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Guide to Next.

FINANCIAL SERVICES

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EMBEDDED FINANCE: UNLEASHING THE POTENTIAL FOR FUTURE GROWTH

Embedded Finance: Unleashing the Potential for Future Growth

EMBEDDED FINANCE (EF) HAS EMERGED AS A TRANSFORMATIVE TREND IN THE FINANCIAL SERVICES INDUSTRY OVER THE PAST FEW YEARS, WITH ITS MAINSTREAM ATTENTION SKYROCKETING IN THE LAST TWO YEARS.

By integrating financial services into non-financial platforms and experiences, embedded finance aims to redefine how we interact with money, payments, insurance and banking.

Embedded finance refers to the integration of financial services and products into non-financial platforms or applications, allowing customers to access financial services seamlessly within the context of their everyday activities. It essentially means bringing banking and financial services to where customers already are, rather than requiring them to visit traditional financial institutions (like 'Buy Now, Pay Later' (BNPL) services).

Traditional financial institutions and challengers have the power to provide consumers with a frictionless financial future. But how can banks seize this opportunity and create a clear strategy that reshapes customer experience and drives growth?

Key factors: The rise of embedded finance

The market opportunity for embedded finance is significant and has been rapidly growing in recent years. Here are some key factors contributing to its rise:

1. DIGITAL TRANSFORMATION

The increasing digitization of various industries, such as e-commerce, ride-sharing, food delivery and others, has created opportunities for embedding financial services. This is because digital transformation has lowered the costs of digital strategy integration, removing a traditional barrier to the embedding model. By integrating payment processing, lending, insurance and other financial services into these platforms, businesses can offer a more comprehensive and convenient experience to their customers.

2. ENHANCED CUSTOMER EXPERIENCE

Embedded finance simplifies financial transactions by eliminating the need for users to switch between different apps or platforms. It streamlines the process and provides a seamless experience within existing products and applications, increasing customer convenience and engagement. This leads to increased product sales, service usage and customer growth.

3. ACCESS TO NEW CUSTOMER SEGMENTS

Many non-financial companies, such as retailers, marketplaces and technology firms, have a large customer base and deep insights into consumer behavior. Integrating finance use cases through software, they can leverage this customer base and extend their reach into new segments, including underbanked or underserved populations.

4. MONETIZATION OPPORTUNITIES

There is potential for companies to generate additional revenue streams beyond their standard offerings. By partnering with financial institutions or leveraging fintech solutions, businesses can earn fees or commissions from transactions, lending, insurance or other financial activities conducted through their platform.

5. INNOVATION AND COMPETITION

Fintech startups have been disrupting the traditional financial services landscape by leveraging technology and offering user-centric solutions. Traditional industries can stay competitive by adopting similar strategies, leveraging fintech innovations and enhancing their value proposition.

6. REGULATORY ADVANCEMENTS

Governments and regulators have been adapting regulations to encourage innovation and competition in the financial sector. Open banking initiatives, which promote the sharing of customer data securely between financial institutions and third-party providers, enable the development of embedded finance ecosystems.

Embedded finance early entrants and macro impacts

In the initial wave of embedded finance propositions, non-bank players began to take the lead, showcasing varying levels of depth and focus in their offerings. Traditional banks have started launching individual embedded finance initiatives in select markets and products, while simultaneously exploring partnerships.

The potential of embedded finance in banking and insurance is yet to be realized. As more organizations look to digitally transform their offerings, a focus on integrated systems enabling financial products and services and honing on platform strategy will be a key focus in years to come.

Currently, **embedded finance use cases** predominantly revolve around payments, with "Buy Now, Pay Later" (BNPL) services gaining global recognition. Although alternative lending use cases are gaining traction, larger ecosystem plays are still in the early stages. Alternative lending technologies in the coming years will focus closely on data to develop a better understanding of consumers' financial health, which will help get loans approved faster.

Fintechs and banks are facing challenges in scaling with partners and ensuring the viability of their offerings. Scaling in a partnership-driven model has proven to be more complex than anticipated, leading to a reevaluation of strategies.

To stay competitive, there is an **opportunity for incumbents** to expand their presence through organic and inorganic capability building. Financial institutions should approach embedded finance by exploring new digital platform models, building partnerships to open distribution channels and embracing non-traditional revenue streams. This will provide the opportunity to introduce new product and service offerings (like digital wallets), retain and increase customer loyalty, gain access to a new customer base and increase revenue by providing additional financial services, such as lending and insurance.

Embedded finance capabilities needed for the future

In their pursuit of the “next” phase of embedded finance, financial institutions must focus on developing the following capabilities:

PROPOSITION DEVELOPMENT WITH PARTNERS

Moving beyond a traditional financial product mindset, banks should collaborate closely with partners to create blended propositions—ones that combine financial services with non-financial offerings. This customer-centric approach will unlock new value propositions and enhance the user experience.

PEOPLE AND OPERATING MODEL

Strengthening partner management and internal coordination capabilities is critical to surface banking capabilities effectively. Establishing a clear path to integrate Banking-as-a-Service (BaaS) capabilities into the existing infrastructure is also necessary, enabling seamless coordination between embedded finance and core banking functions.

TECHNOLOGY

To ensure readiness for BaaS integration and future scalability, incumbents should transition toward decoupled, modern architecture that can scale. This architecture should be flexible, interoperable and aligned with broader technology modernization efforts within the financial institution. This will empower financial institutions to adapt to evolving customer expectations while efficiently supporting a network of BaaS partners profitably.

Embedded finance: Seizing the opportunity

The market opportunity for embedded finance is vast, with the potential to impact multiple sectors. It ranges from small businesses integrating payment processing to large platforms offering a full suite of financial services. The size of the opportunity can be seen in the valuation of companies operating in this space, as well as the investments and partnerships being formed between fintech startups, established financial institutions and non-financial companies.

Overall, embedded finance represents a powerful trend that enables businesses to enhance customer experiences, drive revenue growth and reach new market segments by seamlessly integrating financial services into their existing platforms or applications.

To capitalize on the potential of embedded finance, incumbents must focus on key areas to differentiate themselves and scale effectively. There is a **clear roadmap for banks** to seize this opportunity:

1 DEFINE THEIR TARGET MARKET.

This is both in terms of partners and customers, to identify opportunities for differentiation and scalability. This will enable financial institutions to align their efforts and resources toward developing compelling embedded finance propositions.

2 THINK HARD ABOUT VIABILITY.

Banks must carefully evaluate the effort required to open up their capabilities and scale effectively with partners. This assessment should take into account the potential ROI and the overall sustainability of embedded finance initiatives.

3 BUILD A COMPREHENSIVE CAPABILITY STRATEGY.

Banks should identify which parts of their technology stack and operating model are ready for BaaS integration and determine areas that require strengthening through internal development, partnerships or acquisitions. The goal is to create a robust and adaptable infrastructure that aligns with the broader financial institution's system modernization efforts.

Next starts now.

Embedded finance holds tremendous potential for reshaping the financial services landscape, offering innovative customer experiences and unlocking new revenue streams. We believe that those who are early to market stand a better chance of succeeding. Publicis Sapient can help financial institutions drive successful adoption and build modern architecture to pave the way for a future where financial services are seamlessly integrated into our everyday lives.

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