

EMBEDDED FINANCE - NOW ANYONE CAN INNOVATE ON FINANCIAL SERVICES. ARE YOU READY?



The ability to create products and services that address unmet customer needs is a key ingredient in the recipe to becoming a successful company. Innovators are leveraging Technological evolutions to rapidly create products and services which address such unmet needs. Embedded Finance is all about meeting such unmet needs.

According to UK firm Anthemis, the global embedded finance market will be worth a staggering USD 7 trillion by 2030. This article tries to provide an insight into the trending topic of 2021 – Embedded Finance.

What is Embedded Finance?

Embedded Finance refers to products that have significantly enhanced value propositions through the associated financial services embedded within. While doing so, embedded finance adds value to the financial product providers as well.

In other words, embedded finance is about enabling any business (retailers, utility service providers, brands, etc.) to manage and sell innovative financial services as part of their customer journeys. This would mean seamless integration of innovative & contextual forms of payment, banking, lending, insurance, or even wealth management into their end-user experiences.

Uber - An example of Embedded Finance

An often-quoted example is Uber. You don't need to get out your credit card at the end of the journey. Uber has payments to be embedded into the user experience of getting a ride and, for the driver, into their experience of getting paid the right amount at the right time.

Now with Debit Card and Checking Accounts embedded for the drivers, Uber drivers are getting integrated and easy experience. They need not look

outside of Uber to open accounts. Many unbanked drivers are getting into the financial mainstream. Uber became one of the third largest acquirers of small business bank accounts in the United States and it is not a bank. The Banks are acquiring these new customers with negligible incremental costs. With Insurance services also plugged in for the drivers and the cars, the network effect of Embedded Finance overall is colossal.

There are other examples and what better than Ant Financials, Tencent who manage 85% of China's mobile payment space, or PingAn providing a complete insurance-led financial ecosystem.

The provision of banking products requires significant technology investments and specialized skills to manage the scale, regulatory, and compliance requirements. Imagine if Uber were to do all the 'build' of banking and insurance products, it would have missed the leadership opportunity. It decides to 'buy' such functions from banks and others in the banking-as-a-service stack.

With Embedded Finance, any company can offer innovative financial services.

The Case for Embedded Finance

Embedded Finance is about rethinking the utility of banking in customer's daily lives. It is all about applying the first principles of design thinking and re-imagining the basic utility of banking- the ability to store value, the ability to move money, the ability to access credit, and the ability to secure. Determining the need of the customer at the customer journey and providing for the same by integrating banking services is embedded finance.

Ease and engagement are the two overpowering themes with any customer-facing brand in this hyper-connected world. Such brands always

EMBEDDED FINANCE MEANS BANKS FACILITATE MORE NEW CUSTOMERS, MORE TRANSACTIONS, SERVICE MORE LOANS, AND PROCESS MORE PAYMENTS. BANKS WILL NEED MORE APIS AND AUTOMATED PROCESSES TO MEET THE DEMANDS OF THE BRANDS. BANKS SHOULD INVEST IN MODERN CLOUD-NATIVE ARCHITECTURES TO LEVERAGE SCALE, AVAILABILITY, RESILIENCE, AND ECONOMICS.

strive to keep the customer engaged and create convenient experiences for their customers from product discovery to the completion of the sale. The initial crop of such digital ventures excelled in providing superior customer experiences but hit the wall while making the banks a part of the customer journey during payment settlements. Few banks, cards, and fintech looked at these use cases and offered integrated payments in the check-out process. This is referred to as the first version of embedded finance.

It all started with payment settlements, then the embeddings graduated to Buy Now Pay Later (BNPL) products- providing credit.

This gave birth to Paypal, Stripe/ Fast, Klarna, Affirm, Afterpay, which started offering APIs that make it convenient, easy, and engaging for the

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EMBEDDED FINANCE HAS ALSO GIVEN RISE TO A NEW CLASS OF PLAYERS – BAAS PLATFORM PROVIDERS. THEY PROVIDE A MARKETPLACE OF VARIOUS FINANCIAL SERVICES, WHERE A NON-FINANCE FIRM CAN PICK AND CHOOSE ANY LISTED API/SERVICE.

end customers while enabling far more spending per order and over time.

Now, we see increasing engagement by including an account, a card, and various other banking products offered embedded as part of the customer experience.

Global brands from Mercedes and Amazon to IKEA and Walmart are integrating financial services to offer customers everything from banking and credit to insurance. Now, Amazon can let customers “buy now pay later” when they check out, sellers on Amazon or on Udaan (a B2B trade portal in India) can access working capital without going to the bank. and Mercedes, Audi or Jaguar Land Rover drivers can get their cars to pay for their fuel.

Embedded Finance Ecosystem

This embedded finance solution externalizes the foundations of banking and enables any organization to operate as a bank. There are three groups of players in an embedded finance ecosystem.

1. Containers (Brands): brands and service providers (retailers, ride-

hailing apps, etc.) who provide the customer experience and are part of the daily lives; e.g. Amazon, Shopify, Uber, Lyft

2. Providers: providers of financial services (financial institutions and other companies with financial business licenses), and
3. Enablers: fintech firms acting as enablers connecting Containers and Providers

By embedding the financial functions of Providers into the service flow of Containers through the intervention of Enablers, customers of Containers experience ease and stay engaged. A portion of the resulting increase in the revenue of Containers is returned to Providers and Enablers, thereby establishing an embedded finance ecosystem.

Embedded Finance has also given rise to a new class of players – BaaS Platform providers. They provide a marketplace of various financial services, where a non-finance firm can pick and choose any listed API/service.

Crystal Ball Gazing - How does it Impact the Banks?

Essentially, if you closely observe, a bank distributes its products through a non-financial company. Banking-as-a-Service (BaaS) stack is one of the enablers for the non-banks to offer sophisticated Embedded Finance by rapidly configuring financial service elements into their user experience.

There is a huge gap between what customers need as financial services and what the banks offer. As a result, startups stepped in to fill up the gap. For the banks, Embedded Finance means an opportunity to maximize gains and re-focus from what they do best – banking. transaction processing. In other words, leave the engagement

to the people engaged deep in customers’ daily lives.

- Cards or plastic creates friction. The plastic, in its current form, would likely be the first one to fall.
- Credit Cards as a business are already under stress with BNPL services coming up and with further integration into the checkout processes would eliminate the need for a credit card. The first principles thinking says that the customer needs immediate credit but not the card.
- Embedded Finance means banks facilitate more new customers, more transactions, service more loans, and process more payments. Banks will need more APIs and automated processes to meet the demands of the brands. Banks should invest in modern cloud-native architectures to leverage scale, availability, resilience, and economics.
- Further, traditional Banks have an advantage in this opportunity, the richness of the functionalities and features, if exposed as APIs, will allow them to steal a march over the Neo/Challenger Banks. A rich set of APIs to expose core financial capabilities in a modular and flexible way is vital to enable innovative, seamless, and differentiated embedded finance solutions.
- With Embedded Finance picking up steam and the consumer brands expanding the reach and owning the experience of the customer context, the bank’s investments into their digital channels can be moderate going forward.
- As small and medium businesses (SMBs) would start deep integrations of financial services across the value chain, the

Corporate Banking line of business for SMBs would have to reevaluate their product and market strategies.

- The accelerated pace of evolution in the space of embedded finance is likely in line with Bill Gates’s prediction “we need banking, but we don’t need banks anymore.” Banks should take a leaf out of the ‘Intel inside’ inside marketing strategy and lend the strength of their brand to the platforms or ecosystem.
- Combining BaaS and Open banking/finance would work wonders, where brands can offer real-time, contextual propositions leveraging the data universe of open finance.

Some Initial Responses of the Banks

- BBVA has set up a separate business unit driving a focused strategy on BaaS.
- Starling Bank, a new-age bank has smartly positioned its entire stack as a BaaS offering for anyone to hook on.
- The parent company of the home furnishing retailer IKEA, purchased a 49% stake in IKANO Bank, a UK-based retail finance company specializing in point-of-sale (POS) loans and store-branded credit cards, with the option to acquire the remaining shares at a later date. This is despite the fact that IKEA and IKANO bank have a shared history
- Goldman Sachs has BaaS at the core of its transaction banking GTM and brought in the paradigm shift of “Developers are our Clients”, thereby acknowledging the need for superior Developer Experience (DX) for the innovators.
- In other places, Citigroup has teamed up with Google on bank accounts, Goldman Sachs

provides credit cards for Apple, and JPMorgan is buying into Volkswagen’s payments business.

The Journey Ahead

With Embedded Finance, consumer brands and various non-banks are discovering a new way to differentiate the experience they bring to consumers and helps them attain leadership positions in their vertical.

All-in-one service providers or the so-called super apps are the likely winners of the current market; however, banks can quickly catch up if they address the “whole problem”.

Embedded Payments, Embedded Lending, Embedded Insurance, and other forms of embedded finance would democratize innovation. Companies that would fill in the gaps between what the customer needs and what financial services firms provide today.

By leveraging the BaaS infrastructure and open finance/open data, offers from consumer brands would be more personalized, contextual to the customer journey. This will be the crux of embedded finance. Embedded finance creates enormous opportunities to deepen and strengthen customer relationships—and that companies that fail to seize on that promise will be left behind

There is no time to waste when \$7 trillion of value is at stake.

References

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Disclaimer: Views or opinions represented in this blog are based on the author’s own research and do not represent TCS BaNCS.

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