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Buy Now, Pay Later and the Future of B2B Payments

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Foreword

Louis Carbonnier
Co-founder & co-CEO of Hokodo

Buy Now, Pay Later (BNPL) is undeniably the latest buzz-phrase in the payments world.

The popularity of providers like Klarna and Clearpay, which offer short-term, interest-free credit for online purchases, has exploded in the past two years. In June 2022, Apple presented a preview of its upcoming BNPL feature, called Apple Pay Later – a move that is sure to raise the stakes in this space.

Yet simultaneously, BNPL startups' recent stock market declines and apparent difficulty in becoming profitable is generating questions over the viability of this business model in the consumer sphere. Add to this the increasing likelihood of heightened regulatory oversight and you have all the ingredients of a reshuffling in the world of deferred payments.

At Hokodo, we believe that the future of BNPL is in B2B, and it is bright. Yes, the world is heading towards a recession, financing is drying out and interest rates are rising, all while scrutiny is increasing on the consumer side. However, these tougher market conditions will promote the emergence of B2B solutions with strong business models that solve real problems.

Our research shows that B2B and B2C are two distinct segments with very different purchasing behaviours and market dynamics. B2B BNPL is a virtually untouched opportunity while the B2C side has become highly competitive with dozens of providers catering for the end consumer. Also, let's not forget that the B2B trade market is 2.5 times larger than B2C, and growing twice as fast.

Spurred by the pandemic, B2B trade has moved online, and most business leaders do not want to return to in-person deal-making. A 2020 survey by McKinsey revealed that 96% of European B2B buyers would make a purchase in a fully end-to-end, digital self-serve model. The report also found that 73% of B2B buyers are millennials who prefer buying online.

At the same time, traditional payment methods don't allow B2B merchants to offer payment terms to their professional customers when selling online. This is particularly problematic when more than half of B2B transactions traditionally take place on payment terms. Globally, over $30 trillion of B2B sales rely on trade credit, but the tools to facilitate this have scarcely changed in two centuries!

This requires a fundamental shift in underlying payment methods – and that's where BNPL for B2B can help. Merchants are currently struggling with complex incumbent solutions, including letters of credit, factoring, credit insurance and supply chain finance, which make managing trade credit accounts extraordinarily painful offline and virtually impossible in the context of an online transaction.

Though we don't claim to have a crystal ball, this is Hokodo's attempt at drawing from our own expertise and that of our ecosystem to predict what's needed for seamless digital trade credit to become the norm for buyers and sellers. I hope it sparks lively discussions and inspires the next wave of B2B payment innovation.

Introduction

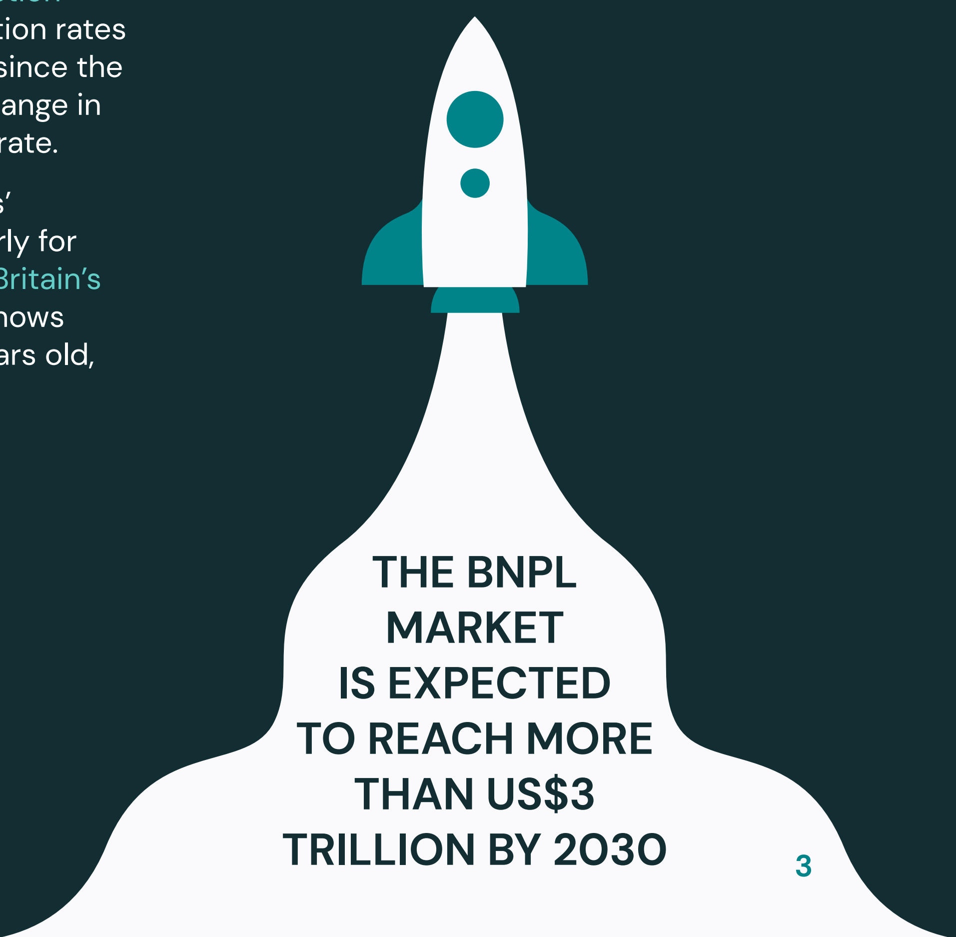
The BNPL market is experiencing skyrocketing growth: according to Precedence Research, its value topped US$125 billion in 2021, and is expected to reach more than US$3 trillion by 2030.

The BNPL boom is largely attributed to the COVID-19 pandemic, which forced consumers to stay home and resulted in a massive growth spurt for e-commerce. As a digitally native solution, BNPL benefited from this trend.

But its popularity has also been driven by other factors. Consumers have long been looking for an alternative to credit card companies, whose high interests and late fees have been blamed for keeping customers in perpetual debt. In fact, research by the US Consumer Financial Protection Bureau found that credit card utilisation rates have declined across all age groups since the start of the pandemic – a historic change in an otherwise remarkably consistent rate.

BNPL has taken a bite of credit cards' longstanding market share, particularly for younger shoppers: a 2021 report by Britain's Financial Conduct Authority (FCA) shows that 25% of BNPL users are 18-24 years old, and half are 25-36.

As a result of this popularity, the BNPL market is quickly becoming saturated. According to S&P Global Market Intelligence's 451 Research, there are more than 100 BNPL providers globally. Pure players like Klarna and Clearpay are facing increasing competition from technology providers like Apple and PayPal, neo-banks like Monzo and Revolut, and even traditional financial providers like American Express, Citi and BNP Paribas – the latter of which recently acquired French BNPL player FLOA.



Addressing the elephant in the room

In writing a white paper on the future of the Buy Now, Pay Later model, we would be remiss not to dive into the current turmoil in the consumer BNPL market.

Unable to generate enough profit, former BNPL unicorn Klarna was forced to return to existing shareholders to look for a US$800 million cash injection in July 2022, lowering its valuation from US$46 billion to US$6.7 billion in the process. This valuation drop was preceded by the laying off of 10% of its staff in May 2022, raising concerns that the BNPL giant's business model was not profitable enough.

And Klarna is not the only company facing trouble. Australian BNPL player Zip was valued at US$5.9 billion last year, but at the time of writing is only worth US$364.6 million. In the US, Affirm went from a valuation of US$47 billion in September 2021 to US$6.1 billion in July 2022.

At the same time, several governments – including those in Australia and the UK – have announced that they will begin regulating BNPL companies to protect consumers from bad debt. But will this regulatory burden, combined with lower access to capital, mean the end of BNPL for consumers? We think not.

Of course, this widespread devaluation of BNPL providers reflects badly on the industry, but business is still booming. Last year alone, Klarna added around 60 million users to its customer base, while both Affirm and Afterpay increased their sales by more than three-quarters.

That's because BNPL creates genuine value for multiple parties, especially online: consumers get access to a more frictionless payment experience, and merchants improve their checkout process, increasing conversion rates and average basket size. Overall, BNPL meets the needs of a new generation of digitally-native consumers who like to purchase online and want to manage their budget better than they can with credit cards whose opaque interest rates compound over time, leading to severe debt issues.

The current difficulties faced by Klarna and others are likely to lead to a certain degree of market consolidation, and these providers will definitely be forced to strengthen their business models, but BNPL is here to stay – both in B2C and in B2B.

Bringing BNPL to B2B

Now that this solution has proved its efficacy in the consumer space, there is an opportunity to replicate its success within B2B trade. One could even argue that BNPL is more aligned with B2B than B2C: after all, businesses have been purchasing on credit terms for centuries. Globally, over US$30 trillion of B2B sales take place on credit terms every year, which means that businesses have been resorting to BNPL without realising it! And while consumer lending faces scrutiny, the B2B space follows a different logic and should remain subject to different due diligence requirements.

However, with much larger average basket sizes leading to increased fraud and credit risk, along with higher expectations from buyers, BNPL is more complex to implement in the world of business trade. This perhaps explains why B2B BNPL adoption has lagged behind take-up in B2C.

Startups and incumbents alike know that overcoming this complexity will bring long-term rewards and have begun to accelerate the development of B2B BNPL accordingly.

The Urgent Need For B2B Payment Innovation

Trade credit is consubstantial with B2B trade and payments. It's estimated that at least 50-60% of B2B transactions take place via trade credit, with some approximations suggesting that closer to 80% or even 90% of business trade relies on these payment terms. Yet, most of the solutions used today were developed around the same time as electricity. They are heavily paper-based, and incompatible with the speed and demands of e-commerce. This is perhaps one reason why the trade finance gap (of US$1.7 trillion in 2020) keeps growing as more and more B2B trade moves online.

"Areas like letters of credit payments, for example, and document collection payments for cross-border transactions, are very archaic and very expensive in terms of how they're organised. Besides, you're working with a bank, and obviously there's not 100% coverage with buyers and sellers to have access to a bank to work with them directly," explains Nick Fulton, CEO and co-founder of B2B fintech for marketplaces, trustshare.

It is nearly impossible to arrange credit terms when selling online (see infographic). In most cases, buyers first need to apply by filling out a lengthy form and waiting for a credit review that involves web searches and reference calls. E-commerce platforms have to manage limits manually, perform painful reconciliations, orchestrate third-party debt collectors, financiers or credit insurers and chase payment over the phone.

IT'S ESTIMATED THAT 80% TO 90% OF B2B TRANSACTIONS RELY ON TRADE CREDIT.

This inefficiency is leading to many lost opportunities:

Sellers find themselves:

- not selling as much as they could,
- bearing risk from unpaid invoices,
- having to funnel precious resources into dunning and collections,
- and facing outdated providers who can't serve all their geographies;

Meanwhile buyers:

- don't get access to the credit terms they deserve,
- waste precious time populating long forms,
- and miss out on potential business opportunities.

All in all, the cost to the global economy is immeasurable. Until online platforms find an efficient and affordable way to support credit terms, there won't be a payment solution that's properly suited to online B2B trade.

Now is the time for a payment revolution in B2B e-commerce, and Taavet Hinrikus, founder of Wise (formerly TransferWise), tells us why: "It's about speed, cost and ease of use. Having a large amount of money in transit will have an impact on your balance sheet so speed matters. B2B financial services is an especially big place for people to get ripped off, so how do you drive the cost down by 10 times? And, finally, everything around Know Your Customer (KYC) and onboarding has a big impact on B2B. It's a pain to do it well, so it's worth putting in the effort to ease KYC and onboarding pain," he says.

MANAGING TRADE CREDIT ACCOUNTS IS EXTRAORDINARILY PAINFUL TODAY

1 Receive application

Print, Fill Out, Scan, Email

2 Run credit check

Web Search, Reference Calls

3 Manage Limits

Credit Account Registration

4 Chase Payment

5 Reconcile Cash

6 Deal with 3rd Parties

Debt Collectors
Factor/Financer
Credit Insurer

Business is being digitised at an incredibly fast pace. According to Grandview Research, the B2B e-commerce market size was valued at close to US$6.9 billion in 2021, and is projected to expand at a compound annual growth rate of 19.7% from 2022 to 2030. Much of this growth is expected to come from marketplaces. A new business paradigm has emerged: the marketplace model is growing much faster than regular merchants' platforms, and is particularly suited to become the dominant form of trading in the online world.

THE B2B E-COMMERCE MARKET SIZE WAS VALUED AT CLOSE TO US$6.9 BILLION IN 2021, AND IS PROJECTED TO EXPAND AT A COMPOUND ANNUAL GROWTH RATE OF 19.7% FROM 2022 TO 2030.

BNPL for Businesses

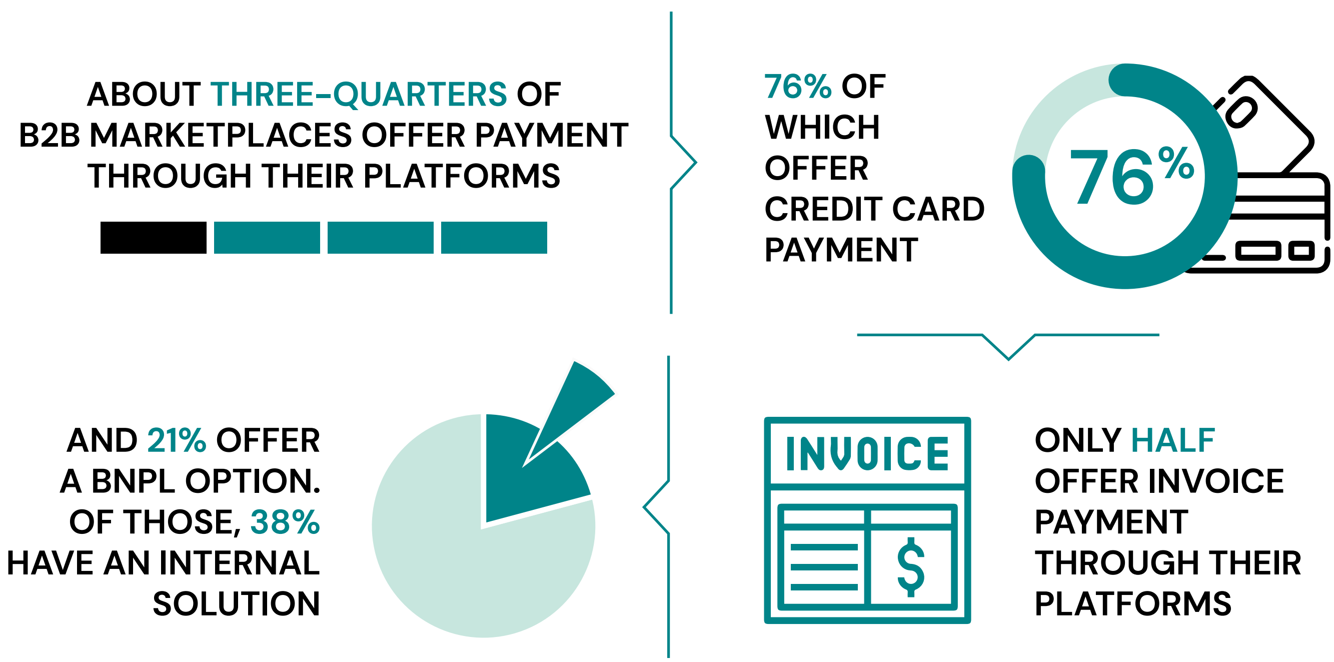
By now, it is clear that credit terms are a necessary added-value service for B2B payments. And yet, very few payment solutions support payment terms for online sales. As a result, most B2B marketplaces end up with a sub-optimal checkout process that doesn't support credit terms. Research by another BNPL provider reveals that about three-quarters of B2B marketplaces offer payment through their platforms, 76% of which offer credit card payment. Only half offer invoice payment through their platforms, and 21% offer a BNPL option. Of those, 38% have an internal solution, which comes with the risks of offering credit from their own balance sheet.

Luckily, the sector is evolving fast. New players have emerged to offer credit terms on e-commerce platforms, whether they call it Trade Credit-as-a-Service (CaaS), terms, embedded lending or BNPL. Hokodo, TreviPay, Billie, Two, Balance and Resolve are just some of the emerging players in Europe and the US.

In the evolving landscape of B2B payments, BNPL is fast emerging as the best option. "Embedded lending offers a route for adding value to the transaction which maybe the buyers and sellers wouldn't necessarily have access to themselves without the help of the marketplace to bring it all together," says Fulton. "But I would say it also adds a convenience layer as well. If there's an easy way to get credit terms on a transaction and you can go ahead and get it authorised immediately then that adds value."

Recent research commissioned by Hokodo found that nearly 60% of B2B suppliers have granted their own customers credit terms in order to win deals, while 41% of SME business owners actively search for suppliers who offer credit terms. A quarter of all businesses surveyed said that access to payment terms would be crucial to their survival in the coming year.

Clearly, appetite exists for deferred payment schemes in the world of business trade, but payments companies seeking longevity must be able to satisfy the idiosyncrasies of B2B.



Catering for the specificities of B2B trade

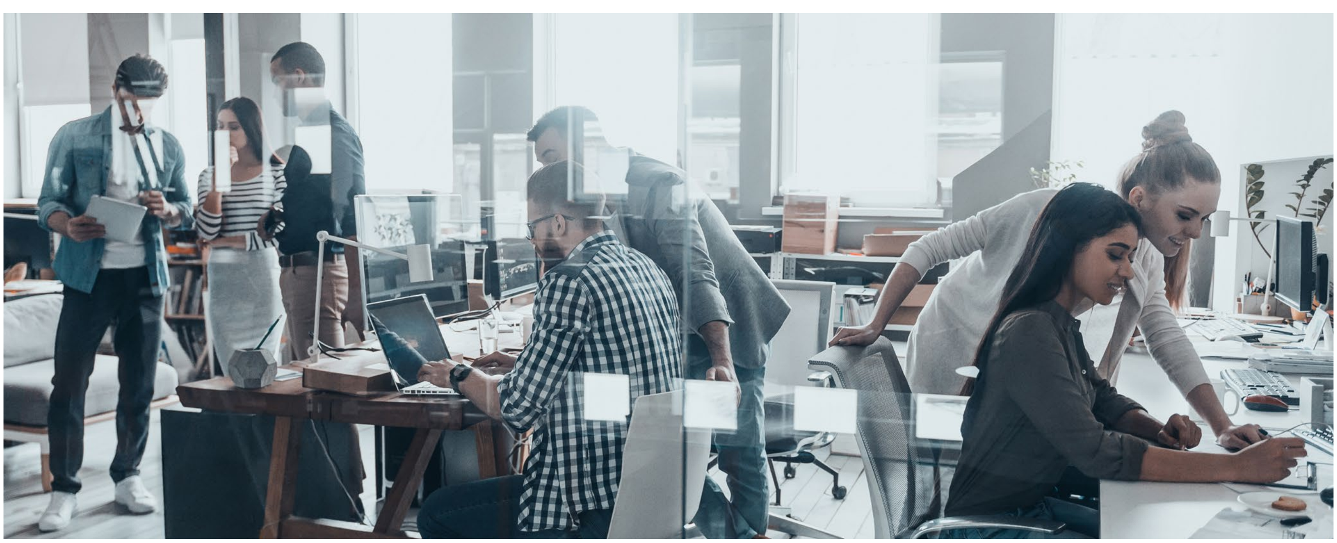
There are significant differences between BNPL solutions for B2C and B2B payments. First, a B2B company's AOV is much larger than that of a B2C company. And unlike in B2C, where a BNPL solution could incentivise a customer to overspend and/or to buy something they do not need, B2B credit terms don't carry the same negative side-effects. Businesses are always striving to reduce costs and increase profitability.

To take a real life example, no matter what payment terms are offered, it's highly unlikely that a construction firm will purchase three bags of cement when they only need two to finish a given job. However, this construction firm is likely to be more loyal to the supplier that was offering payment terms along with a great digital experience. In B2B, deferred payment is about meeting the basic expectation of the modern procurement manager: most of the world's B2B trade already uses payment terms, so if online trade is to reach its full potential, these solutions must be brought to the digital sphere.

Then, there are a number of characteristics that make B2B transactions far more complex than those in B2C, which BNPL providers must consider. To start with, the purchasing process usually involves consulting with different stakeholders and decision makers.

Credit assessments are also far more complex. At incumbent companies, this requires work from two specialist employees. Credit Analysts assess the risk of a given buyer, while Credit Underwriters make the actual credit decision and decide on the size of credit limits. Related to this are the various opportunities for fraud, such as the risk of buyer impersonation or merchants creating fake transactions, which can easily escalate and spell the end for the BNPL provider involved.

B2B transactions are often unable to rely on credit cards, which is unfortunate as this type of payment has become particularly safe and well-protected against fraud risk. Instead, B2B merchants prefer settlement methods such as direct debit or transfer. Invoicing and managing the various related taxes quickly becomes complicated, especially since B2B merchants tend to operate across multiple geographies and currencies.



The case of B2B marketplaces

According to the latest McKinsey B2B Pulse survey of close to 3,500 decision-makers in 12 markets, 72% of companies that built their own marketplace gained market share over the past two years, compared to just 42% among those that did not build a marketplace. Marketplaces are a powerful vehicle for B2B trade growth, but in order to be successful, they need to seamlessly integrate all the different parts of a transaction, and take into account the specificities of B2B trade.

“B2B payments require specific processes related to sending and receiving invoices and process flows to approve purchases. These aspects require marketplaces to develop specific process flows and an in-depth understanding of buyers’ and sellers’ needs regarding key aspects such as payment terms, management of pay-ins and pay-outs, and financial reconciliation,” explains Sophie Zellmeyer, Head of Global Payment & Fintech Partnerships at Mirakl.

Significantly, Zellmeyer highlights the fact that marketplaces not only need to organise pay-ins, but that they also need to perform pay-outs. This involves collecting the money from an order, and then splitting it before sending the relevant amount to each supplier from whom a product or products were bought. The marketplace’s commission is subtracted prior to the pay-out.

This process can be complex, but is eased by the utilisation of partnerships between BNPL providers and payment service providers (PSPs) specialising in marketplace payments. For example, Hokodo is partnered with Mangopay, Lemonway, Stripe, trustshare and many others in order to facilitate straightforward payouts for our shared marketplace clients.

Additionally, it's important to remember that professional buyers are not only procuring for themselves, but also for their clients and stakeholders. This makes them more conservative when choosing new suppliers, and this is especially true in a marketplace where the marketplace itself, as well as each of its suppliers, need to be vetted.

As already mentioned, corporate decision cycles are longer than those in B2C – usually made based on several quotes, after consulting multiple internal stakeholders and gatekeepers. Changing the purchasing behaviour of an entire organisation is extremely challenging, which is why B2B marketplaces need to come up with a proposition that's 10 times better than the incumbent option.

"A key piece is offering lots and lots of different payment methods, because the consumer is now so spoilt with being able to use Apple Pay here, open banking payment there, bank transfer there. And it's all just become so incredibly seamless. So offering a multitude of different payment options, including BNPL options, plus making that process as smooth as possible, is crucial for marketplaces," explains Anna Tsyupko, COO of tomato pay.

AOV is often higher on B2B marketplaces – at least 20% of businesses are comfortable spending up to US$250,000 entirely remotely (McKinsey) – which means that mistakes are typically more expensive, not only in terms of money but also in terms of operational and reputational risk. Because of that, offering a secure and efficient payment and credit solution is a sure way to generate loyalty, not just from buyers, but also from suppliers.

Embedded lending: Merging payments and financing

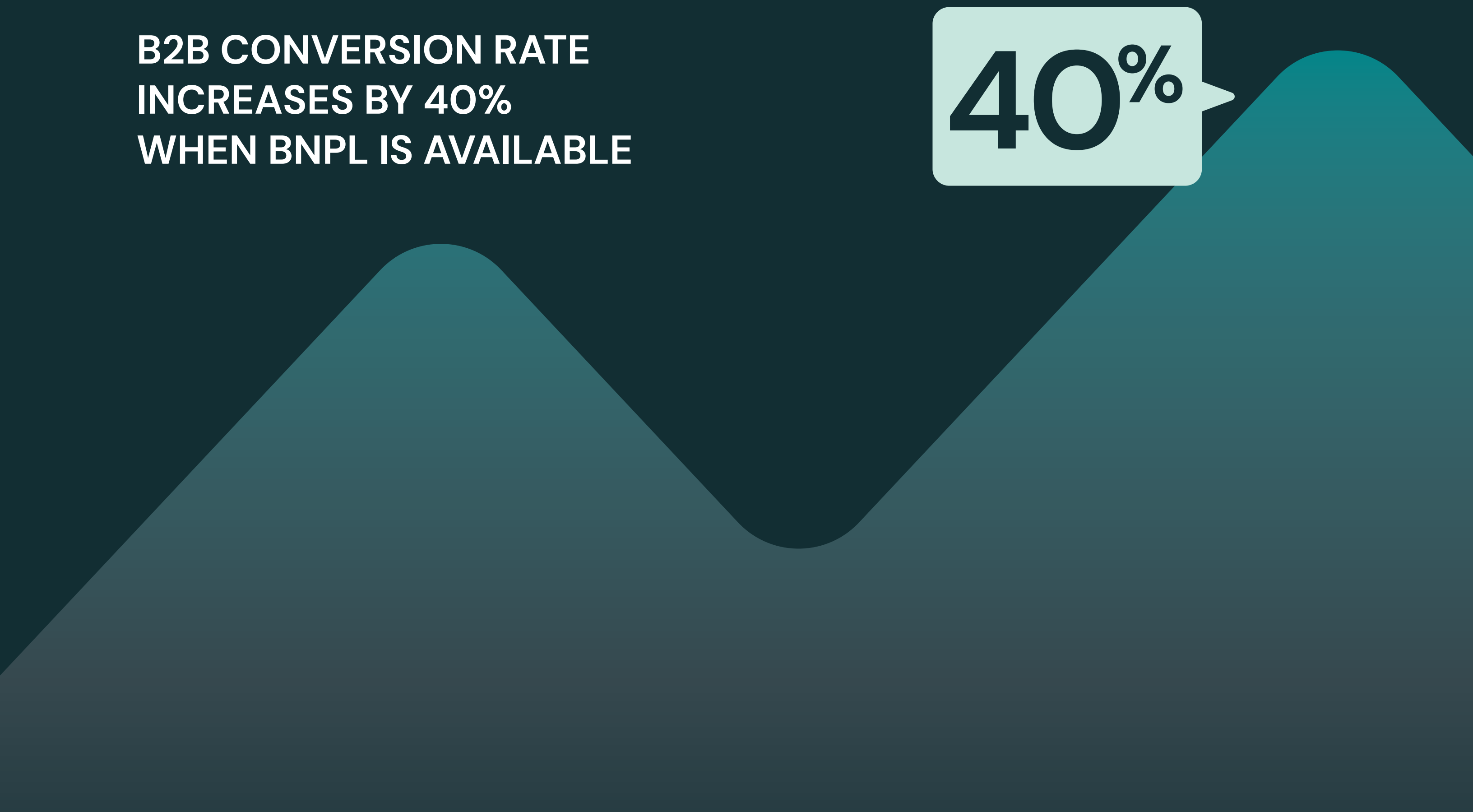
The truth is, if all a business wants is financing, they tend to prefer their bank over any BNPL solution: no fintech provider can beat the rates that a bank can offer. The reason businesses choose BNPL is that it supports a better payment experience, which in turn increases sales and user satisfaction – something traditional invoice financing solutions can't deliver.

BNPL is primarily a tech product, delivered via API. It helps to improve the buyer journey by giving trade customers the experience they expect. Giving buyers the option to Buy Now, Pay Later at checkout, even on their first purchase, dramatically increases conversion rates – by around 20 to 30% in B2C and by 40% on average in B2B, as observed by Hokodo.

Secondly, BNPL is a payment solution that supports merchants with credit checks, reconciliations, limit and concentration management, collections and protection against bad debt. This is the other major benefit of this service: merchants are able to get rid of burdensome credit management activities which used to take up a lot of time and resources.

To conclude, merchant financing is not inherent to BNPL in B2B. In fact, some providers, like Hokodo, even offer BNPL without financing (i.e., the buyers benefit from payment terms but the merchants don't have to be paid upfront if they don't need it). The fundamental benefit is to be able to help merchants manage trade credit to their buyers when selling online.

B2B CONVERSION RATE INCREASES BY 40% WHEN BNPL IS AVAILABLE



How does BNPL for businesses work?

There are several BNPL providers out there, each of which offer a slightly different solution. Some, for instance, rely on outsourcing underwriting and credit decisions. Other providers have taken the decision to bring this in-house because it allows for quicker decision making and greater agility. US-based provider Resolve doesn't guarantee full payment for merchants, instead promising receipt of at least 90% of each invoice. Many other providers protect invoices in full, even if their buyer is unable or unwilling to pay. Meanwhile TreviPay – another US provider – does not offer instant credit decisions, while others make it a key feature of their proposition. Aside from Hokodo's solution, which is already available in 6 European markets, all B2B BNPL providers are currently restricted to just one or two geographies.

This is how Hokodo's BNPL solutions for businesses works (see infographic).

"I think that in the future, BNPL will take the place of a bank and replace PSPs: they have all of the agreements and documentation to cash the money on behalf of the vendor; they are able to manage financial flows, accreditations and risk to propose a complete solution to marketplaces," says Jérôme Connac, a freelance marketplace specialist.

B2B BUY NOW, PAY LATER: HOW IT WORKS

Here's a step-by-step guide on how our B2B BNPL solution works for buyers and sellers

STEP 1
Customers shop as normal

In the background, Hokodo runs a credit and fraud check using our in-house underwriting rules. This takes less than a second.

STEP 2
Then, they head to the checkout

Customers see only the payment options for which they have been approved.

STEP 3
Customers choose to Buy Now, Pay Later

They select their preferred Hokodo payment option.

STEP 4
We pay the merchant upfront

Once the goods are shipped or the service delivered, we pay the merchant.

STEP 5
Your customer pays us back 30, 60 or 90 days later

We handle all collections and bear risk for nonpayment.

Looking Ahead

We've established that B2B payments are in dire need of an upgrade, and that BNPL, which has proven its relevance in the consumer world, is the best suited solution for the specific needs of online B2B trade. So, what's ahead for this market? How will the controversies surrounding consumer BNPL players, the impending regulation of the sector and the lower appetite for fintech investment impact the development of B2B solutions?

Short-term: Dark clouds are looming

As mentioned at the beginning of this white paper, several B2C BNPL players are currently struggling to stay afloat financially. These hits are made worse by the fact that the global economy is heading towards a recession, and that funding for fintechs is drying out rapidly. After a record 2021, funding decreased by 18% in Q1 2022 – the largest quarterly drop in funding since 2018. In a Boston Consulting Group report on the most recent Money 20/20 conference, BCG partners noted that investors stated the need to "dramatically reduce the burn rate" and "turn to profitable business models" when reassessing the viability of fintech investments.

On top of that, government scrutiny is increasing. This regulatory burden, combined with more restrictive market conditions, is set to lead to market consolidation, but also to more clarity in the BNPL world.

"B2C is definitely the area of focus for the regulator, but could there be anything specific to B2B that emerges?," asks Matt Robinson, founder of Nested and GoCardless. "In many ways it feels probably better if it does, because once you have some ground rules on how things work and how to engage in the relevant regulation, you can grow as fast as you want, whereas as long as you are operating in a legal lacuna, it's actually quite tricky to know exactly how to set things up," he adds.

It is worth noting that while B2C BNPL players are facing turmoil, in the B2B space, recent funding rounds indicate that things are not as bleak: Mondu, Tranch and Playter have all closed significant funding rounds in recent months, and we at Hokodo announced a US$40 million Series B fundraise in June 2022.

Despite this positive news, funding is likely to become less abundant in the medium term for everyone in the BNPL market, but this is not necessarily a bad thing: weak business models will disappear and only the ones with the strongest value propositions will remain.

Long term: a global, integrated solution

While there may be some difficult times ahead, trade credit is here to stay, and the trend of business digitisation will not stop any time soon. Actually, the growth of e-commerce is set to accelerate in B2B, where 70% of buyers are happy to make purchases of over €50,000 online. The continued need for innovative payment solutions and the upcoming market consolidation in the fintech world will support the growth of viable BNPL companies – as long as they find ways to operate on a global scale.

“Geographic spread is key. It is so easy for marketplaces to scale internationally, and when choosing a payments provider, startups or businesses in general want to future-proof themselves,” notes Tsyupko.

Therefore, payment providers are expected to cover multiple geographies. In addition, it takes scale to truly achieve operational efficiencies in the payments space, so as VC funding becomes less available, we’re inevitably going to see some consolidation, which will lead to the emergence of global champions in B2B payments, in the same way as Stripe, Adyen and Checkout captured B2C.

“A B2B payments provider cannot win in the market if it’s not global, and that also means being able to do multi-currency conversion: splitting the payments correctly and sending money anywhere a seller is based, in their local currency,” adds Zellmeyer.

OF B2B BUYERS ARE HAPPY TO MAKE PURCHASES OF OVER €50,000 ONLINE

To consolidate their offering, B2B BNPL providers must integrate relevant capabilities beyond payments. For instance, they may look to offer additional services such as FX management, payouts, invoicing, ERP integrations, or even tax support, helping businesses selling worldwide to understand payment regulations and manage the taxes associated with their overseas sales. We’re still in the early stages of the B2B BNPL industry and we expect providers to develop creative, differentiated propositions in order to achieve the best product-market fit.

Great businesses are built in times of crisis, and B2B BNPL will be no exception: we predict that the coming months of turmoil will spur consolidation, innovation and diversification in the embedded lending space.

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