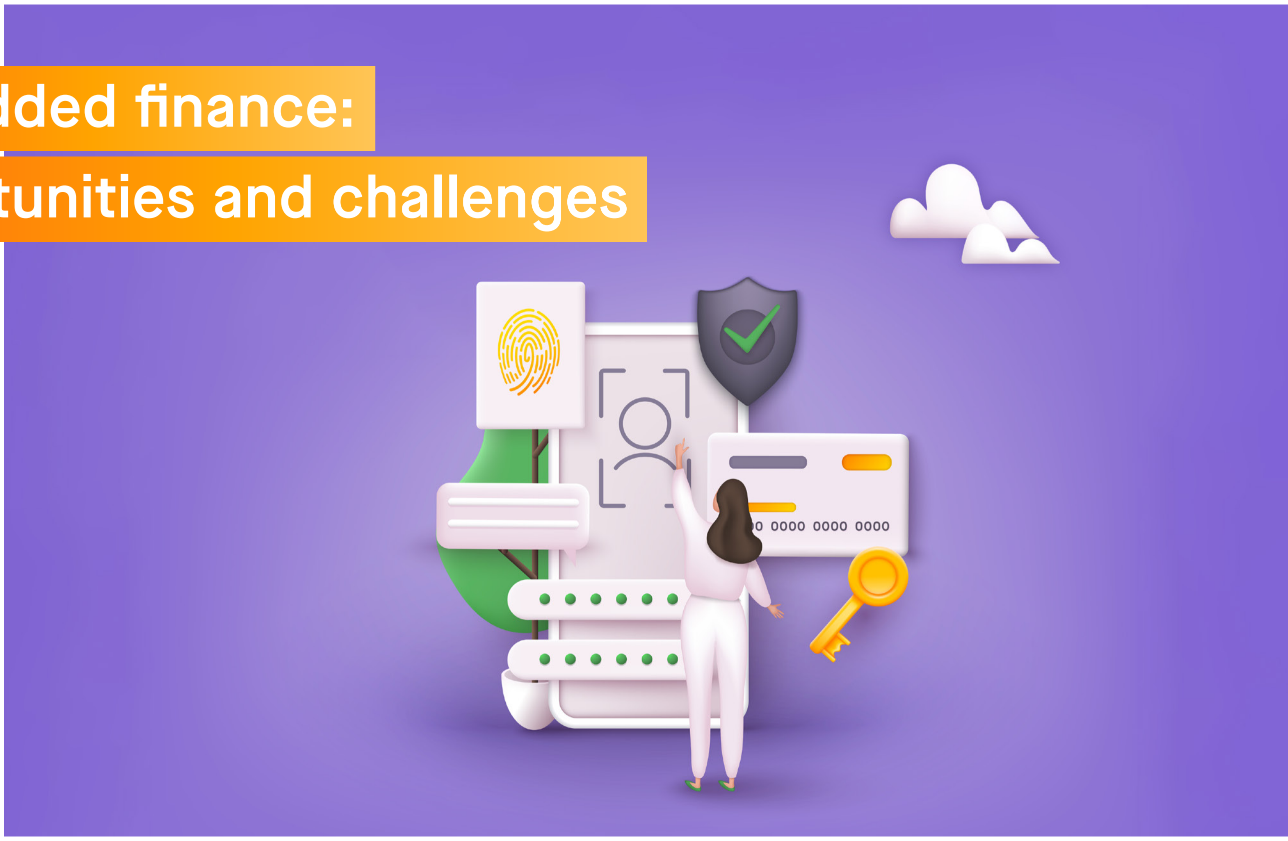
Embedded finance: opportunities and challenges



"Embedded finance" is gradually establishing itself as a major, innovative trend. What is Embedded Finance ? What are the benefits and threats for companies, financial institutions and end users?

Charles-Henry Monchau *Chief Investment Officer*

PRIVATE BANKING

Key takeaways

- Embedded Finance presents a unique opportunity to explore and grow the business channel outside traditional financial services structures.
- Embedded payments offer customers the convenience of secure payment storage and the ability to carry out transactions effortlessly within a single platform.
- Embedded BNPL and embedded lending enable consumers to access credit and make purchases in installments.
- Embedded Investing presents a convenient way for individuals to engage with the stock market.
- Finally, embedded insurance provides a streamlined experience that meets customers' insurance needs effectively.
- All players, whether banks, fintechs or non-financial companies, need to take advantage of this technological evolution.

What is "Embedded Finance"?

It consists of the seamless integration of various financial services, such as credit, payment services and insurance, directly in the infrastructure and product and service offering of non-financial companies, thus avoiding the need for them to redirect their customers to traditional financial institutions.

This innovative approach provides users with a practical, accessible tool for managing their finances. In the context of e-commerce in particular, where the user experience is of crucial importance, embedded finance is a game-changer.

According to Grand View Research, the global embedded finance market is set to grow considerably in the coming years. The market is estimated at $65 billion in 2022, and is expected to reach nearly $300 billion by 2033, with an average annual growth rate of over 30%.

According to Plaid, 88% of companies that have implemented integrated finance solutions have increased customer engagement, and 85% say it helps them acquire new customers. This significant growth is facilitated by the increasing adoption of smartphones and high internet penetration worldwide.

Benefits for companies, financial institutions & end users

In today's rapidly evolving financial landscape, several factors, including the entry of new players, stricter regulations imposed by government authorities, and evolving customer expectations, have contributed to its transformation. The emergence of embedded finance is shaped by collaborative partnerships between banks, technology providers, such as fintech companies, and non-financial companies.

Embedded finance offers companies an alternative source of revenue by allowing them to earn a share of the income generated from financial products sold on their websites and apps. By integrating embedded financial solutions, businesses not only gain the trust of their customers but also gain a competitive edge.

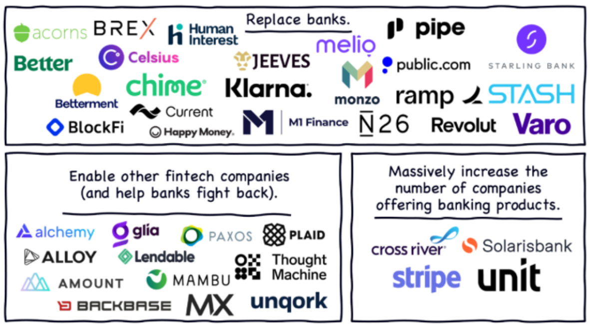
Financial institutions, particularly fintech companies, benefit from embedded finance by acquiring a large customer base at a relatively low cost through strategic partnerships with businesses. Moreover, with companies responsible for interacting with customers on their websites and apps, the burden of customer service and support is divided between financial institutions and the non-financial companies.

Another significant advantage of embedded finance is the ability to collect relevant data for both companies and financial institutions. By accessing not only customers' financial banking details but also their shopping preferences, preferred payment methods, and spending habits, companies and financial institutions can use this information to offer targeted financial products, as well as engage in the cross-selling of other products and services.

On the user front, embedded finance offers substantial benefits for consumers, including faster and easier financial transactions without the need for intermediaries, thus contributing to a seamless shopping experience. Moreover, embedded finance enables underserved users to gain access to financial services that they would otherwise struggle to obtain due to complex processes and stringent eligibility criteria imposed by traditional financial institutions.

The role played by Fintech

As Alex Johnson points out in Workweek, fintech companies can be classified into 3 different categories.



1. Fintechs aiming to replace banks.

Their aim is to identify the specific tasks performed by traditional banks and propose better alternatives. These Fintechs aim to excel in areas where banks may be deficient. For example, Revolut is renowned for its hyper-competitive exchange rates and the benefits of sponsoring new customers.

2. Fintechs enabling the development of other fintechs.

These fintechs focus on providing the infrastructure and tools necessary for the emergence and development of other fintechs. They act as operators, equipping the financial sector with innovative technologies.

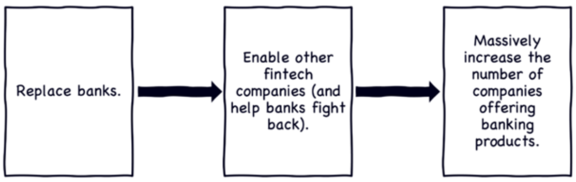
Backbase, for example, helps commercial banks reorganize their banking services to align with customer needs, thanks to a platform that covers the entire customer lifecycle.

3. Fintechs aiming to massively increase the number of companies offering banking products.

They aim to expand the market by helping non-financial companies integrate financial products into their offerings. These companies, often referred to as "infrastructure providers", enable seamless integration of financial services. Cross River, for example, offers companies API-based financial solutions, including ACH (Automated Clearing House) payments, push-to-card payments, and fraud prevention, facilitating the efficiency of electronic funds transfers.

According to Statista, in 2021, there were over 10,000 registered fintech startups in the United States alone, and over 26,000 globally. The distribution of companies in the above-mentioned categories reflects the evolution of fintech. While the "replace banks" category has seen significant progress, the "enabling infrastructure" category is relatively less mature, and the "embedded finance" category is a newer, fast-growing segment.

Understanding these categories in a sequential manner provides valuable insights into the progression of the fintech ecosystem.



Notably, respected voices in the industry suggest that embedded finance represents the ultimate destination for fintech. This implies that the future of fintech will involve seamlessly integrating financial services into various industries and platforms, offering a more interconnected and streamlined experience for consumers.

The different types of embedded finance

1. Embedded payments

This is the most-well known type of embedded financial offerings. This form of embedded finance has gained widespread recognition and adoption, with major players like Amazon, Uber, DoorDash, and Walmart. Apps such as Google Pay, Apple Pay and Venmo are examples of simplified payment solutions that enable users to store their financial data and carry out transactions seamlessly within a common interface.

In this way, businesses enable customers to place orders and pay directly on the same app. Users no longer need to re-enter credit card details or rely on third-party platforms to process payments securely. The main benefit for customers lies in the seamless payment experience and the elimination of friction points.

To illustrate the effectiveness of integrated payments, let's take the example of the Starbucks app. Starbucks not only securely stores payment information, but also encourages customers to participate in a loyalty program that allows them to earn points using the app. Such integrations enhance the user experience by providing a simple and attractive payment process.

2. Embedded buy now, pay later installment plans.

Buy Now Pay Later (BNPL) enables retailers to offer their customers access to credit directly through their e-commerce applications. BNPL works like an installment plan, allowing customers to spread the total cost of a purchase over several payments over a set period.

By opting for the merchant's BNPL option, customers take out a small loan to pay for their purchase. They then makes payments for the chosen product or service over several weeks, usually at zero interest. Simultaneously, the retailer receives full payment for the total cost of the purchase, while the BNPL provider collects the customer's funds on pre-agreed due dates.

Fintech companies such as Klarna and afterpay facilitate this service by providing the necessary technology and data infrastructure and enable their customers to pay using BNPL on a wide range of websites, including those of Nike, Valentino and JBL.

3. Embedded lending

Embedded lending enables companies to offer loans directly on their platforms, without using traditional financial institutions, saving customers the hassle of having to seek out separate financial services.

Through partnerships with fintech companies, these businesses can offer their customers various financing options, including installment plans, "Just in time lending" and BNPL schemes, as mentioned above.

Customers can access these lending services directly on the company's app or website, without having to navigate the traditional banking system.

Stride Funding, for example, is a fintech offering alternative financing solutions for students and families. Its models include income-sharing and employer-sponsored loans, and deferred tuition agreements.

4. Embedded investing

It is increasingly possible to integrate market investment products and services on non-banking platforms and applications. Robinhood, Acorns and Cash App are examples of integrated investment companies that enable users to buy, sell and trade stocks without having to leave the app or involve investment advisors. Their apps have democratized access to the stock market by offering intuitive interfaces and simplified processes, attracting a wider range of people, including the new generation of "do-it-yourself" investors. By eliminating traditional constraints such as high fees and complex interfaces, they enable individuals to better manage their investment decisions.

Acorns, for example, is a fintech that focuses on micro-investing by automatically rounding up daily purchases and investing the difference in a diversified portfolio.

These apps also enable users to follow the markets in real time and carry out transactions easily on their mobile devices, making the investment experience more attractive and inclusive.

5. Embedded Insurance

Embedded insurance eliminates the need for dealing with insurance companies by seamlessly integrating the coverage process into the various transactions, enabling individuals to obtain an insurance policy without the traditional formalities.

A common approach by companies is to incorporate the coverage process directly into the purchasing process, as an add-on.

For instance, when booking a flight, travelers can opt for insurance coverage as part of the booking process without the need for separate engagements with insurance companies or agents. This approach ensures that insurance is available precisely when and where individuals need it, and thus, enhancing the customer experience.

For further information

Banque Syz SA
Quai des Bergues 1
CH-1201 Geneva
Tel +41 58 799 10 00
Fax +41 58 799 20 00
syzgroup.com

Charles-Henry Monchau, Chief Investment Officer
charles-henry.monchau@syzgroup.com