Afterpay mega-deal puts spotlight on 'buy now, pay later' platforms

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The $29-billion takeover of Australia's "buy now, pay later" app Afterpay by US firm Square has thrown a spotlight on a sector that is growing rapidly and grabbing the attention of regulators.

The seven-year-old Sydney-based app—which allows users to pay off smaller purchases in regular instalments—is aimed at millennials who embrace a cashless lifestyle.

It now boasts more than 16 million customers worldwide and works with almost 100,000 retailers.

Afterpay is the best-known "buy now, pay later"—or BNPL—app, alongside Sweden's Klarna.

Its success caught the eye of Square, a digital payment platform owned by Twitter chief Jack Dorsey, who announced the mega deal on Sunday.

But other big-name players are also vying for a piece of the cake, including electronic payment service PayPal, online retailer Amazon and banks.

According to a study by Kaleido Intelligence, the valuation of the BNPL sector quadrupled to nearly $80 billion globally between 2018 and 2020 and could rise to as much as $250 billion by 2025.

"It's a principle that has been around for quite a long time, but the process of signing up to it has never been so fluid, effective and responsive," said Thomas Rocafull, banking analyst at Sia Partners.

Unlike a credit card, BNPL users are not charged interest or a joining fee and spending limits are kept low.

Companies make most of their money by charging retailers for transaction costs.

In the case of Afterpay, stores using the app lose around four percent of the value of the transaction, but get the rest of the cash upfront and are not exposed to the risk of non-payment.

"For users, it offers a cheaper alternative to credit cards for financing purchases, and is convenient for them during the checkout process," said Nick Maynard, analyst at Juniper Research.

"For a merchant, it is relatively simple to integrate BNPL in their checkouts, and it can allow them to boost their average order value and conversion rate."

According to Kaleido Intelligence analyst Steffen Sorrell, retailers offering a BNPL option see the number of visitors to their site finalising a purchase rise by around 20 percent.

Congested market

Kaleido Intelligence estimates that Americans are the biggest customers for such apps and accounted for around one-third of worldwide BNPL market in 2020. But Asia is also gaining ground rapidly, while the picture in Europe is much more mixed.

According to Sia Partners, BNPL payments made up for 23 percent of online retail turnover in Sweden in 2020 and 19 percent in Germany.

By contrast, in countries such as Spain and Italy, where consumers still prefer traditional methods of payment, the proportion was only two percent, and in France four percent.

Nevertheless, Rocafull said he expected the market in southern Europe to "explode" in the coming years.

Jean-Pierre Viboud, head of BNPL specialist Oney Bank, said the market a projected annual growth rate of 30 percent in Europe.

However, as the providers of such BNPL services has grown in number, "the market is very congested," said Maynard, predicting a "period of consolidation" in the foreseeable future.

Square's purchase of Afterpay is only the latest in a series of recent mergers and acquisitions in the sector.

In January, Affirm—set up by PayPal's co-founders—acquired Canada's PayBright. Last year, Klarna bought Italy's Moneymour.

In France, banking giant BNP Paribas last week signed an agreement to purchase online consumer credit provider Floa. In May, Banque Postale teamed up with fintech start-up Alma.

Not risk-free

But there are risks, too, with critics arguing that Afterpay and similar apps may tempt people to spend money they do not have.

The BNPL industry is largely unregulated in most countries, and there have been calls for regulators to step in to protect consumers.

"Some consumers are not aware of the consequences of what happens if they default on payments, which is bad for the overall industry," Sorrell said.

Users who fail to meet their scheduled payments are hit with substantial late fees.

The board of the UK's Financial Conduct Authority said in February that there was a "strong and pressing case to bring buy-now pay-later business into regulation".

An FCA-commissioned report said the use of BNPL products had nearly quadrupled in 2020, standing at £2.7 billion ($3.8 billion) with five million users.

The review found that while BNPL products give consumers an alternative to more expensive credit, it "also represents a significant potential consumer harm".

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