VISA

Visa Consulting & Analytics (VCA)

Embedded finance

What are the emerging opportunities in this new value chain

How can financial institutions and digital players capitalize on the growth potential

Companies have long strengthened their value propositions by diversifying payment options for their customers at the point of sale: short- and long-term loan options, private-label credit cards or buy-now-pay-later (BNPL) deferment options.

What's new are the emerging opportunities for financial institutions around embedded finance, which refers to the embedding of third-party financial products and services into digital platforms of non-financial companies. The non-financial player acts as a distribution channel for the financial service being provided, and the result is a fully integrated, customized experience in-line with modern customer expectations.

Players across the value chain include issuing banks, fintechs, super apps, start-ups, merchants, solution providers, among others, are all participants in the embedded-finance value chain.

In this paper, Visa Consulting & Analytics (VCA) outlines the emerging trends around embedded finance and the associated opportunities for financial institutions (FIs).

Three main players in the embedded finance value chain

Providers

Offer financial products and services through application programming interfaces (APIs)

Enablers

Interfaces the providers and distributors and provides software and regulatory support

Distributors

Operate the platforms where consumers choose to congregate and transact

In theory, embedded finance offers these three parties a win-win-win scenario: Providers benefit from the low-cost distribution channel; enablers tap into the growing trend for convenience and simplicity; distributors create better engagement on their platforms; and end-users gain instant access to contextualized financial services automatically and in one place.

Plotting the customer journey

The native customer journey on these non-banking platforms embeds financial services, as a value-add offering, ranging across payments, lending, banking, wealth and insurance. Embedded finance enhances the overall customer experience on these platforms, positioning financial services in a frictionless manner at the right step in the journey. Embedded finance tends to be most effective when it is offered earlier in the journey and is contextualized to the customer need.

Understanding the mechanics

Embedded finance is typically facilitated by a thin stack or a middle layer of software. This acts as a data enabling platform that uniquely offers infrastructure, domain expertise, industry licensing certifications, and ready integrations.

The platform could be a featured provider (specializing in one of the domains across payments, lending, etc.) or a full stack provider covering all manner of financial services. The embedded finance platform connects the financial services provider (e.g., an FI with Open API architecture) with the distributor (i.e., the non-banking channel) with a set of quick integrations. The financial services could be enriched with an open data exchange (e.g., an open banking interface) to bring additional value to the integration.

How embedded finance has evolved in recent years

Early versions of embedded finance typically appeared in high-ticket value transactions, such as an airline issuing credit cards or insurance, or a car dealership extending auto loans. Often, these journeys were fragmented, with the user being redirected from merchant's website to the bank's portal to complete the transaction. By contrast, embedded finance is today offering real-time frictionless digital experiences, such as BNPL in e-commerce platforms and account onboarding in a super app, and the financial journey can be completed within the non-banking platform with a few clicks.

Six examples of embedded finance

Embedded payments

In consumer payments, OEM wallets (wallets built by the device's original manufacturer), have enabled frictionless payments, both online and offline, using stored credentials. In B2B payments, payment enablers (a platform that allows businesses to issue cards and process payments) have simplified cross-border payables and receivables for business customers. Meanwhile, payment facilitators (a payment service provider for merchants) have streamlined merchant acceptance with quick onboarding, underwriting, and integrating diverse payment methods across different geographies.

Embedded lending

BNPL players have integrated installment solutions at the checkout across both online and offline channels. Similarly, SMBs have been able to access loans for working capital on accounting/ commerce platforms, facilitated by a balance sheet lender in the backend.

Embedded issuance

Enablers have offered card issuance capabilities and empower digital platforms (e.g., gig economy marketplaces), which, in turn, offer members of their ecosystem (e.g., gig workers) virtual cards that can be used for paying and receiving funds.

Embedded deposits

Several interesting models have emerged; for example, in a banking as a service (BaaS) partnership with BBVA and Green Dot, Uber provides tools for drivers to deposit, track, manage and move money. Meanwhile, Angel List, in partnership with Blue Ridge Bank, offers various financial products for start-ups to raise capital and to manage funds.

Embedded insurance

Online travel agents and airlines have played the role of a distributer by offering travel insurance at checkout when travelers book tickets.

Embedded wealth management

Super apps like Alipay have partnered with wealth providers like Vanguard to offer robo-advisory financial planning and mutual fund investment capabilities.

Three trends emerging in embedded finance

VCA has identified three key trends emerging around embedded finance, which have relevance in both the consumer and small- to medium-sized business (SMB) markets.

Trend #1

Payment solutions become more deeply embedded and integrated into the merchant ecosystem

Consumers become more willing to buy a product when payment options are deeply integrated into the infrastructure of the merchant ecosystem. In their purchasing journeys, they demand maximum personalization and minimum friction. And, in response, many retail brands have taken direct control of payment experiences.

For example, building on the popularity of its ride-hailing apps in Southeast Asia, Grab has developed its own in-house e-wallet solution, Grab Pay, which brings added convenience to customers and rewards them for making in-app payments.

Trend #2

The demand for unsecured embedded finance lending continues to grow

Merchants are working on point-of-sale financing solutions by partnering with financial institutions who offer via issuer brand or via their BaaS model with white label products. Customers can now access the instant credit options that are highly tailored to their requirements based on their transactional and other user data on the merchant app.[1] This is popular in emerging markets, where there is high demand for alternative and flexible lending solutions.

Trend #3

White-label embedded finance payment solutions gather momentum

For smaller merchants that may lack the internal resources or the budgets to develop their own embedded payment solutions, some third-party players (e.g., payment gateways, prepaid solution providers) offer white-label alternatives.

This trend is expected to continue, presenting an opportunity for traditional FIs to partner with third parties to provide bundled solutions. Instead of working with multiple payments and financial services partners, many online merchants now prefer to work with a single provider offering a portfolio of solutions. By developing partnerships with payment gateways, FIs can then provide a valuable white-label payment solution to online merchants, bundled with other more traditional solutions like offline payments acceptance.

1. Visa commissioned research for Embedded Finance by BCG Digital Ventures, Nov 2022

Unravelling the embedded finance value chain

Again, the embedded finance value chain generally has three players (the provider, the distributor, and the enabler). To understand opportunities in embedded finance, it is worth focusing on some of the details.

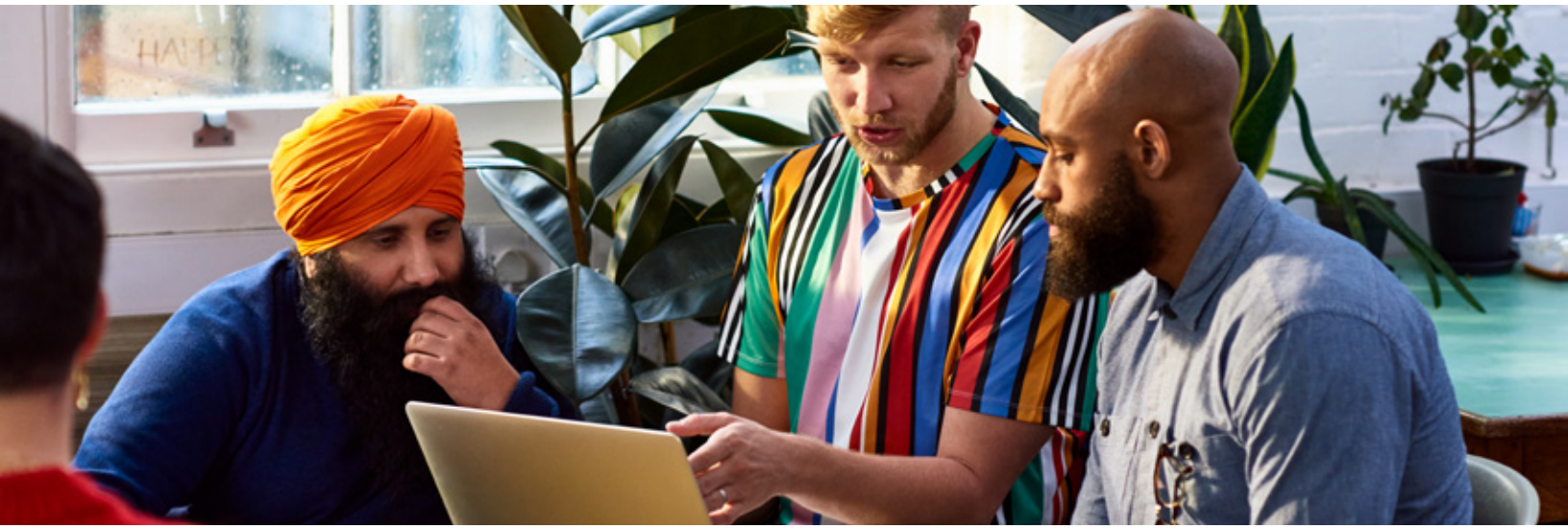
Player #1

The provider

The provider is a regulated financial institution that holds a license to provide financial services. It provides the financial products, operates the risk framework, enables access to the last-mile payment infrastructure, holds funds, and can service deposits.

Increasingly, FIs that want to be included in this space are redesigning their architectures, building an API exchange model, and driving data collaboration.

The embedded finance model gives them an opportunity to serve multiple customer segments, merchant platforms, and jurisdictions – via one integration.



Player #2

The distributor

The distributor is a non-financial distribution channel and provides the interface from which the financial products are offered to end users. Distributors can be classified as either platforms or Independent Software Vendors (ISVs).

Platforms examples:

Super apps which offer wealth management and personal financial management solutions – by partnering with specialist players.

E-commerce offer customers payment, banking, and lending features by either deploying a full-stack model or by playing as a thin-stack frontend provider.

Gig economy players provide their workers banking and insurance capabilities by partnering with external financial balance sheet providers in a full-stack model.

Independent Software Vendors (ISVs) examples:

ISVs examples play this role by offering niche solutions to meet the unique needs of a given industry. They offer diverse solutions to help a business throughout its lifecycle, such as setting up a new entity, managing payments across jurisdictions and payment methods, consumer loyalty and employee management, working capital, and inventory management, and taxation.

Functional specialists offer deep solutions in a particular domain such as invoicing, expense tracking, managing cash flows, customizing invoices, financial reporting, and inventory management.

Player #3

The enabler

The enabler is the middle layer that integrates across providers and offers a one-stop-shop to distributors. Typically, it will bring together a wide range of offerings across payments, insurance, lending, wealth management, issuing, and compliance. Examples include:

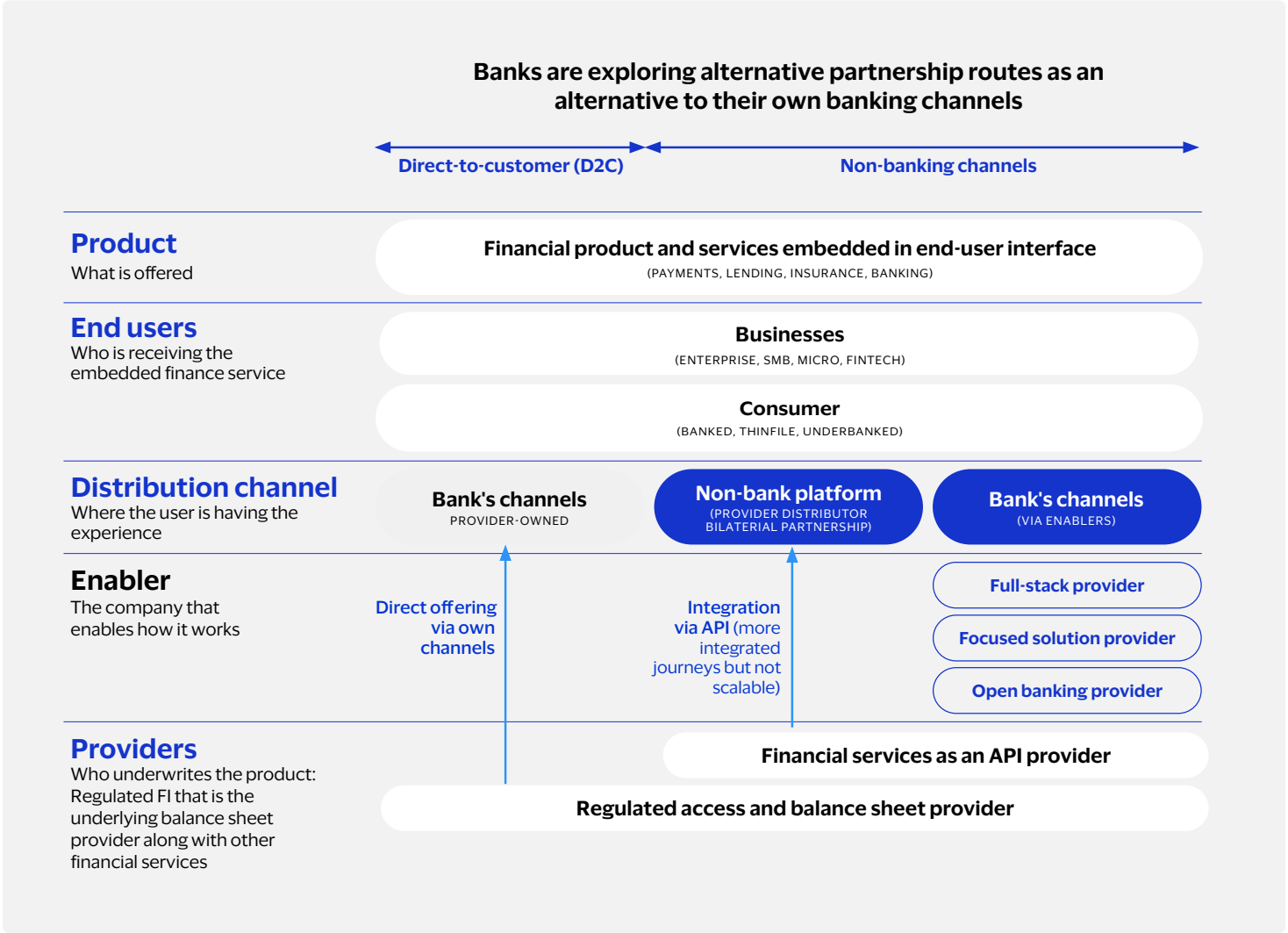
Full-stack enablers offer banking as a service (BaaS), which enable businesses to build their own financial products on the enabler's banking platform, such as savings or current accounts, integrated digital wallets, debit cards, and children's prepaid cards. The enabler handles the technical and regulatory demands behind the scenes, leaving the business to take care of its customers. The enabler's value offering includes regulatory approvals and protection, industry certifications and integrations, and easy onboarding with simple seamless API integration.

Focused enablers service SMBs and corporations by offering a focused banking offer like payments. In the face of payments, the enabler offers various infrastructure solutions like cross-border payments with local bank acceptance, accounts payable and receivable, and virtual accounts. They could also offer card issuance, and revenue/financial management features.

Open banking enablers offer data integration solutions. There are many use-cases where financial data is accessed by the enabler to improve service – such as seamless onboarding, affordability assessments, customer engagement solutions and, in some jurisdictions, embedded payments pulled directly from a bank account.

Financial service providers now have multiple routes to distribute their services

Figure 1: Embedded Finance Value Chain



Value created for players in the ecosystem

Figure 2: Value Proposition of Participant

End User

Users gain from access to financial services accross channels they frequently interact with, enjoying reduced cost and risk, and enhanced speed and transparency.

e.g., Consumers, businesses

Distribution Channel

Platforms gain from secondary source of revenue (e.g., referral fees), data and user ownership, as well as superior user stickiness and loyalty.

e.g., Market platforms, super apps and independent software providers

Enabler

Enablers access a new business model by establishing value exchange between FIs and distributors with integrations.

e.g., Solution providers - full-stack or focused, and open banking providers

Provider

Providers create an alternative distribution network, scale to new verticals/ segments, be cost-effective and go-to-market faster.

e.g., Banks, financial institutions

How embedded finance will evolve

The embedded finance space is set to grow, driven by a combination of emerging user expectations, progressive regulatory reforms, and commercial upsides for FIs.

Globally, embedded finance is expected to expand steadily over the coming years, with a compound annual growth rate of 23.9 percent, reaching US$776 billion by 2029.[2] Over this period, the consumer and commercial category revenues are projected to be split 30:70, with the commercial sector growing faster.[3]

Embedded finance will accelerate

Driven by evolving user expectations, an increasing public – private focus on financial inclusion, and strong supply-side economics benefitting FIs and merchants, we believe growth should quicken.

Also, regulators in many geographies are strong supporters of enabling solutions and frameworks like open banking.

Payments and lending will emerge as to use cases

The strong supply-side economics will be particularly apparent in payments and lending – leading to disproportionate growth for these use cases.

Regarding lending, FIs should retain more than half of the related revenues, simply by acting as balance sheet providers – yet the acquisition and distribution costs will be borne by other players in the value chain.[4]

Similarly, in payments, FIs should retain around a third of the related revenues – with a higher share available to players who enhance their customer experiences or carry additional risks.[4]

2. Fintech Futures, Global Embedded Finance Markets and Investment Opportunities Report, 2022: https://www.fintechfutures.com/techwire/global-embedded-finance-markets-and-investment-opportunities-report-2022-market-is-expected-to-grow-by-39-4-to-surpass-240-billion-in-2022-forecast-to-2029/
3. Visa Consulting & Analytics 2022-23
4. Visa commissioned research for Embedded Finance by BCG Digital Ventures, Nov 2022

Functional ISVs and platform players will help accelerate distribution

Based on their scale efficiencies, functional or horizontal, ISVs, such as those operating in the cloud-based accounting space, should outperform sector-specific players.

For FIs, this means that distribution of embedded finance can be accelerated across many industry verticals and that the distributors are likely to expand from a single service to a multi-service model.

Enablers will provide many-to-many networks

Increasingly, the enablers will become a one-stop-shop for providers and distributors alike which, in turn, will facilitate rapid embedded finance expansion.

They will therefore fulfill a key function in the embedded finance space – providing quick abstraction of financial services for FIs and faster, fuller integration for distributors.

FIs are set to benefit – but will need to adapt rapidly

To benefit from the true potential of embedded finance, FIs need to be technically and operationally ready, and establish partnerships with the right distributors and enablers.

Specifically, it will be necessary for FIs to redefine their channel or go-to-market strategy, become API-ready, and identify target partnerships. Necessary technical capabilities include data warehousing, API management, open banking, personalization, and data governance.

Partnering on next steps

For help addressing any of the questions raised in this paper, please reach out to your Visa Account Executive, who can schedule time with a VCA team member. They can also update you on the full range of embedded finance solutions and partnerships the wider Visa organization has been developing.

Alternatively, send an email to VCA@Visa.com or visit us at Visa.com/VCA

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About Visa Consulting & Analytics

We are a global team of 1000+ payments consultants, data scientists and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital and more with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics, and machine learning, with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

