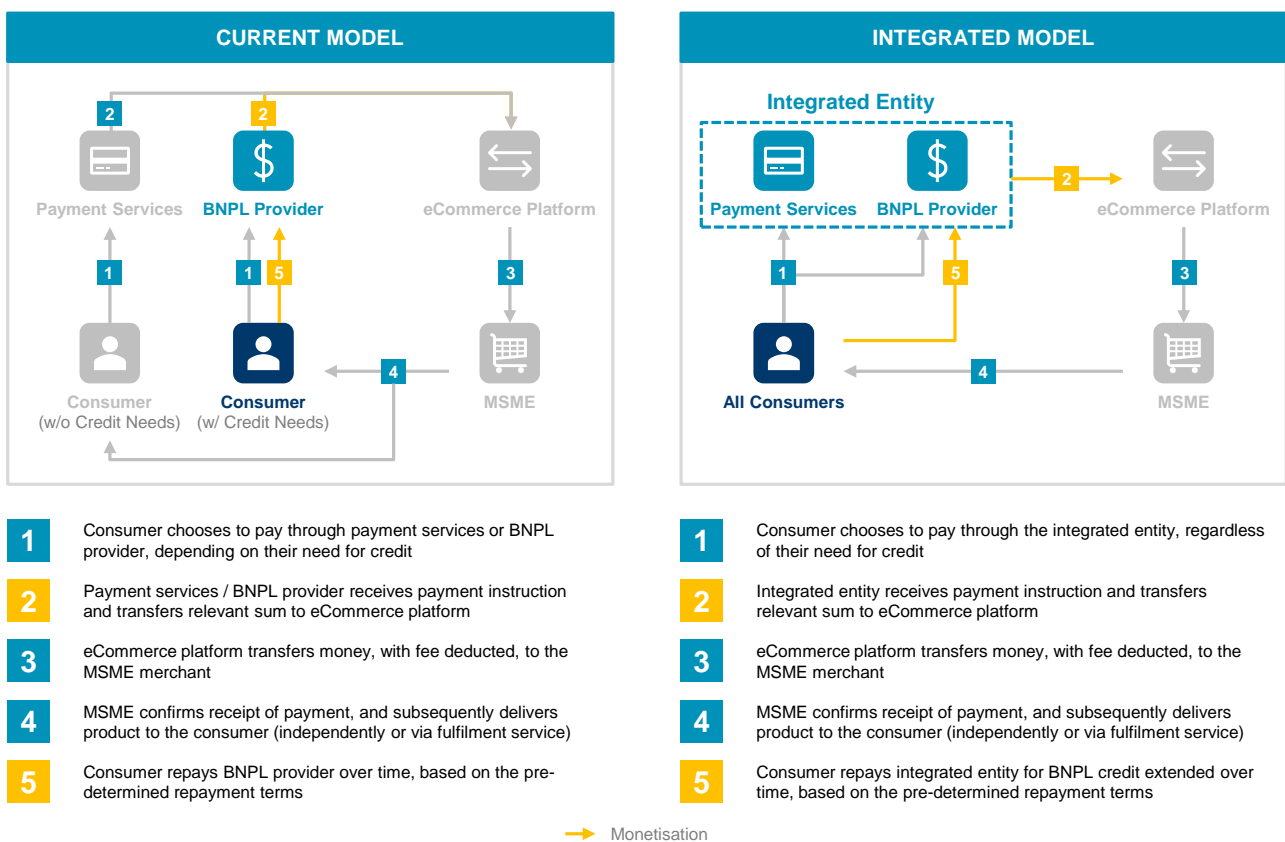
Depending on the scale of the eCommerce platform, fulfilment services may also be provided. Larger incumbents may look to offer an end-to-end fulfilment service, managing the logistics and delivery process for merchants, while smaller players may look to provide a matching service, with sellers organising product delivery (or pickup) independently.

Given BNPL's primary nature as a digital business, these players likely do not have the physical infrastructure in place to offer delivery / logistics services. As such, we see expansion into the fulfilment space as more of a second-phase, long-term strategic ambition.

2.2 PAYMENT SERVICES

At the time of purchase, consumers can choose from various payment options, including debit / credit cards, payment services (e.g. digital wallets), and BNPL. BNPL essentially has to compete against other options – some of which also provide access to credit – to further acquire market share. Integration with different payment services enables BNPL companies to be part of the – or remove – substitutes, driving consumer flow (see Figure 33).

FIGURE 33: PAYMENTS SERVICES INTEGRATION



Source: Quinlan & Associates analysis

With their existing operations, BNPL companies have already developed capabilities and implemented systems in the payment space, enabling rapid integration post acquisition. Compatible solutions also make the integration / migration of users easier.

By integrating BNPL with payments services, consumers can complete their purchases with multiple payment methods with the additional option to access credit. Moreover, the BNPL company can charge merchants both a transaction fee for handling the transaction and an MDR for any credit extended.

Indeed, the integration of payment services and BNPL has already been observed in the

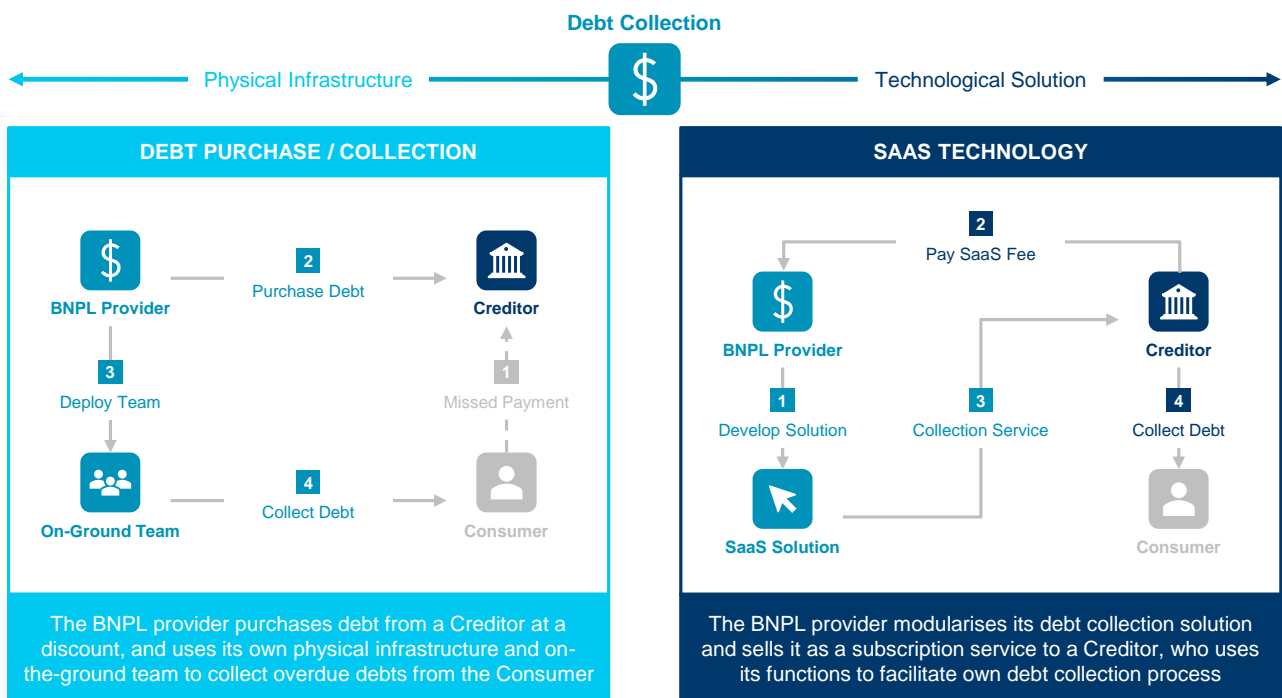
industry, with Square’s acquisition of Afterpay and PayPal’s purchase of Paidy in 2021. Such deals also point to the possibility of BNPL companies seeking potential buyers as a key strategic exit option.

2.3 CREDIT (& DEBT COLLECTION)

A key step within the value chain of any company operating in the credit space is debt collection.

Numerous BNPL players have invested heavily in debt collection, including physical infrastructure and / or technological solutions, both of which can be leveraged for stronger vertical integration (see Figure 34).

FIGURE 34: DEBT COLLECTION



Source: Quinlan & Associates analysis

Debt collection rates for BNPL providers with strong physical infrastructure and on-the-ground debt collection teams tend to be relatively higher than players without such capabilities. Given their existing setup, these BNPL firms, particularly those operating in developing Asian markets, can either purchase unpaid debts from creditors (e.g. banks, and consumer finance companies) or engage them as an outsourced debt collection agency, deploying their internal teams to recover outstanding payments. In this model, the BNPL provider diversifies into the debt collection / debt agency space, purchasing debt at significant discount and recovering payment as a revenue source.

Some BNPL providers focus on technological solutions in the credit space, such as repayment tracking / monitoring, automatic reminders, robot calls / predictive dialling, and collection prioritisation. BNPL players developed these functions to streamline their own debt collection process in a more consumer-friendly manner. With a proven track record, these could be sold to credit institutions as SaaS solutions. In this case, the BNPL provider enters the B2B technology space, supporting other credit players in enhancing their debt collection process in exchange for a SaaS fee.

LIMITATIONS / CONSIDERATIONS

While vertical integration provides significant potential for BNPL companies looking to expand and enhance their value propositions, there may be external constraints, especially from regulators, which may limit the ultimate success of such a strategy.

For example, in September 2021, Alipay was instructed to separate its loan services from its payment app, with Chinese regulators citing concerns over Alipay's potential monopoly power with respect to the use of consumer data.¹⁵

Nonetheless, regulators and anti-trust laws place a much stronger emphasis on closer oversight of more established BNPL players. As such, we believe earlier-stage BNPL firms should seize the opportunity to establish a well-integrated, sustainable ecosystem and business model before suffering from heightened regulatory scrutiny.

¹⁵ Financial Times, 'Beijing to break up Ant's Alipay and force creation of separate loans app', 14 September 2021, available at: <https://www.ft.com/content/01b7c7ca-71ad-4baa-bddf-a4d5e65c5d79>

3. EXPANSION

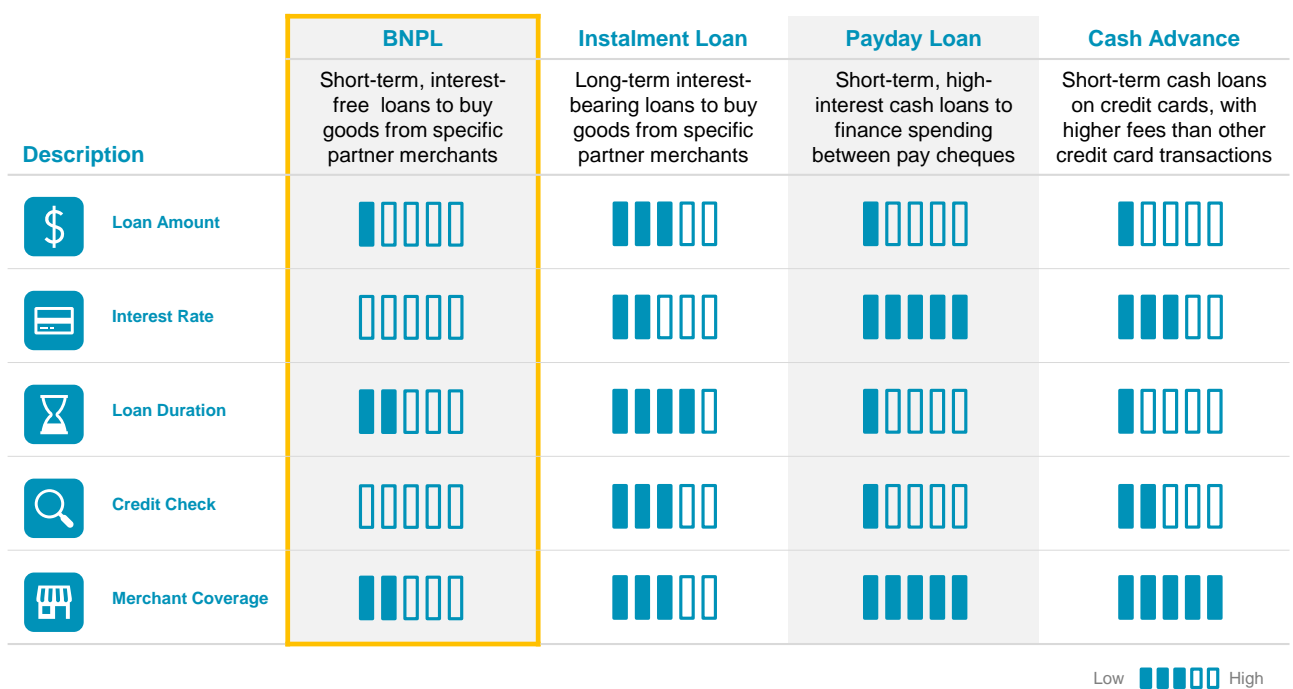
We see considerable potential for BNPL companies to leverage their existing credit capabilities to tap into additional revenue streams in the credit space. This can be executed based on both products and services, enabling BNPL players to diversify their revenues while focusing on their core BNPL DNA.

3.1 PRODUCT EXTENSION

While BNPL players operate in the credit space, they focus on a niche: short-term consumer financing needs. With the expertise and experience gained in this space, we see scope for BNPL providers to venture into other credit products, based on the needs of their users.

Among the additional credit products that can be considered are instalment loans, payday loans, and cash advances, each with different terms across interest rates and duration (see Figure 35).

FIGURE 35: PRODUCT EXTENSION



Source: Quinlan & Associates analysis

We believe many BNPL companies can focus initially on the unsecured lending space, given its alignment with their existing offering. Nonetheless, additional licences may be required to extend these credit offerings, especially since the key revenue opportunity

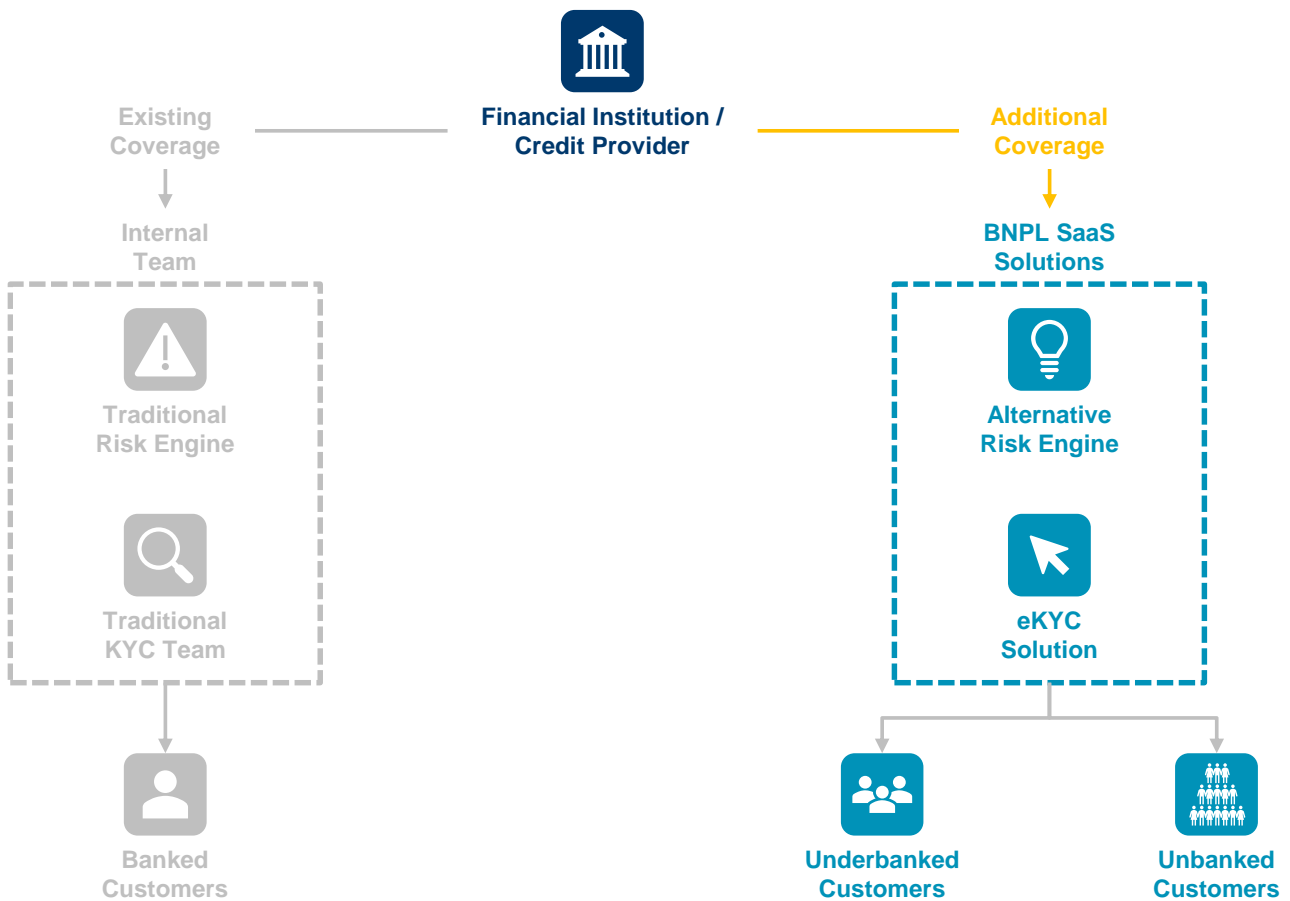
lies in interest income (as opposed to an MDR). Licensing costs and operational / compliance requirements need to be evaluated against revenue opportunities in order for BNPL players to prioritise their product extension efforts.

3.2 BUSINESS MODEL TRANSFORMATION

Instead of diversifying their product offering, BNPL companies can consider expanding into the service space. A transition from a B2C to a

B2B model can be achieved by modularising proprietary technologies and offering them as a SaaS solution to other financial institutions (see Figure 36).

FIGURE 36: BUSINESS MODEL TRANSFORMATION



Source: Quinlan & Associates analysis

3.2.1 eKYC

As BNPL is primarily an app-based, digital solution, many players have developed eKYC solutions to comply with customer onboarding regulations in a streamlined manner. These digital onboarding capabilities may be extremely attractive for incumbent financial institutions, especially in developing Asia, many of whom still rely heavily on manual processes for KYC, resulting in long delays and the potential for errors. The cumbersome onboarding process also limits the ability for these institutions to cover long tail customers, given the marginal revenue upside does not justify the marginal KYC / compliance costs for such customers.

BNPL companies can offer their proprietary eKYC solutions as a service to these financial institutions, supporting them in processing onboarding applications and transaction instructions to cover higher risk customer segments. In fact, ASEAN banks are already partnering with FinTech firms to implement eKYC solutions, with notable examples including partnerships between Bank BRI and Everest in Indonesia, and CIMB Bank Philippines and Jumio.

eKYC solutions can help financial institutions reduce cost by streamlining the onboarding process, while enhancing revenue potential by enabling them to service more clients. BNPL companies receive a monthly subscription fee – which may be tiered based on processing volume – in exchange for the service provided.

3.2.2 CREDIT SCORING ENGINE

Emerging market specialists primarily focus on servicing the unbanked / underbanked population and have, to-date, amassed a considerable trove of data on their spending habits and repayment patterns. More advanced players have also developed alternative credit scoring engines / algorithms, refining them over time based on user behaviour. For BNPL companies with a robust track record, we see an opportunity to sell these alternative credit scoring engines as a subscription-based service.

This transition is particularly relevant for ASEAN markets, in which the unbanked / underbanked population presents a vast market opportunity for consumer finance companies. However, immature credit scoring systems / infrastructure in these markets only cover banked customers. The low creditworthiness of the target user base of these consumer finance companies results in sizeable volumes of bad debt, translating to demand for more sophisticated credit scoring engines.

Recognising the potential for FinTech-driven enhancements, financial institutions in the region have increasingly sought help from credit scoring specialists. For example, Vietnam's PVcomBank is working with Trusting Social, while CIMB Bank Philippines has partnered with CredoLab, leveraging advanced scoring engines to enhance customer credit profiling.

We see example opportunity for BNPL companies to partner with banks and consumer finance institutions with a strong cash balance / deposit base and the appetite to extend additional credit. Through enabling the distribution of credit products, BNPL companies can charge a fixed subscription fee, or a proportional transaction fee, based on the volume of loan extended.

STRATEGY OPTIMISATION

Given heightened credit risks and funding costs resulting from the Covid-19 pandemic, it is imperative that BNPL firms consider all options available to them to carve out a path to profitability, especially as the investor community shies away from lending-led businesses. We believe this strategic repositioning exercise should not be limited to earlier stage BNPL players, but also the most established operators, given their continued inability to turn a profit.

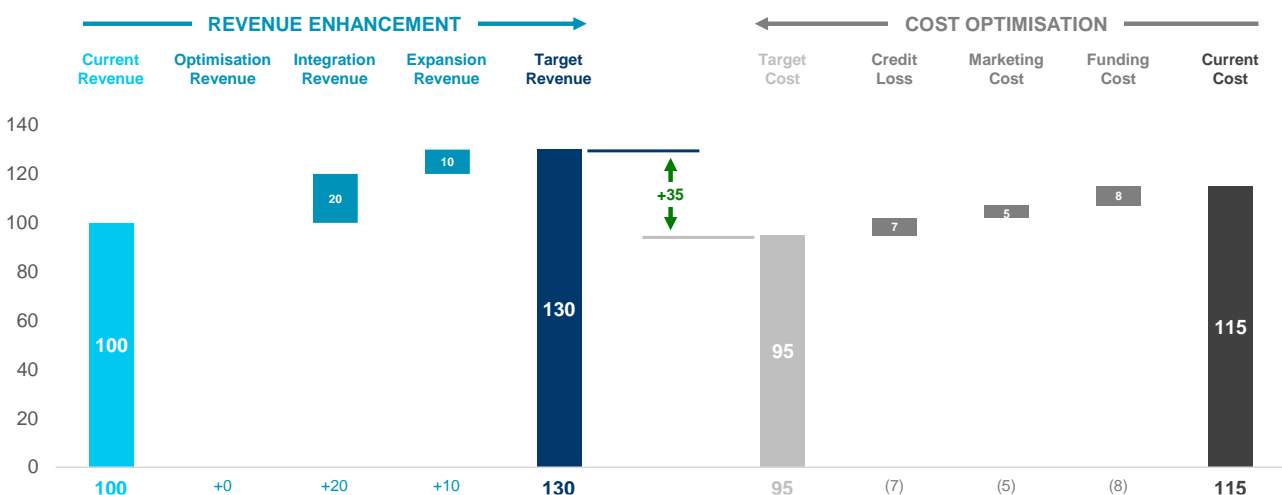
DEVELOPED MARKET PLAYERS

For developed market players, the strategic focus should be on vertical integration and service expansion. We see potential for a ~20% revenue uplift by capturing additional pockets of opportunity of vertical integration

along the consumption value chain. For instance, a developed market player may consider the integration with an eCommerce platform to capture additional revenue from platform handling fees. Another potential revenue source can be originated by the expansion of product lines. We expect developed market players to increase their revenue by ~10% through offering new product categories (e.g. loans) and exploring new business models (e.g. eKYC as a SaaS model).

In addition, we believe operational optimisation (such as more cost-effective marketing spend and more robust credit risk control) and financial enhancement (especially with regards to establishing funding partnerships to replace the current debt financing facilities, which may save funding costs by ~8%) can reduce annual operating costs by up to 20% in total (see Figure 37).

FIGURE 37: IMPLICATIONS – DEVELOPED MARKET PLAYERS (2020-25E)



Note: values are indexed to Current Revenue
Source: Quinlan & Associates estimates

With suitable strategic adjustments, along with operational refinement, we see the potential for BNPL companies in developed markets to turn

around their business, moving from an average operating loss of 15% at present to average profit margins of 27% within three years.

EMERGING MARKET SPECIALISTS

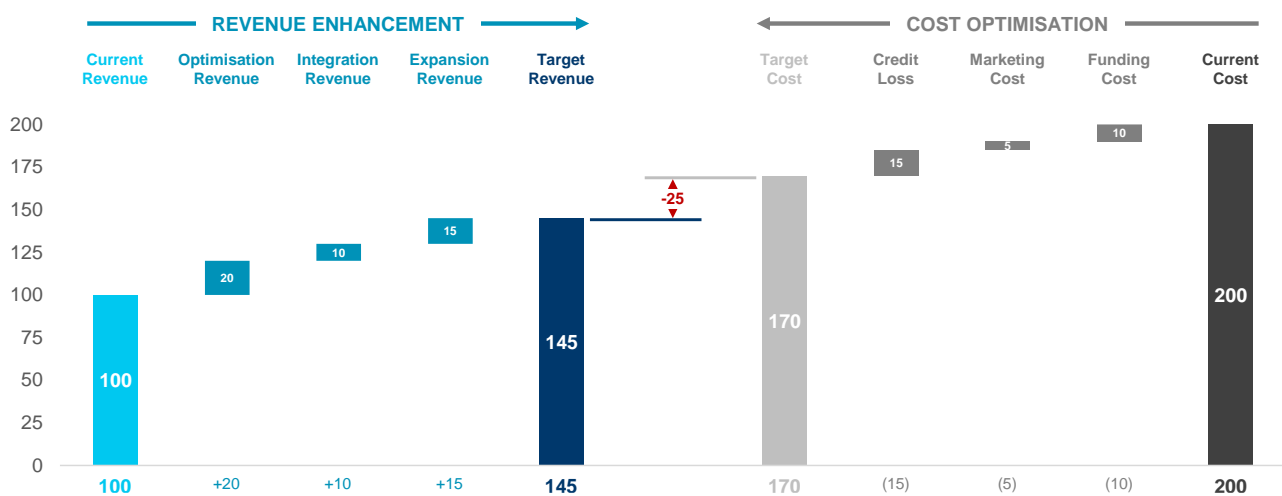
As emerging market specialists are at relatively nascent stages of their company lifecycles, all three directions – optimisation, integration, and expansion – should be considered.

Overall, we see the opportunity for BNPL providers in this space to increase their revenues by 45%. The initial additional revenue source is the optimisation of current operations across a number of areas (e.g. a more efficient marketing positioning strategy), which we estimate to bring ~20% more revenue based on

the current level. We also see potential in vertical integration and offering expansion, estimating revenue increases of 10% and 15% respectively.

Moreover, costs can be controlled through refining risk engines and data usage for credit evaluation, which should reduce NPLs by 15%, on account that credit loss is the lion's share of current costs. Similar to their developed markets counterparts, improving marketing campaigns and shifting to a partnership-based funding model can reduce operating costs by and additional 15% (see Figure 38).

FIGURE 38: IMPLICATIONS – EMERGING MARKET SPECIALISTS (2020-25E)



Note: values are indexed to Current Revenue
Source: Quinlan & Associates estimates

With significant improvements to the business model's strategy and operations, there is potential to reduce net loss margin from 100% (at present) to 17%. After establishing themselves as developed BNPL players, a second-phase business optimisation (similar to that of developed market players) can be

considered, to drive profitability and sustainability further. Nonetheless, we see this as a long process that many smaller BNPL firms may not be able to survive in light of a more muted fundraising environment, opening opportunities for acquisition by more established players in the market.

SECTION 5

THE OPPORTUNITY FOR INCUMBENTS

With BNPL offering an attractive alternative means to access credit, the industry is presenting itself as a strong competition to incumbent consumer finance companies (and even payments services firms). On the flipside, this development also brings an opportunity for incumbent institutions to enhance their value proposition and amass a younger consumer base.

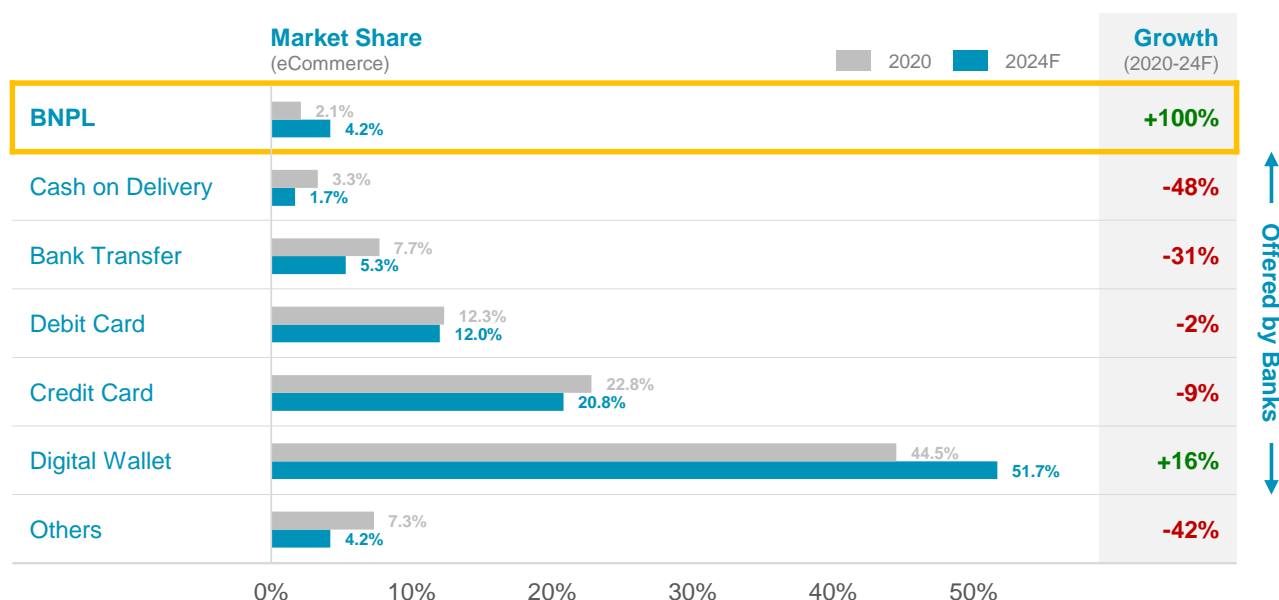
Given the relatively low barrier to entry and the ease of replicating the BNPL model, many new players have sprung up in recent years. Besides independent BNPL start-ups, banks with a solid customer base are itching to step into the industry, along with incumbent payment services providers.

1. BANKS

BNPL firms offers more friendly financing terms to consumers and act as strong substitutes for banks' traditional consumer finance products. Banks are also facing increased pressure from the growing spate of BNPL offerings in the offering, particularly as consumers continue shifting their preference towards digital offerings.

Looking specifically at the eCommerce space, all payment and credit distribution channels offered by banks are expected to experience a decline in market share / usage rate in coming years, which will be largely captured by digital wallets and BNPL offerings. In fact, BNPL is expected to experience a 100% growth in market share from 2020-24 (see Figure 39).

FIGURE 39: SHIFT IN PAYMENTS¹⁶ (eCommerce)



Source: World Pay, Statista, Quinlan & Associates analysis

¹⁶ Note that the data refers to the proportion of eCommerce transactions being paid for using the specified method / channel

However, we believe banks have the capabilities and expertise to turn this challenge into an opportunity, leveraging their vast base of captive customers, extensive merchant relationships (and their capabilities to acquire additional merchants), and low-cost funding from retail deposits. Moreover, with their existing credit expertise, banks already possess rich information on the creditworthiness of retail consumers, as well as robust risk engines.

By capturing suitable opportunities in the BNPL space, we believe banks can generate additional revenue by expanding their customer coverage without cannibalising on their currently profitable interest products (or bearing outsized credit risks).

Recognising this potential, we have seen a number of banks launching their own BNPL

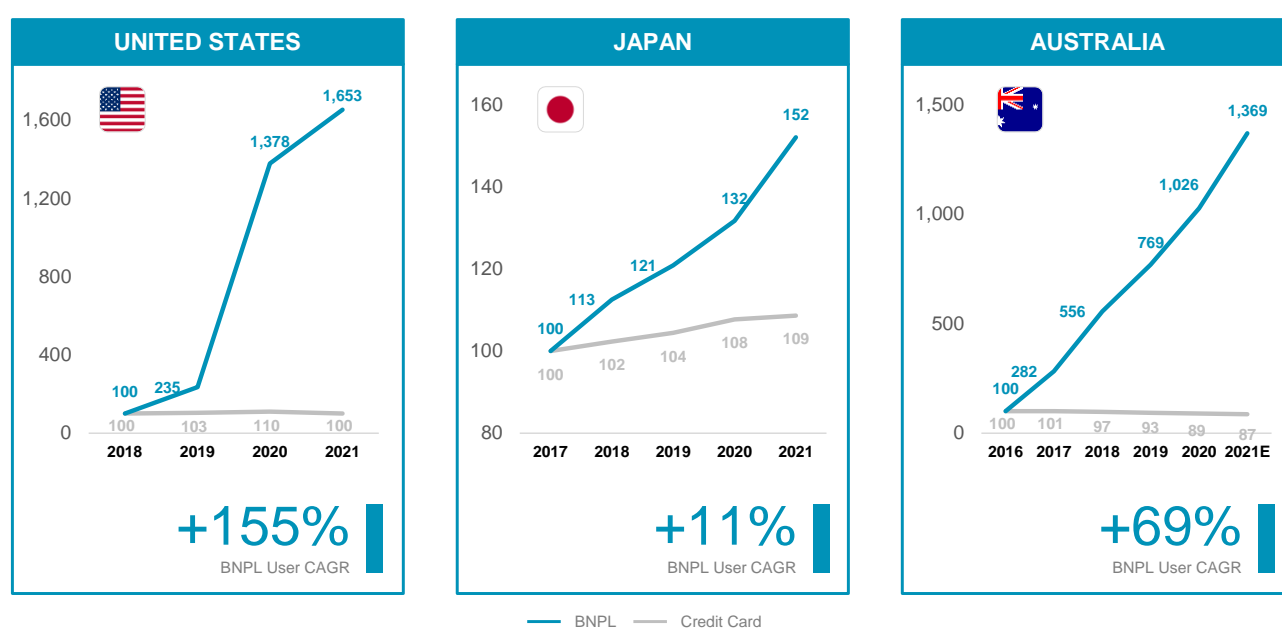
products. In Hong Kong, virtual banks were the first to make a move. Livi Bank, backed by Bank of China, launched the Livi PayLater service, a hybrid model of instalment loans and the BNPL product. Consumers are offered an interest-free instalment plan through Livi PayLater whenever they make purchases at partner merchants, such as IKEA.

2. PAYMENT SERVICES COMPANIES

While BNPL is primarily a credit service, it also operates as an alternative payment method, competing against other payment services.

Indeed, BNPL has been experiencing rapid growth in recent years, taking market share and customers away from credit card companies in a number of markets (see Figure 40).

FIGURE 40: SHIFT IN CREDIT MARKETS



Source: CEIC, Forbes, annual reports, Quinlan & Associates analysis

For example, since BNPL services launched in Australia, the number of credit cards has dropped by 3% annually, while the number of BNPL users increased by 69% per year (from 2016-2021). These trends indicate that consumers have been turning away from traditional payment methods, in favour of BNPL.

To defend their market share, incumbent payment services companies have ventured aggressively into the BNPL space. In China, Alipay expanded its business by adding an interest-free option for its consumer finance product, Huabei, with users able to purchase goods via BNPL from Huabei partner merchants.¹⁷ In addition, Grab – the transport and food delivery giant in Singapore – has enriched its payment services by tapping Adyen to enable BNPL functions. These incumbents were able to enter the BNPL space rapidly, due to their wide existing merchant relationships, as well as their sizeable userbase from other offerings.

MasterCard launched an interest-free instalment programme (in the US, U.K., and Australia) in September 2021 to tap into the BNPL market. Apple and Goldman Sachs have also announced a collaboration to provide ApplePay users with BNPL services for both online and offline purchases.

American Express (“Amex”) has also ventured into the BNPL space, launching Plan It on 17 February 2022. Using the service, Amex cardholders can pay for flights with Delta Air Lines (of USD 100 or more) through BNPL.¹⁸

PayPal has also been very active in the space, introducing their own BNPL product – an interest-free instalment plan named “Pay in 4” – in the US in August 2020. In addition, PayPal entered the Asian market by acquiring Paidy, a leading Japanese BNPL with a userbase of 4 million customer and over 700,000 partner merchants.

Moreover, Square entered the BNPL space via a USD 29 billion acquisition of Afterpay, which had 16 million users (closed on 31 January 2022).¹⁹ This acquisition not only provides Square with multi-channel payment services integration, but also bolsters its business presence via access to Afterpay’s 85,000 partner merchants. Afterpay has already been integrated, with eCommerce sellers in US and Australia using Square Online being able to offer the BNPL function. Merchants saw positive impact immediately, experience an increased ticket size of up to 20%.²⁰

We see a clear opportunity for incumbent payment services providers to leverage their sizeable customer bases and existing payments infrastructure to tap further into the BNPL market.

¹⁷ While Ant has been ordered to split Huabei away from Alipay, this service expansion still showcases the potential for payments services company to enter the BNPL space

¹⁸ CNBC, ‘American Express and Delta Air Lines introduce Buy now, Pay later option for flight fares’, 17 February 2022, available at: <https://www.cnbc.com/select/american-express-delta-air-lines-buy-now-pay-later/>

¹⁹ Square, ‘Square Sellers Can Now Offer Buy Now, Pay Later Through Afterpay’, 31 January 2022, available at: <https://squareup.com/us/en/press/square-sellers-can-now-offer-afterpay>

²⁰ Square, ‘Square Sellers Can Now Offer Buy Now, Pay Later Through Afterpay’, 31 January 2022, available at: <https://squareup.com/us/en/press/square-sellers-can-now-offer-afterpay>

SECTION 6 CONCLUSION

INDUSTRY OPPORTUNITY

REVENUE POTENTIAL

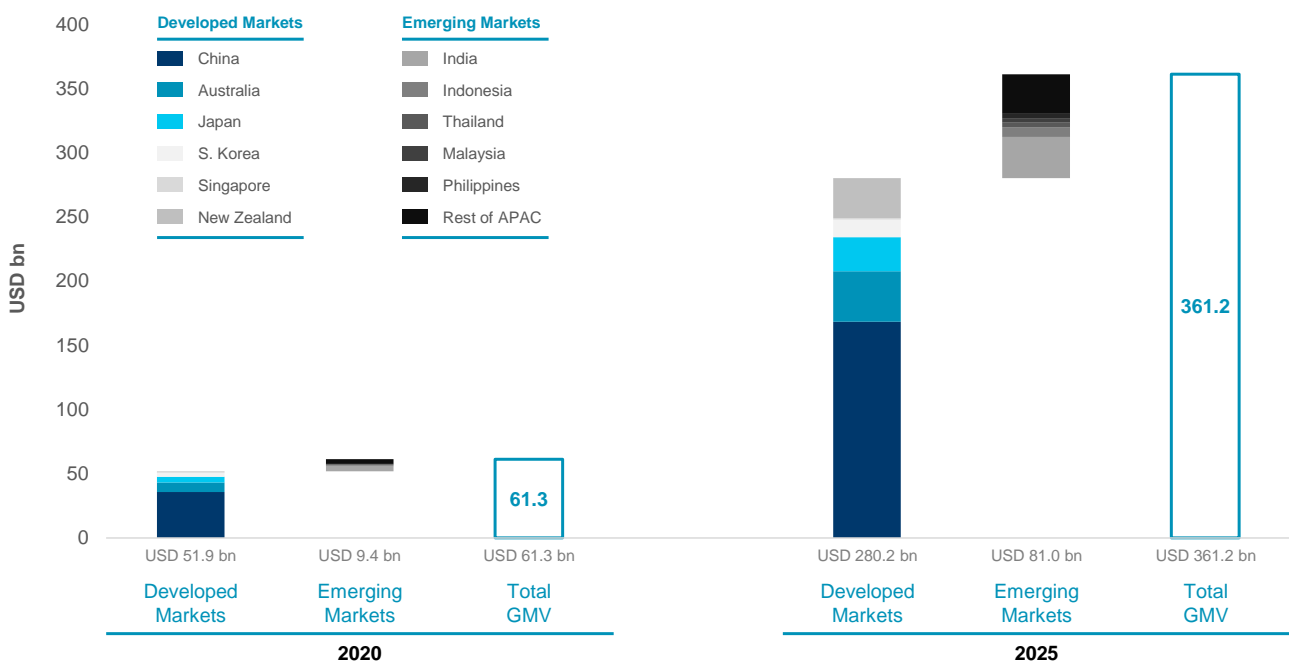
As previously discussed, the GMV processed by APAC BNPL players is estimated to grow from USD 61.3 billion in 2020 to USD 316.2 billion in 2025 (see Figure 7).

BNPL players in developed markets – including Australia, China, Japan, New Zealand, Singapore, and South Korea – are relatively mature, with a large user base, wide merchant partnerships, and are well integrated with

various payment channels. We estimate these firms processed 85% of APAC BNPL GMV in 2020 (USD 52 billion) and will process 78% by 2025 (USD 280 billion) (see Figure 41).

For emerging Asian markets, including India, Indonesia, Malaysia, Philippines, and Thailand, the industry is still relatively nascent. BNPL players are still acquiring users and establishing merchant partnerships. However, growth rates remain high, and we estimate they will process USD 81 billion (i.e. 22%) of BNPL GMV via 2025, a 9x increase from the USD 9 billion they processed in 2020 (see Figure 41).

FIGURE 41: APAC BNPL GMV



Source: Research and Markets, Quinlan & Associates analysis

With a weighted-average MDR of 3.7%, we estimate transaction revenues for BNPL firms in developed APAC markets to reach USD 10.2 billion by 2025. Adding in other fees (e.g. late fees), we estimate the total revenue pool for these firms to be USD 12.8 billion in 2025.

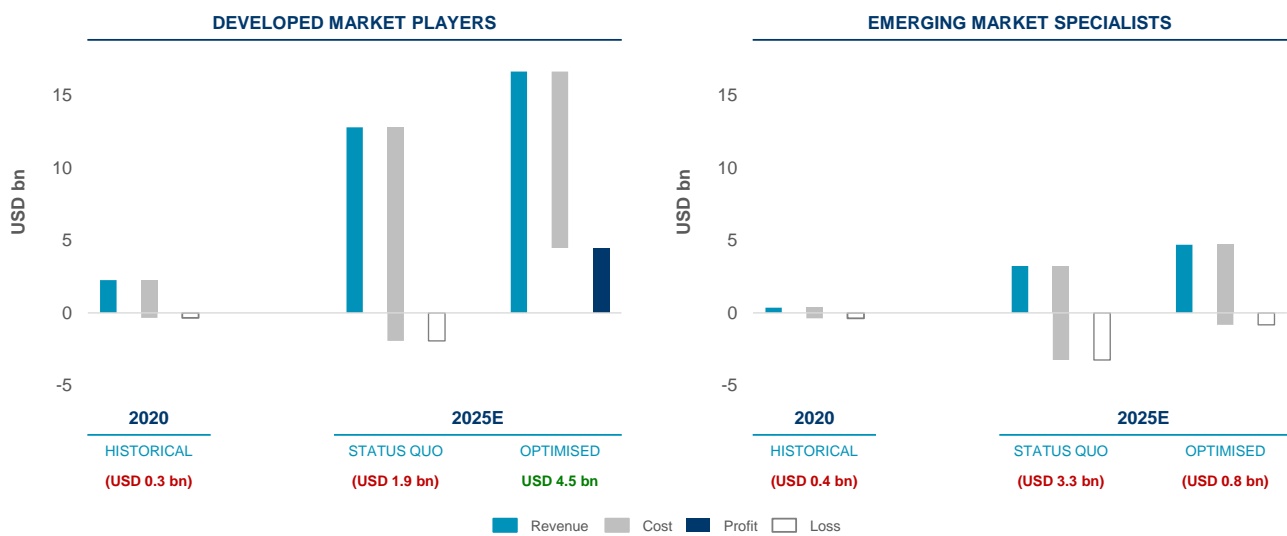
For emerging market players, a weighted-average MDR of 2.0% translates to estimated transaction revenues of USD 1.6 billion by 2025, and total revenues of USD 3.2 billion (taking into account the higher proportion of additional fees they charge).

PROFIT OPPORTUNITY

We anticipate BNPL providers in APAC to continue wearing losses indefinitely if no fundamental adaptations are made to their current business models. For developed market

players, we expect a combined market loss of USD 1.9 billion by 2025, forecasting emerging market specialists to lose a combined USD 3.3 billion by the same period. This represents a total BNPL industry loss of USD 5.2 billion by 2025 (see Figure 42).

FIGURE 42: APAC BNPL PROFIT OPPORTUNITY



Source: Quinlan & Associates analysis

However, if BNPL companies are able to make suitable adjustments to their core strategies – across optimisation, integration, and expansion – we see a much more positive outlook for the industry.

We believe developed market players, in particular, stand to benefit from as much as USD 4.5 billion in profit upside by 2025, translating to a profit margin of 27%, with emerging market specialists having the potential to cut their current losses by over 70% relative to their current P&L trajectories.

In aggregate, the APAC BNPL market could represent a USD 3.7 billion profit opportunity by 2025 for existing incumbents and new challengers alike, though major changes are needed to turn such ambitions into a reality.

SECTION 7

HOW CAN WE HELP?

Our consultants have extensive experience in the BNPL space, from strategy development to operational optimisation to new market entry. Our project work involves supporting our clients across the entire BNPL strategy spectrum:

1. OPTIMISATION

Review BNPL players' business and operations, to identify and address pain points / key capability gaps across its value chain:

- Establish a suitable industry positioning, based on local / regional consumer dynamics and competitive landscape
- Enhance processes across the user journey, across acquisition, evaluation, and retention, to drive service adoption and recurring usage
- Review existing funding and channels to minimise ongoing funding costs and/or explore alternative funding models to reduce / remove credit risk
- Examine potential for acquiring a virtual banking licence (or an existing bank) to streamline long term funding model and facilitate product expansion, along with licence application support

2. INTEGRATION & EXPANSION

Explore additional opportunities outside of the BNPL space, leveraging current consumer finance / credit expertise:

- Evaluate service integration across the retail value chain, including opportunities to expand into adjacent sectors / industries
- Identify new credit product offerings based on consumer appetite, operational viability, and regulatory requirements
- Transform from a B2C credit company to a B2B technology service provider, moving from a risk-based to a SaaS-based model
- Explore inorganic growth opportunities, identifying relevant industry entry options and/or potential M&A targets / acquirers

3. MARKET ENTRY

Evaluate the opportunity to enter new markets, for both existing BNPL firms seeking to expand internationally and non-BNPL players looking to enter the space:

- Review consumer dynamics and competitive landscape (both consumer credit and BNPL industries) to determine potential wallet opportunity
- Benchmark local BNPL competitors' capabilities and service offering, to identify industry best practices and key success drivers
- Establish go-to-market strategy and operating model
- Recommend optimal market entry / growth strategy, along with guidance on initial launch campaigns, to drive customer and user acquisition

APPENDIX

BNPL CONSUMER SURVEY (HONG KONG)

OVERVIEW

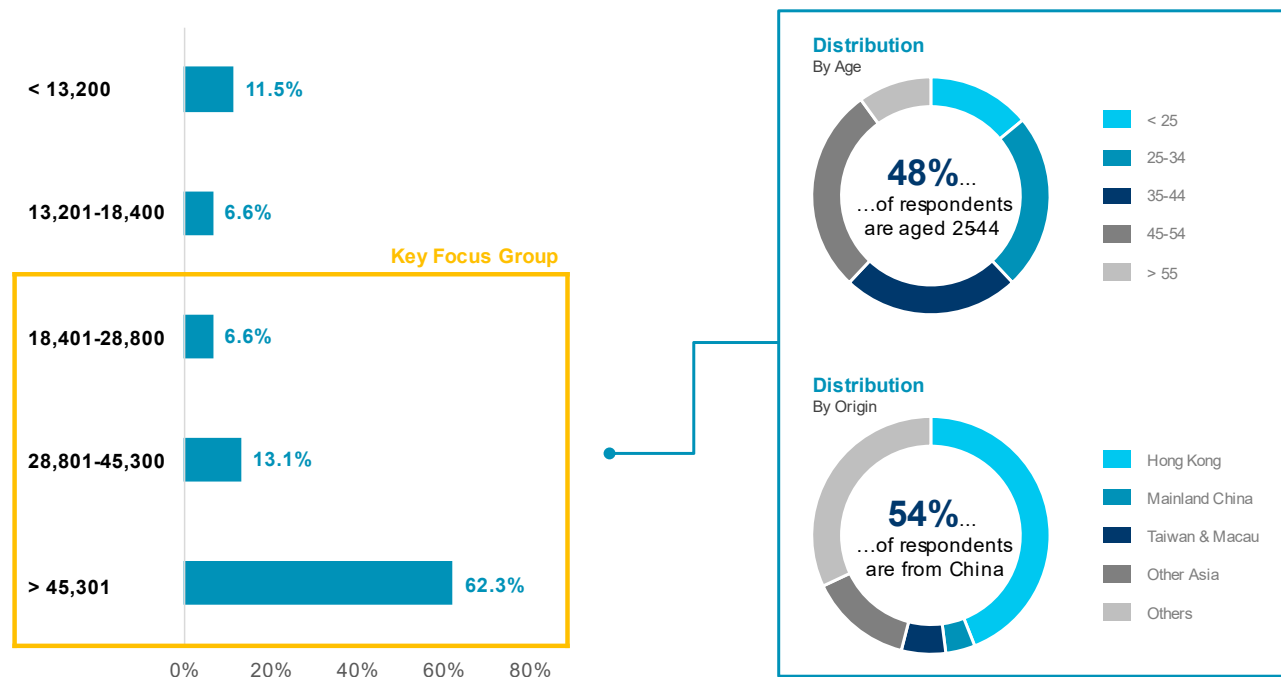
To better understand industry trends and user dynamics in the BNPL market, we conducted an online survey of local Hong Kong residents.

The BNPL industry is relatively new in Hong Kong, with only two pure play BNPL players in operation – namely, Atome and Hoolah. Two Hong Kong virtual banks, Livi and Mox, also launched traditional loan-BNPL hybrid offerings in 2021. Due to the nascent nature of the

industry in Hong Kong, the survey focused on industry awareness and the interest levels.

In total, we received 244 responses to our survey (see Figure 42). To better understand the potential for a high-end positioning for a BNPL service in Hong Kong, we focused on responses from the higher-income segments, with over 80% of survey respondents reporting a monthly income of over HKD 18,400 (median income), of which over three quarters have a monthly income of over 45,301 (90th percentile).

FIGURE 42: SURVEY RESPONDENTS (BY MONTHLY INCOME, HKD)



Source: survey responses, Quinlan & Associates analysis

From our key focus group, 48% of respondents were aged between 25-44, representing the key target customer segment for many BNPL companies in APAC, given their considerably appetite for consumer products and greater levels of digitally savviness.

As our online survey was conducted in English and the survey was distributed primarily through Quinlan & Associates' social media / email channels, respondents were more skewed towards expatriates and employees working in professional services (e.g. banking and finance, law, accounting, etc.).

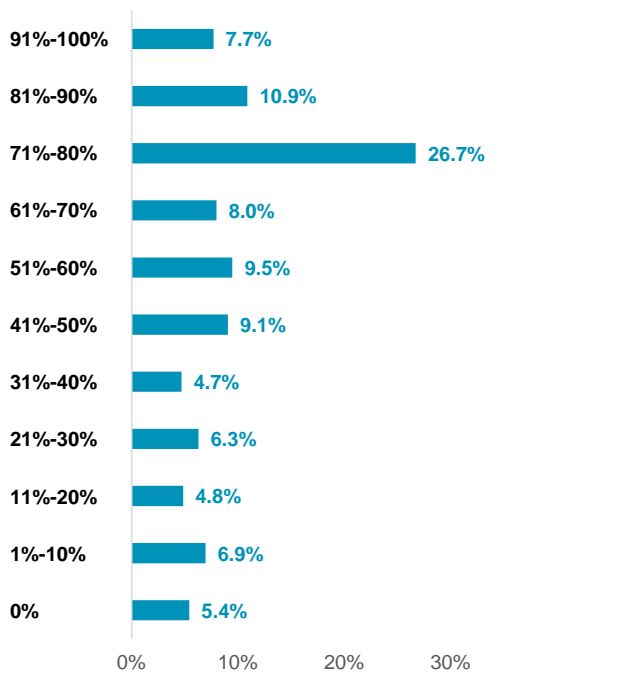
CURRENT CREDIT USAGE BEHAVIOUR

We asked respondents about their credit usage, including: (1) the proportion of retail purchases

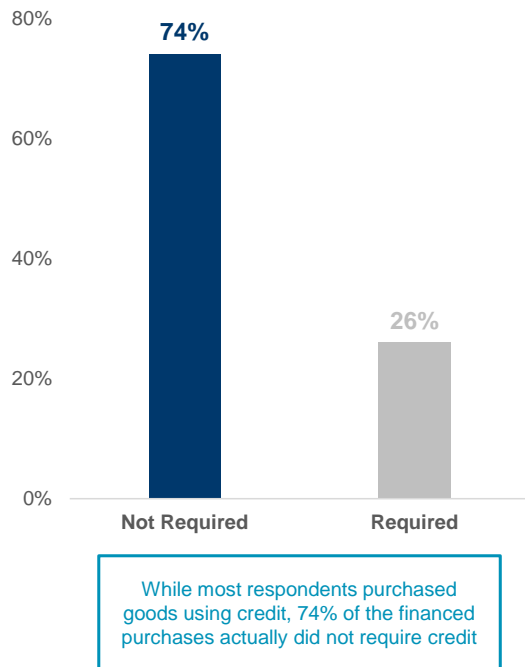
conducted in the past year using credit; and (2) whether financing was actually required for those purchases (see Figure 43).

FIGURE 43: CREDIT USAGE

Financed Purchase % of Total Retail Purchase



Credit Needs % of Respondents



Source: survey responses, Quinlan & Associates analysis

Over 90% of respondents reported using credit for some purchase in the past year, with 27% of respondents stating that 71-80% of transactions were financed. However, of those purchases, 74% did not require any credit.

While this may seem counter-intuitive at first glance, this is unsurprising in Hong Kong, with credit card penetration rates being one of the highest in the world, and payments through credit cards being seen as extremely convenient (and designed to collect “points”). As a result, many citizens use credit cards as a secondary, if not primary, method of payment.

As the core offering of BNPL is an alternate form of financing, which seems to be of low demand in the city, BNPL players operating in Hong Kong need to deliver a unique value proposition to end consumers.

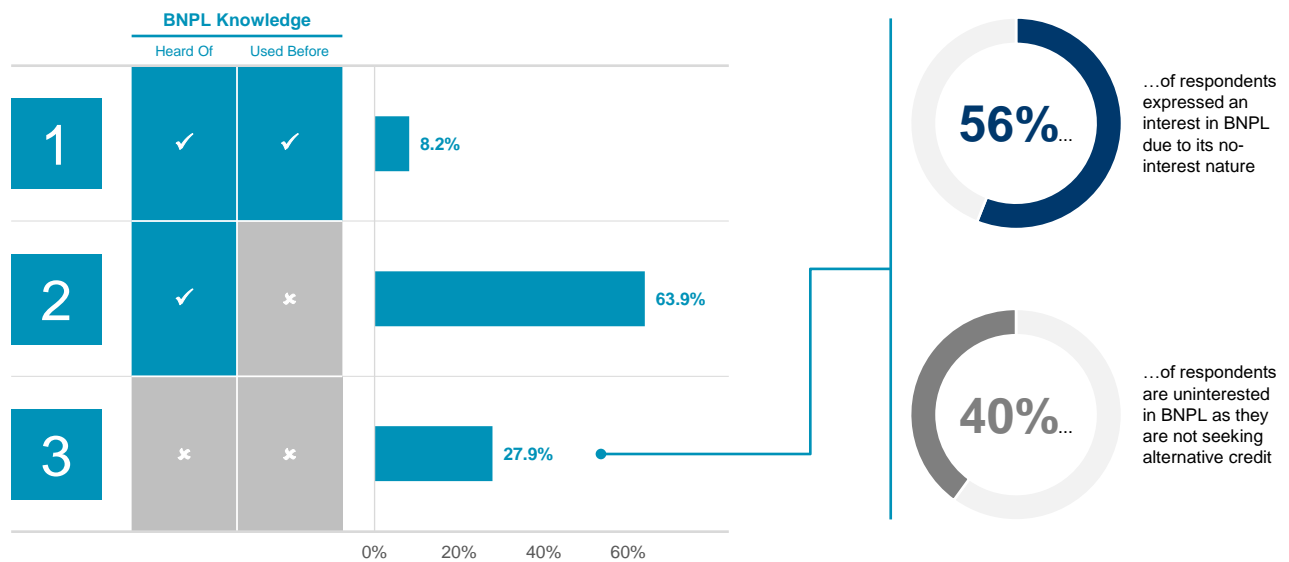
In short, BNPL services need to present themselves as an easier and more intuitive method of transacting (both online and offline) and offer significant rewards / discounts, in addition to being a credit channel, if they are to successfully compete against incumbents.

BNPL AWARENESS

We asked about the awareness of BNPL services in Hong Kong, including: (1) whether

respondents have heard of BNPL before; and (2) whether they have used BNPL before (see Figure 44).

FIGURE 44: BNPL ADOPTION



Source: survey responses, Quinlan & Associates analysis

Only 8% of our survey respondents said they had adopted BNPL, while over 60% of respondents know of – but have yet to use – BNPL. This seems to point to a conversion problem, where BNPL firms in Hong Kong have managed to raise awareness of their offering, but failed to acquire customers, hinting at potential need for stronger user acquisition campaigns.

Of those that have not heard of BNPL before, 56% indicated an interest to try out the service due to its no-interest nature. However, 40% remain uninterested in BNPL, as they do not need alternative forms of financing. This resonates with our view that BNPL firms need to present an enhanced value proposition, in addition to just being an alternative credit channel.

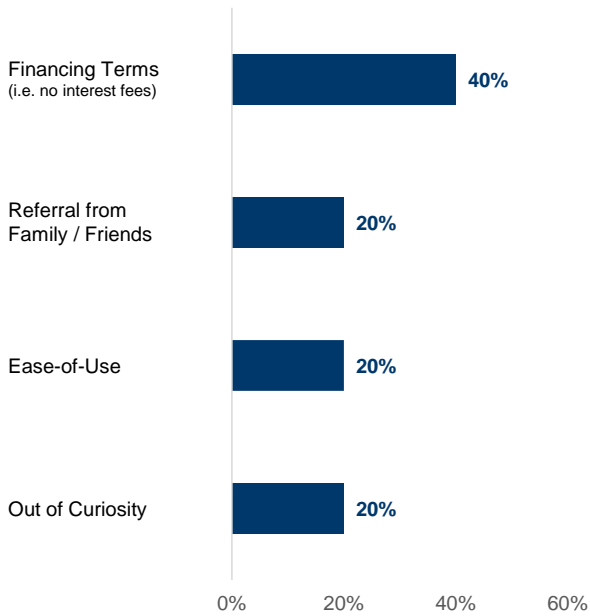
BNPL USAGE

We asked existing BNPL users: (1) why they adopted the BNPL service; and (2) how they

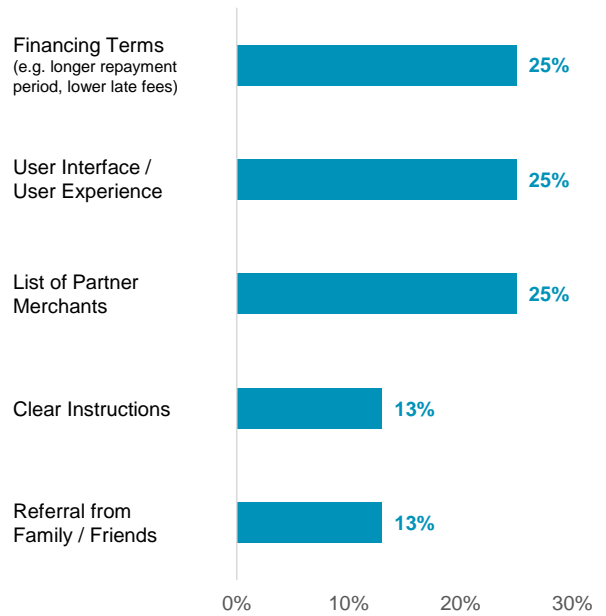
chose between different BNPL service providers (see Figure 45).

FIGURE 45: EXISTING BNPL USERS

ADOPTION DRIVER



VENDOR SELECTION



Source: survey responses, Quinlan & Associates analysis

Financing terms represent both the key adoption driver for BNPL and selection driver for different vendors. In addition, BNPL users look for a smooth and intuitive user interface /

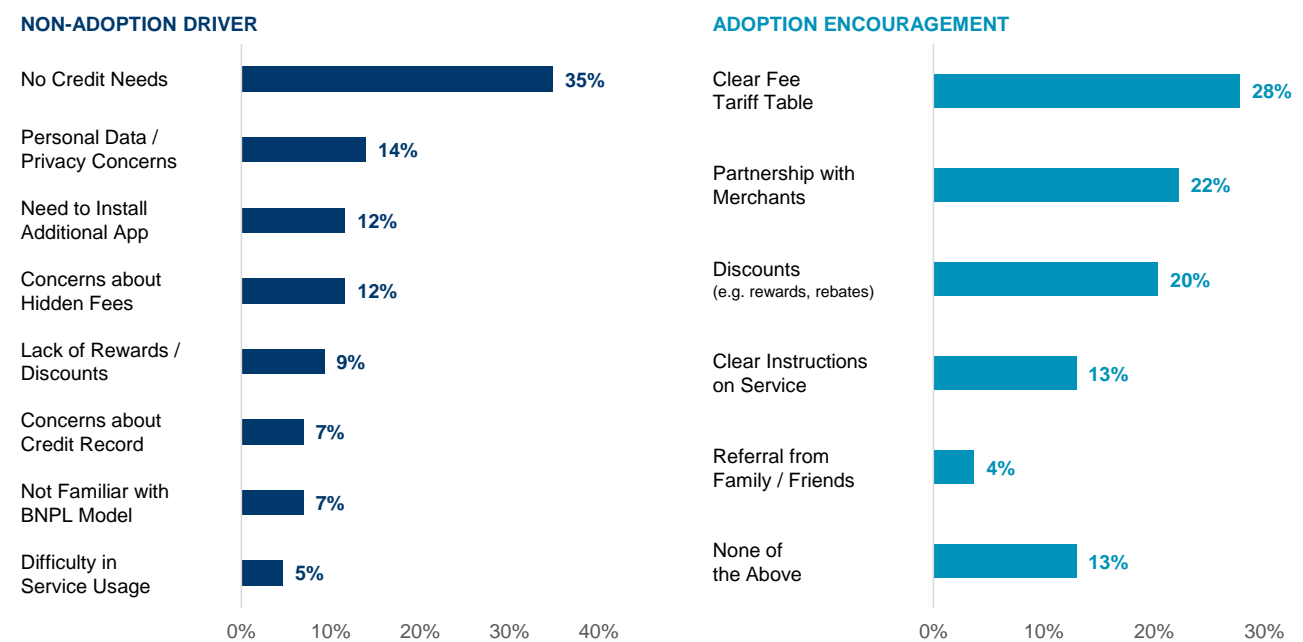
experience and list of relevant partner merchants when choosing between BNPL services.

BNPL ADOPTION CONSIDERATIONS

We also asked non-users of BNPL services a number of additional questions to understand:

(1) why they have yet to adopt the service; and
 (2) what would be needed to increase their interest in using BNPL (see Figure 46).

FIGURE 46: BNPL NON-USERS



Source: survey responses, Quinlan & Associates analysis

In addition to a lack of additional credit needs, many survey respondents are shying away from BNPL due to: (1) data privacy concerns; (2) concerns regarding hidden fees; and (3) a lack of clear benefits.

To address these concerns, BNPL companies need to establish (and promote) a clear fee tariff table and offer relevant discounts, at least at a level similar to what consumers are already receiving from credit card companies. If BNPL players can successfully implement these changes and partner with popular merchants, consumers are likely to exhibit a stronger level of interest for BNPL services in Hong Kong.

QUINLAN & ASSOCIATES

STRATEGY WITH A DIFFERENCE

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