‘Buy Now Pay Later’

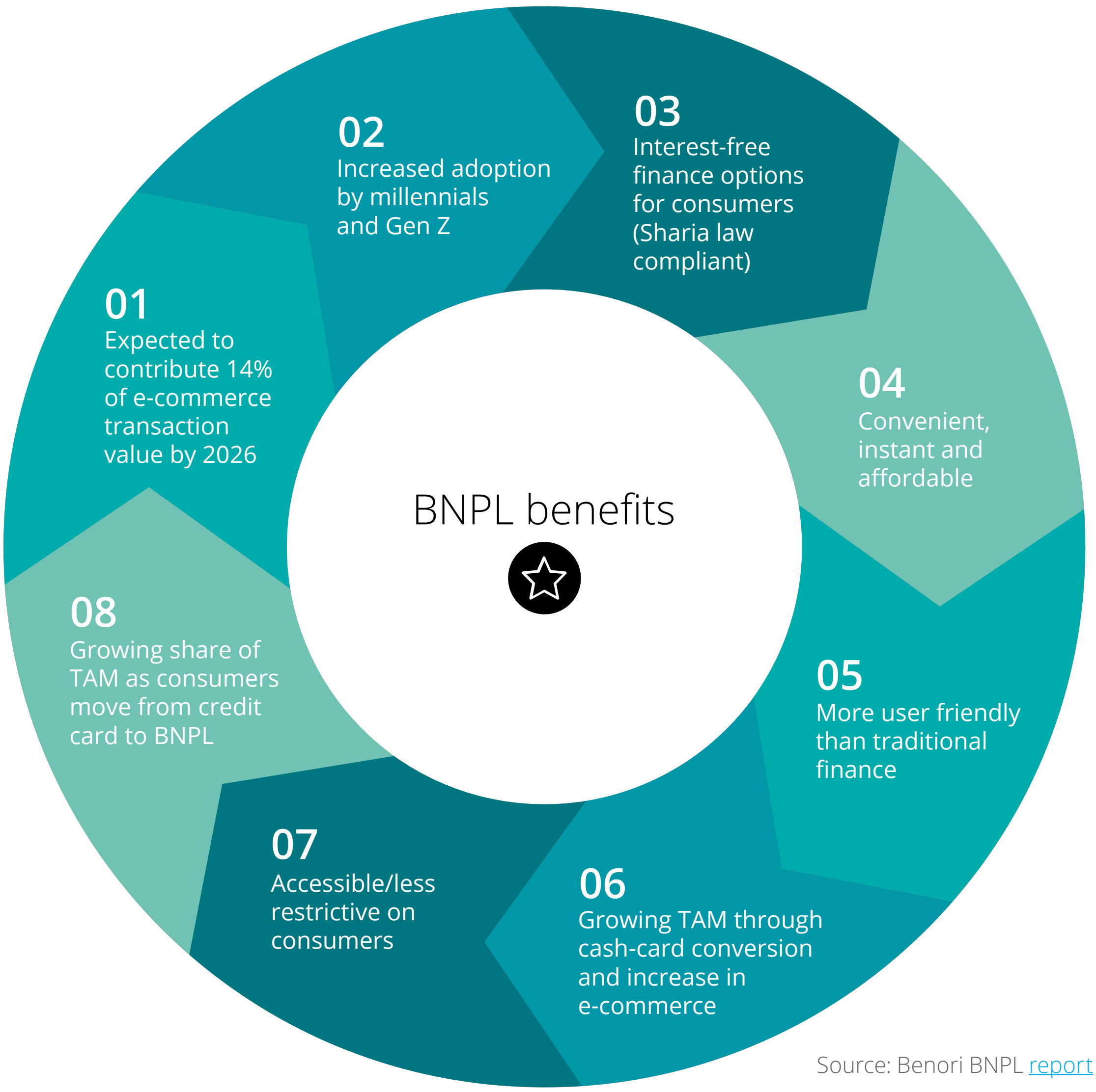
The future of BNPL in the Middle East

MAKING AN IMPACT THAT MATTERS since 1845

Contents

Overview - Benefits

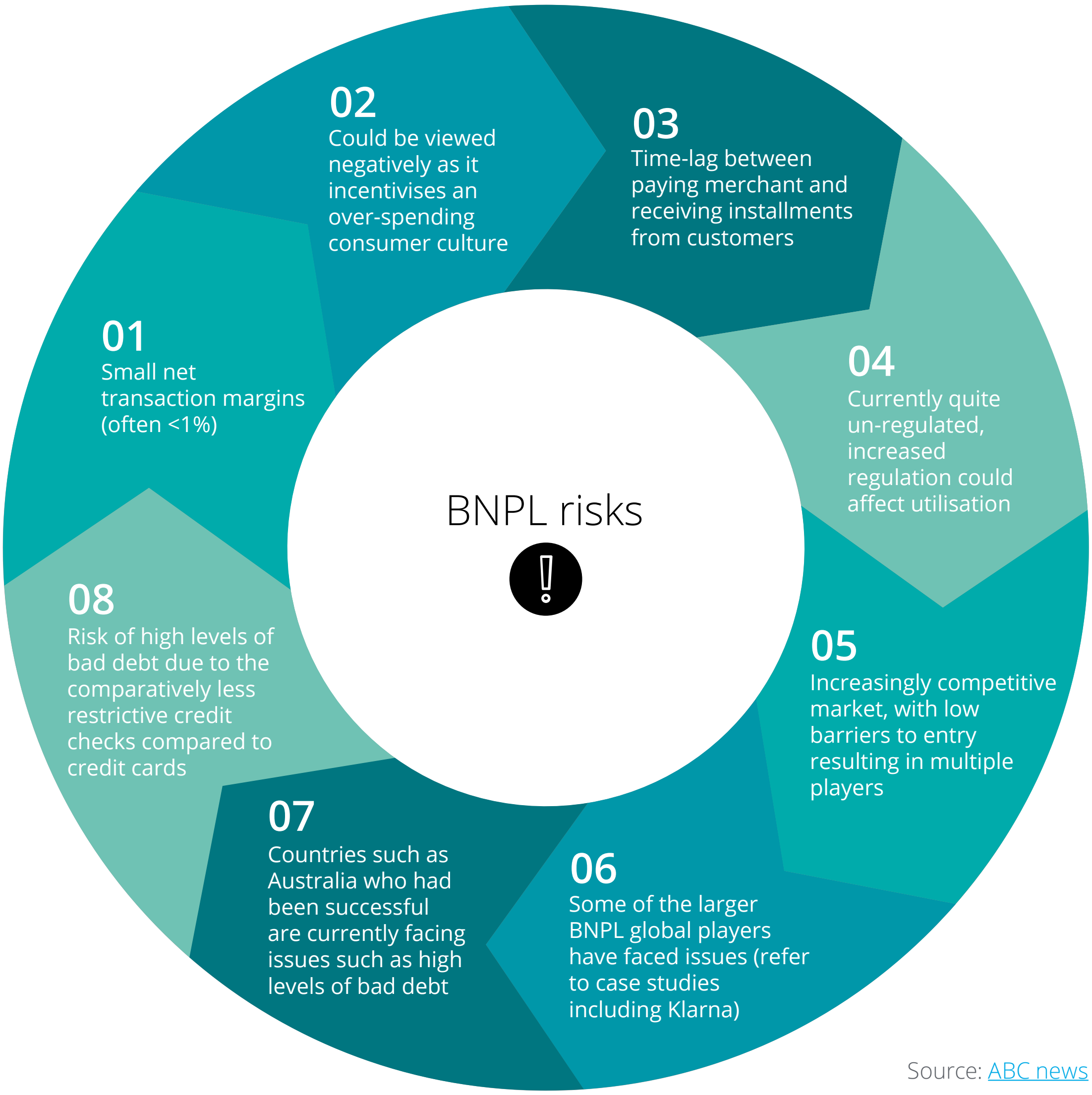
The global Buy Now Pay Later (BNPL) market has experienced rapid growth in recent years. This growth can be attributed to the rising demand for flexible payment options among consumers, and the continued increase in e-commerce which is expected to further expand the total addressable market (TAM).



Source: Benori BNPL report

Overview - Risks

While BNPL presents significant opportunities, particularly in the Middle East, many global companies have historically encountered substantial challenges that impact their profit margins and, ultimately, their valuation.



Source: [ABC news]

How it works

BNPL payment methods provide consumers with the option to divide purchases into installments, often with a 0% annual percentage rate (APR) and no hidden fees. The financing ranges from short-term pay in X options to longer-term financing for higher ticket items.

Purchasing → Financing option → Payment to merchant → Payment by consumers → Late payment fees

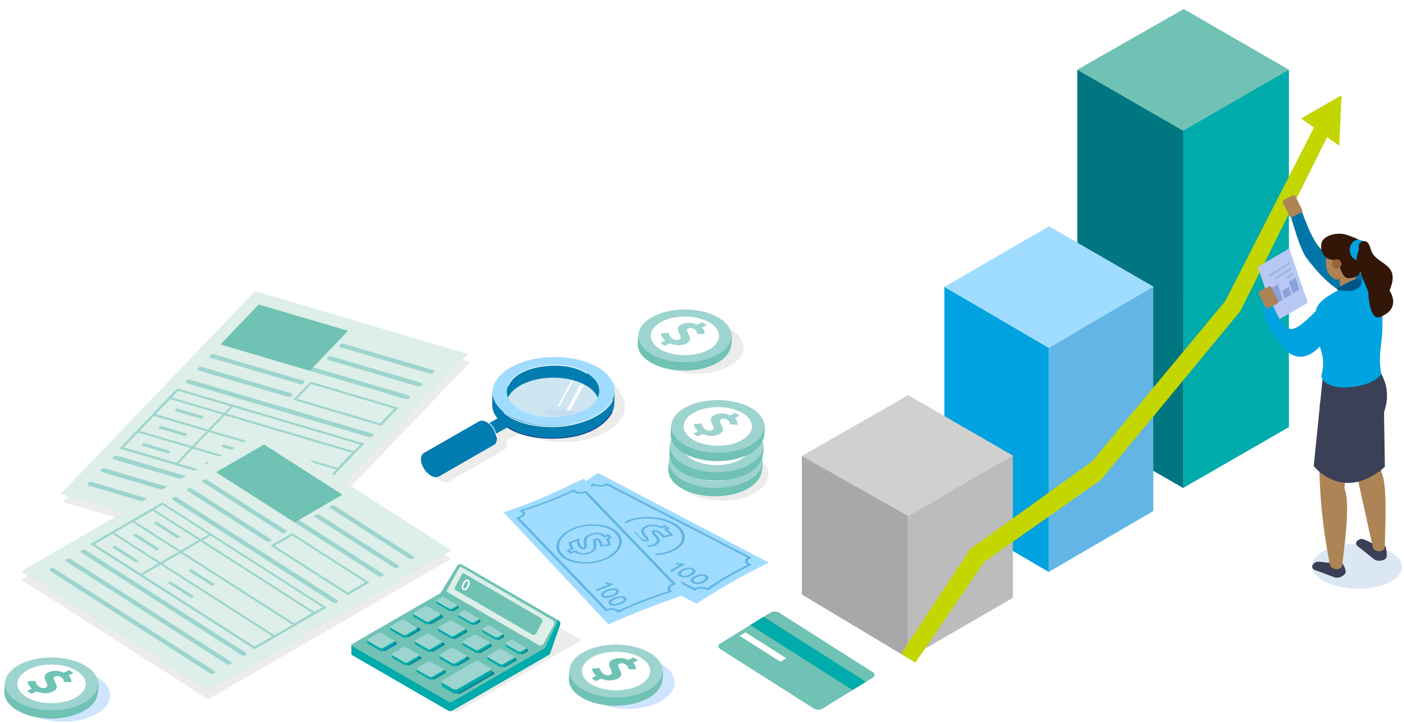
BNPL 1.0: "Pay in X solutions"

- Consumers shop online with the merchant on the BNPL provider app or in-store.
- The "Pay in X" option is presented at checkout, offering a range of one to six months for instalment payments. The consumer then logs in or registers an account and the BNPL provider conducts soft, real-time credit checks to assess the customer's eligibility.
- The BNPL provider pays the total purchase price upfront to the merchant deducting their fees, a few days after the transaction.
- Consumers will make monthly payments to the BNPL provider, paying a specified amount each month over the instalment period.
- If the consumer fails to pay instalments, they are subject to late fees and will be removed from the platform if they ultimately do not pay.

BNPL 2.0: Longer-term financing with interest

- Consumers shop online with the merchant on the BNPL provider app or in-store, typically with a higher order value.
- The BNPL provider pre-qualifies the consumer for a specific dollar amount. The consumer then selects a payment plan, which can range from six months to multiple years.
- The BNPL provider pays the total purchase price upfront to the merchant deducting their fees, a few days after the transaction.
- Consumers will make monthly payments to the BNPL provider, which includes a small interest component. The loan is either securitised or kept on the BNPL provider's balance sheet.
- If the consumer fails to pay instalments, they are subject to late fees and will be removed from the platform if they ultimately do not pay.

Source: FTI BNPL report



How it works

Different types of BNPL options

		Card-linked only			Hybrid		Off-card only		
		Consumer funded	Merchant/ Consumer funded	Merchant as lender	Consumer funded	Merchant/ Consumer funded	Consumer funded	Merchant/ Consumer funded	Merchant as lender
Own & Pay	Integrated E2E CX	Most issuers have existing offer portals and apps (e.g., Amex Offers) that could be extended to the pre-purchase journey (discovery and pre-instalment selection)	**Zilch, CareCredit, Apple** Apple card monthly instalments	**Argos** Argos Card Credit Plan1	NewDay offer loyalty programmes together with credit offering in their white-labelled solution	**Klarna, ZIP, Clearpay, Affirm, LAZYBUY**	Many historically off-card only providers (e.g., Klarna) have added card solutions to overcome limitation of requiring merchant partnership / checkout integration	**Openpay, Uplift, Payl8r**	**Verypay** Pay in 3 with Take 3 **Littlewoods** Buy Now, Pay Later
	One-off CX	Most are post-purchase, single instance engagement **Citi, Chase, Tymit, AMEX, Monzo**	Some narrowly targeted merchant partnerships in the market for at-purchase solutions (e.g., Amazon x Citi, Amazon x Chase, Delta x Amex)			Card-linked example NewDay x Amazon NewDay x ao Off-card example	Paypal has capabilities (app, web, extension) that could be extended to E2E instalment offers White-labelled solutions; typically, consumer relationships are predominantly owned / hosted on merchant sites	**PayPal Barclays x Amazon** **Novuna x Pedalon** **Creation x John Lewis**	PayPal is a provider-branded solution while Barclays offers both provider-branded and white-label solutions
Lease-to-own	Lease to own	Lease-to-own models often come with significantly high implied APRs, and merchants may even receive incentives and rebates, including exclusive partnerships as LTO providers			**Acima**	To complete its off-card only model, Acima launched a LTO card (same mechanism as virtual prepaid card)	**Progressive Leasing, Katapult**		

Global growth opportunities

The forecast for global BNPL Gross Merchandise Value (GMV) predicts an increase from US$ 433 billion in 2022 to US$ 960 billion by 2028.

2022 Global GMV

On-going e-commerce volumes increasing (especially during COVID-19)

Increased cash-card conversion ratios have globally increased TAM

2023 Global GMV

Increase in major retailers such as Walmart offering their own BNPL solutions

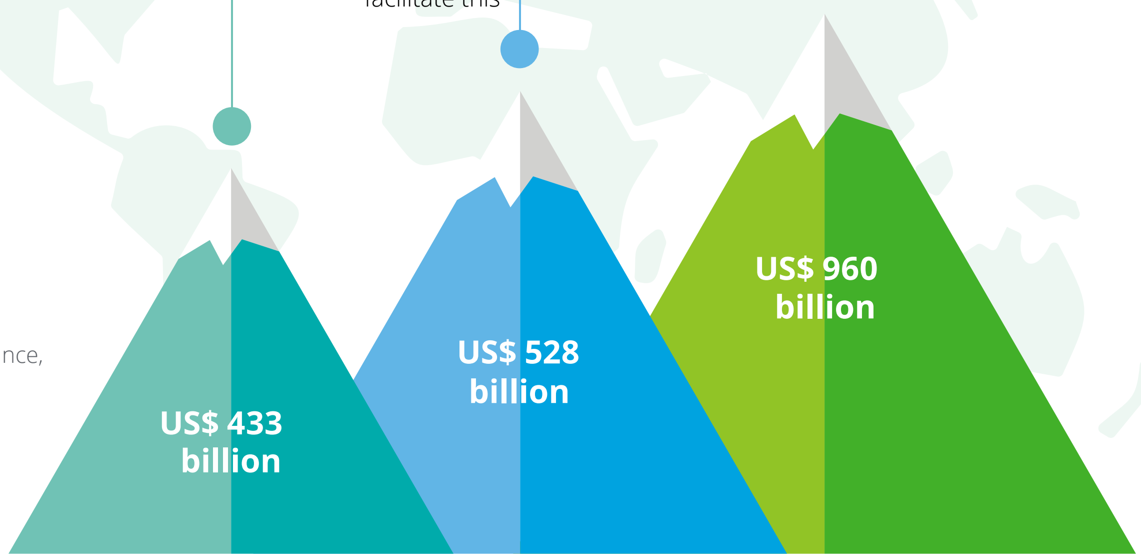
Increase in Business to Business (B2B) BNPL offerings

Increase in 'pent-up' travel demand and BNPL offerings to facilitate this

2028 Global GMV

Growing TAM as e-commerce volumes increase and card payments increase

Growing share by BNPL sector of TAM (3% in 2021 to 5% in 2025) due to in-store BNPL through Point of Sale (POS) options

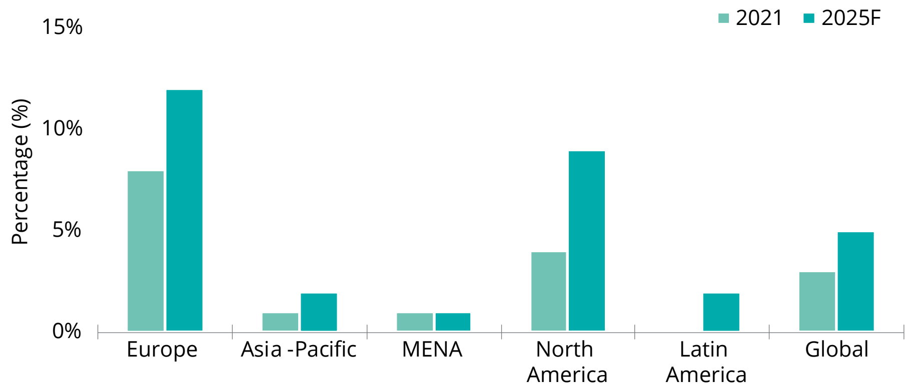


Sources: Yahoo Finance, Benori BNPL report

Global BNPL share

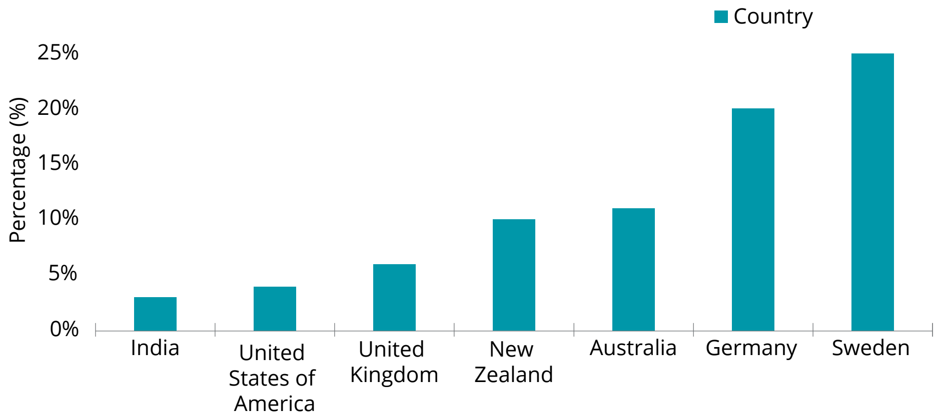
BNPL payment methods provide consumers with the option to divide purchases into instalments, often with a 0% APR and no hidden fees. The financing ranges from short-term pay in X options to longer-term financing for higher ticket items.

BNPL share amongst e-commerce payment methods by region



Source: GPR 2022

BNPL share amongst e-commerce payment methods by country (2021)



Source: GPR 2022

Why is MENA's share less than the rest of the world?

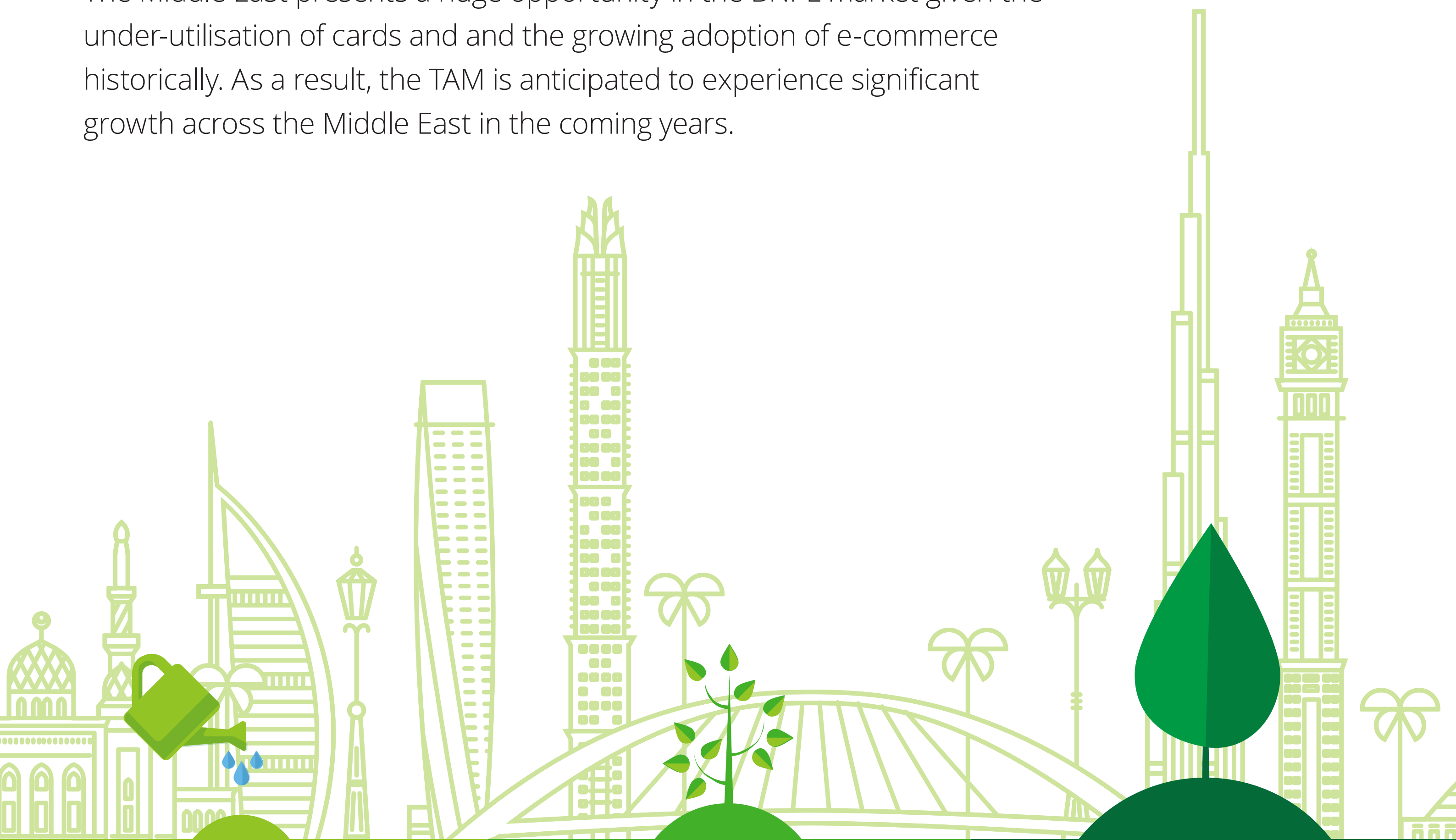
The current share of BNPL as a payment option in MENA's e-commerce spend is approximately 1%, and it is not expected to surpass that even by 2025. This figure is considerably lower compared to other regions such as Europe, North America and Australia.

The lower share across MENA could be due to BNPL being relatively new in the region, as its currently in the early stages of adoption. Established BNPL players such as Klarna (Europe), Affirm (North America) and Afterpay (Australia) were founded much earlier, whereas major players in the Middle East, such as Tabby (founded in 2019), Cashew (founded in 2020), and Saudi Arabia's leading BNPL provider Tamara (founded in 2020), entered the market relatively recently. MENA is a few years behind other regions, not because of lack of interest, but BNPL is more mature and understood in other places.

Source: Benori BNPL report

Middle East growth opportunities

The Middle East presents a huge opportunity in the BNPL market given the under-utilisation of cards and and the growing adoption of e-commerce historically. As a result, the TAM is anticipated to experience significant growth across the Middle East in the coming years.



- The increased adoption of e-commerce, along with the increased use of mobile banking and payments, has resulted in significant investments into BNPL firms in the Middle East. Tabby serves as an example, having raised US$ 333 million since its launch in 2019.

- Despite credit cards being accessible in the Middle East and linked to monthly salary rather than credit history, credit card usage in MENA remains significantly lower (20%) than North America and Europe.
- Given that BNPL is compliant with Sharia law, it provides a more preferable option for most consumers in the Middle East compared to credit cards.

- MENA consumers are young and tech-savvy, having a growing appetite for new financial services. In line with this trend, internet penetration in the UAE and KSA is nearing 100%.
- KSA, in particular, represents a significant growth opportunity as Vision 2030's economic development plan includes initiatives and regulatory support to grow the number of private sector fintech and financial services firms. Consequently, the forecasted TAM for BNPL in KSA is expected to reach US$ 3 billion by 2028.

Source: Trading economics, Fintech news Middle East, World Bank, BCG Fintech Saudi Annual Report 2020-2021, gulf news

Is BNPL the solution to affordable credit?

Will BNPL be suitable for all sectors? Is it appropriate to use it for transactions of any value? Will it work equally well for in-person purchases as it does for online transactions?

What sectors is BNPL not designed for?

Sectors with a propensity to return:

- In sectors where customers often purchase multiple items and have a higher tendency to return unwanted items (such as the clothing sector), this behaviour is more prevalent among credit customers than debit customers.
- Processing returns incurs costs for merchants, in addition to the fees associated with BNPL. Therefore, in these sectors, BNPL usage by customers could potentially lead to increased costs for merchants.
- Some merchants may offer incentives for customers to use non-BNPL payment methods in order to minimise post-purchase expenses.

What value bucket of goods is BNPL not designed for?

Low-value, inelastic demand and short-term consumption sectors:

- Sectors such as the grocery sector are examples of industries for which BNPL was not initially intended. This is because the transaction values in these sectors are typically low, and customers will purchase the goods regardless of the payment method.
- It is crucial to use BNPL responsibly, as extending the credit bubble globally could potentially lead to widespread issues. In these sectors, BNPL is seen as an unnecessary incentive by merchants.
- The installment period should generally align with the consumption period, which is not the case in these sectors.

In person vs online?

Will in-person BNPL cause issues?

- While BNPL is currently predominantly used online, there will be increasing options in the future to convert payments into multiple instalments directly at the POS machine.
- An issue that may arise is the time required to approve and assess creditworthiness, which could result in longer waiting times.
- While longer waiting times may not pose a significant problem for customers making online purchases, it could lead to frustration for both customers and merchants in a physical retail setting.

What could help BNPL?

Open banking:

- Open banking is a concept that enables responsible access to credit for customers, rather than granting credit to anyone who requests it.
- Implementing an open banking system could potentially reduce customer defaults and contribute to the development of an improved BNPL system.
- Open banking can provide several benefits which include:
  - Showing a consolidated view of all BNPL commitments.
  - Providing customer insights into effective payment mechanisms, based on overall financial commitments.

Opportunities in the Middle East

BNPL has the potential to benefit merchants, consumers and investors/credit issuers.

Consumers

- Allows consumers affordable, accessible and instant Sharia law financing.

Merchants

- Enables merchants to boost in-store and online sales volumes by attracting consumers who may not otherwise make purchases.

BNPL providers

- BNPL itself could be profitable if volumes were significant enough.
- Additionally, it serves as a means of establishing a consumer base to offer more traditional products, such as POS financing.

Investors

- **Short-term growth strategy**: BNPL could present an opportunity for a significant increase in equity value in the Middle East, with significant valuations of certain companies such as Tabby already above amount invested.
- **New business line/hedging strategy**: It could represent a new business line for other Middle East credit issuers such as lenders and banks, and act as a form of hedging if typical credit cards/traditional loan products are used less going forward. It does not have to replace credit cards, but it is important for issuers to recognise it as another option.
- **Access to a new merchant book**: It can be another way for other investors, such as payment firms, to expand their merchant book.

BNPL vs credit cards

Is BNPL the solution across the whole payment life-cycle above credit cards?

End-to-end payment journey	Key players in the value chain	Key metric	BNPL	Credit cards
Pre-purchase	Issuer	Better credit checks/lower risk		✓
		Access to new customer segments	✓	
		Better rates to charge merchants	✓	
	Merchant	Lower fees (costs)		✓
		Higher volumes	✓	
		Better engagement with customers	✓	
	Customer	Lower cost	✓	
		More accessible	✓	
At purchase	Issuer	Better cash flow (slower payment to merchant)		✓
	Merchant	Quicker payment by issuer	✓	
	Customer	Better cash flow options	✓	
Post-purchase	Issuer	Higher chance of collection		✓
		Quicker collection		✓
	Merchant	Higher chance of returns	✓	
	Customer	Better payment terms	✓	

Case studies

Case studies of largest BNPL providers

Largest BNPL provider valuations over time

* Datapoints are not exact given stock prices change daily, however this gives an indication of the change in valuation over time.
** Klarna valuation over time only taken using four data points given it is not listed, and assumes valuation is constant between the data points.

Leading BNPL providers globally – case studies

- Many leading market players have had their valuations slashed over time.
  - One of the leading players **Affirm**, was initially valued at US$ 26.4 billion (Jan '21) before increasing to US$ 45.6 billion (Nov '21). Since then it dropped to US$ 2.6 billion (Jan '23).
  - While **Klarna** is not listed on the stock exchange, it was valued at US$ 10.6 billion (Sep '20) and then increased to US$ 45.6 billion (Jun '21) after multiple capital raises in 2021. Since that point, Klarna's valuation has deteriorated by 80-90% from its peak valuation to US$ 6.7 billion (Jul '22), after it cut 10% of its workforce and had pre-tax losses triple for the first three months of 2022.
  - **Afterpay's** valuation increased dramatically from US$ 0.5 billion (Jun '17) to US$ 35.1 billion (Feb '21). It has since dropped to US$ 14 billion (Feb '22). Since then, **Square** took over Afterpay.
    - Given, Square's valuation is dependent on more than just BNPL, the valuation of Square as a whole has not been considered.

Source: Companies market cap, Sifted

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