

# Strategic Reflections on FinTech, BaaS and Embedded Finance

Dr. Angel Gavieiro

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*“We cannot solve our problems with the same thinking we used when we created them” (Albert Einstein)*

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## *Disruption is moving from FinTech via BaaS to Embedded Finance*

### **Context – Financial Services Industry Disruption**

- Over the last 10 years, the banking industry has experienced a plethora of disruption, initially driven by Vertical FinTechs and Neobanks, some of them launched by incumbents
- Vertical FinTechs, Banks and Neobanks, facilitated by Open Banking Enablers, have evolved into different aggregations

### **Payments & Data Innovation**

- Speed & data infrastructure innovation forces banks to drastically update legacy payment engines and core banking systems
- PSD2 and Open Banking mean an end to banks' monopoly on data, opening access to authorised 3rd party service providers
- The competitive landscape to capture 'End user' payments has developed from BaaS / BaaP offerings to Marketplace Digital Banks, reaching a cusp of digital product integration
- As a result, payment product is rapidly evolving both for B2C and B2B: in the short term, from 'Traditional Pay', 'Fast Pay' to 'Easy Pay', in the not so distant future to fully 'Invisible Pay'

### **Embedded Finance**

- BaaS/Open Banking become the enablers of Embedded Finance, within corporate brands' curated experiences, in a 'next horizon' for B2B2C and later also for B2B2B
- Embedded Finance could reach, conservatively, \$1 Tr. revenue pool by 2030 between Europe and the US
- Consumers are willing to use financial services from retailers' online stores and willing to share financial information in pursuit of a better offer
- Corporates are willing to use open banking ecosystems to gain innovative services and reach more clients and partners
- Embedded Finance will develop along the continuum of Value-added Services, financial and non-financial, with a different mix of focus between large vs small/medium businesses...
- ... but it requires a profound 'mindset shift' from Traditional Financial Services

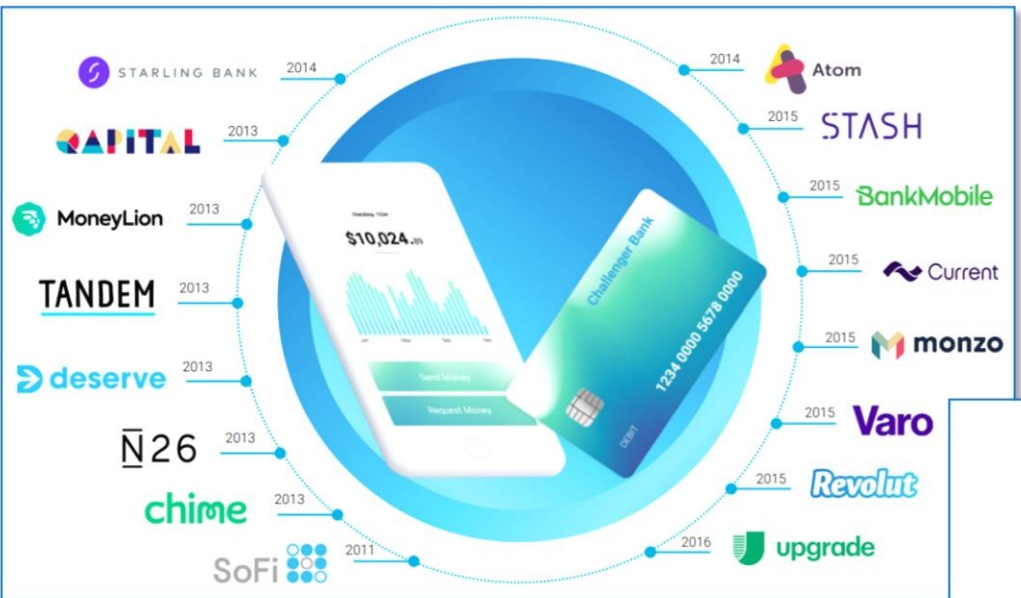
## AGENDA

- **Context: Financial Services Industry Disruption**
- Payments & Data Innovation
- Embedded Finance

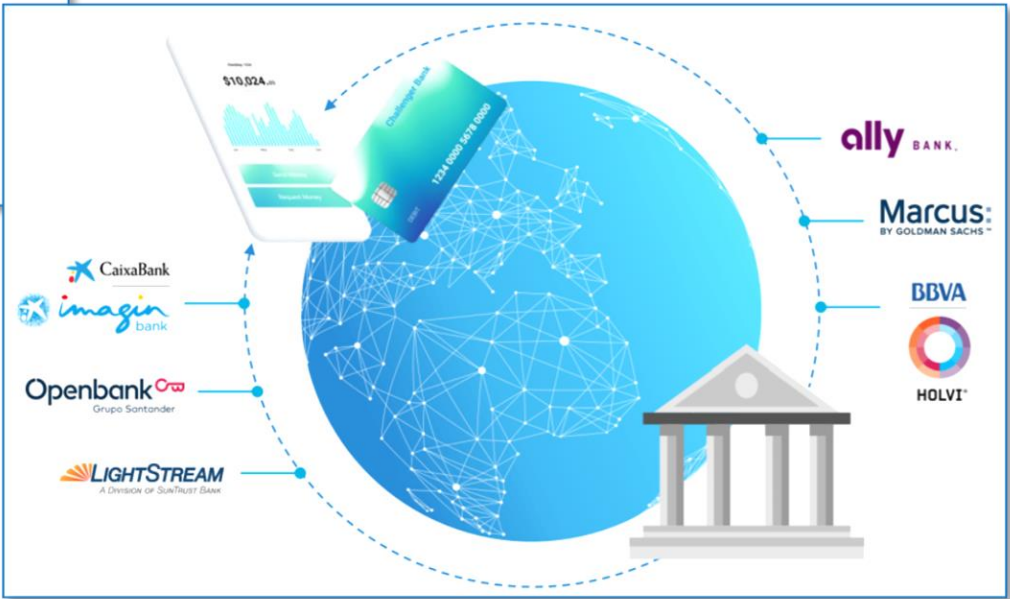
# CONTEXT – FINANCIAL SERVICES INDUSTRY DISRUPTION (1/2)

Over the last 10 years, the banking industry has experienced a plethora of disruption, initially driven by Vertical FinTechs and Neobanks, some of them launched by incumbents

## Vertical FinTechs and Neobanks



## Neobanks by Incumbent Banks



Sources: "The Rise of the Challenger Banks" (FT Partners; Jan.20); own analysis



# CONTEXT – FINANCIAL SERVICES INDUSTRY DISRUPTION (2/2)

## Vertical FinTechs, Banks and Neobanks, facilitated by Open Banking Enablers, have evolved into different aggregations

Strength
Neutral
Weakness
Enabler

**2 Incumbent Banks**

- **Large Banks:** “own” the customer; banking license; brand; **huge legacy non-digital platform; cumbersome culture**
- **Challenger Banks:** “attractive” to customers; banking license; gaining trust; **newer non-digital platform; nimble size & culture**

**1 Vertical FinTechs**

- Monoline product proposition
- Full digital business models
- Very agile culture
- “Early-adopter” customers
- **Expensive customer acquisition, difficult to scale**
- **No banking license (i.e. no deposits)**

- 1. Bank-FinTech / FinTech-FinTech Partnership**
  - Alliance-based, revenue-oriented association
- 2. FinTech Platforms**
  - Large FinTechs expanding its own product range
- 3. Mobile/Online-only Marketplace Digital Bank**
  - Banking license, own C/As, 3<sup>rd</sup>-party FinTech for other products
- 4. Mobile/Online-only Digital Bank**
  - Banking license, own branded products

**3 Neobanks**

- Multiproduct propositions
- Full digital business models
- Very agile culture
- Banking license (i.e. deposits)
- “Early-adopter” customers
- **Easier customer acquisition via single interface**
- **Expensive customer acquisition, difficult to scale**

**4 Open Banking Enablers**

- **Open APIs:** **interconnecting software** (i.e. PSD2 for payments)
- **Cloud:** **ubiquitous access to data** (i.e. AWS, Microsoft Azure)
- **BaaS (Banking as a Service):** **private/white-label banking software solutions** (i.e. The Bankcorp, Matchmove...)
- **BaaP (Banking as a Platform):** **supports other FinTechs with open APIs and BaaS, plus banking license** (i.e. Solarisbank)



## AGENDA

- Context: Financial Services Industry Disruption

- **Payments & Data Innovation**

- Embedded Finance



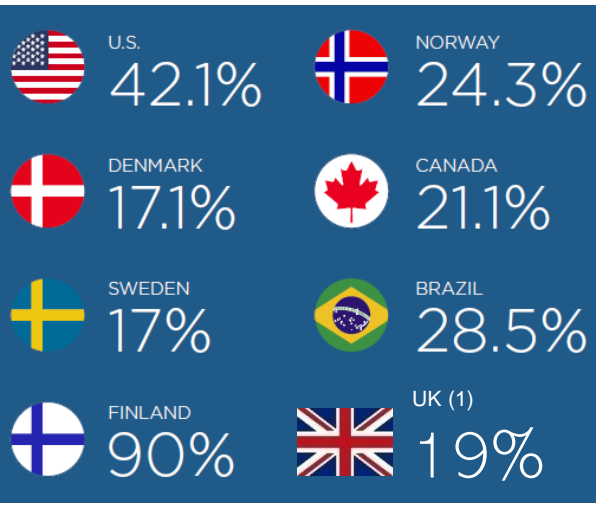
**PAYMENTS & DATA INNOVATION – CORE INFRASTRUCTURE (1/4)**

**Speed & data infrastructure innovation forces banks to drastically update legacy payment engines and core banking systems**

**Legacy Core Banking & Payment Infrastructure - Main Challenges**

- Legacy payment engine
  - &
  - Decades-old core banking system
- 
- Higher faster payments volumes create serious strain
  - Higher volume increases costs from expensive contracts of core systems
  - No 24/7/365
  - Cannot process all relevant standards (e.g. ISO 8583 for UK Faster Payments)
  - Need to adapt to include ISO 20022 by deadline (Nov.22)

**Domestic Faster Payments (eCAGR, %)**



**SWIFT gpi (\$77Tr, +75% 2018-19)**

SWIFT provides a secure network that allows for more than 10,000 financial institutions around the world to send and receive information and financial messages. SWIFT is a key player in payments modernization, and SWIFT gpi – or the “Global Payment Innovation” – aims to improve how cross-border transactions are handled to make payments quicker, more transparent and more traceable.

**New Payments Architecture (NPA) (Arriving in 2024)<sup>2</sup>**

Pay.UK’s 24/7 Real Time clearing system for low value payments to substitute BACS and Faster Payments

**ISO 20022 (Arriving in Nov. 2022)**

ISO 20022 is a standard for electronic data interchange that facilitates the fast, standardized and secure exchange of financial messages across borders. ISO 20022 messages are data-rich, providing granular detail useful both for regulatory compliance and value-added services.

At present, many banks with an IP capability have it set up as a distinct part of their operation – complete with its own targets, stakeholders and budget owners. The message standardization provided by ISO 20022 provides good reason to change that, creating more convergence between schemes and systems.

1. 2019-18 growth; 2. Refer to Appendix 3  
Sources: “Real-Time Payments Modernization” (ACI Universal Payments; 2020); own analysis

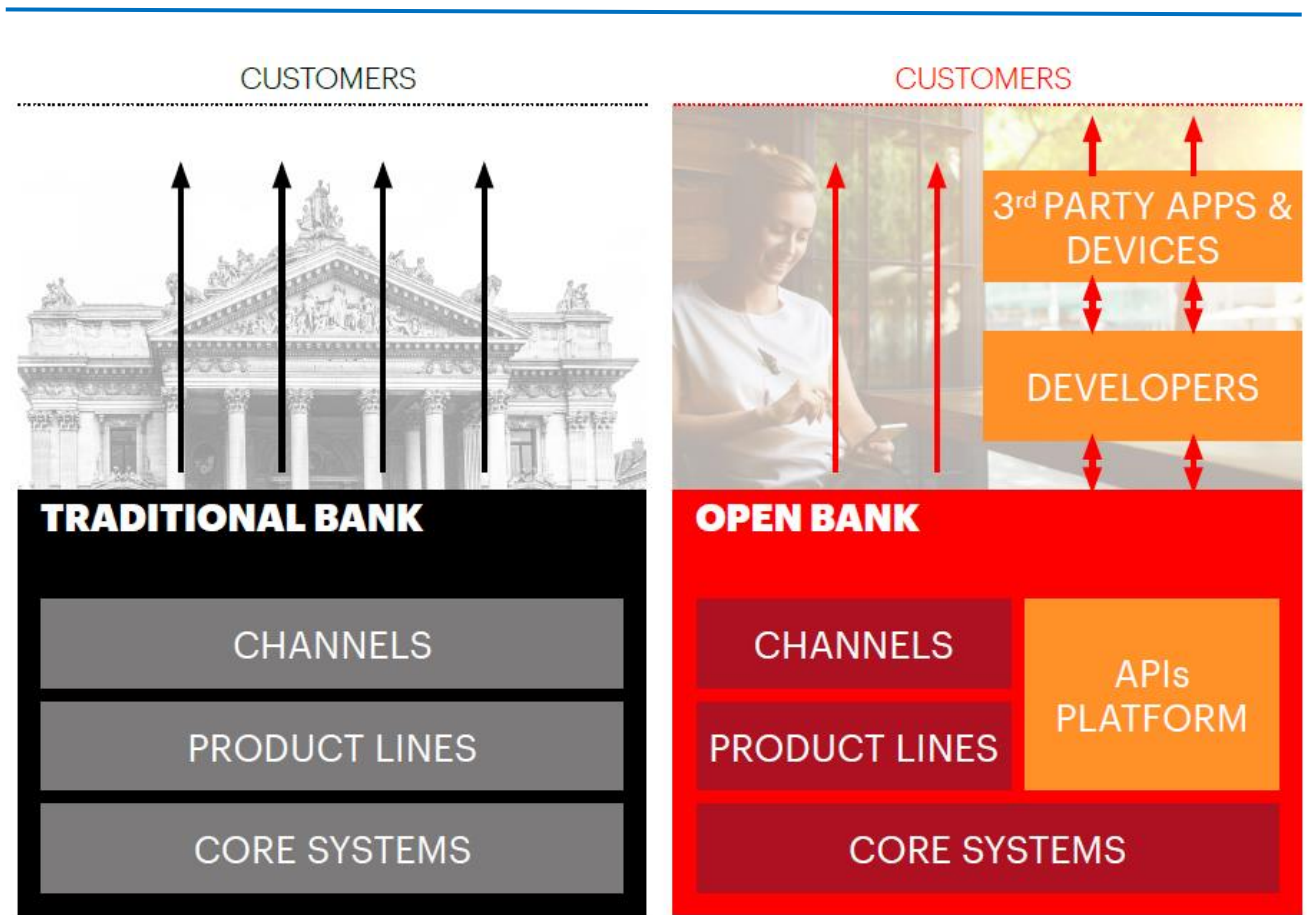


# PAYMENTS & DATA INNOVATION – OPEN BANKING REGULATION (2/4)

## PSD2 and Open Banking mean an end to banks' monopoly on data, opening access to authorised 3<sup>rd</sup> party service providers

- **Payment Service Directive 2 (PSD2)** became effective in the UK and EU in Jan.2018, forcing traditional banks to provide access to authorised 3<sup>rd</sup> parties to their customers data and/or to instruct payments on customers' behalf
- **Open Banking** is enabled by the banks' development of **Application Programming Interface (APIs)** software for the usage of 3<sup>rd</sup> party developers

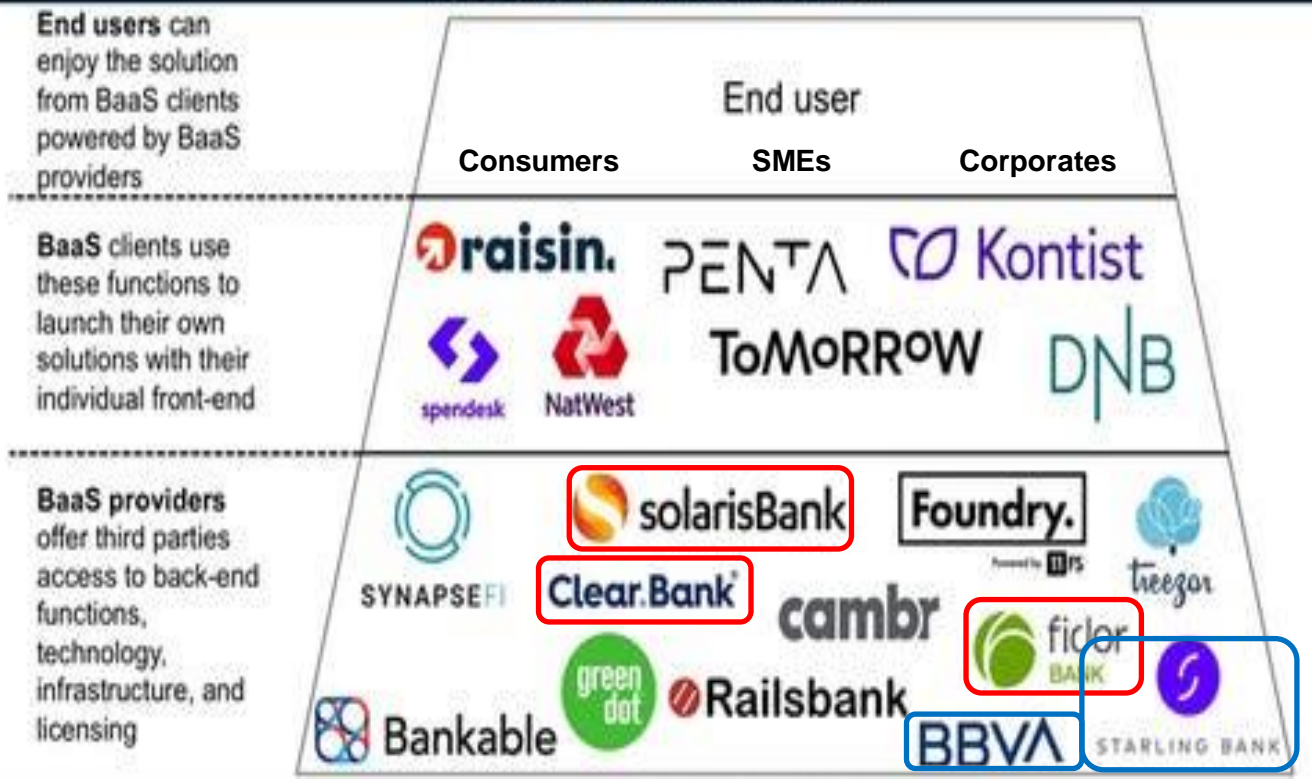
### From Traditional Bank to Open Bank



The competitive landscape to capture ‘End user’ payments has developed from BaaS / BaaP offerings to Marketplace Digital Banks, reaching a cusp of digital product integration

B2B2C Payments - Competitive Landscape

THE BAAS ECOSYSTEM

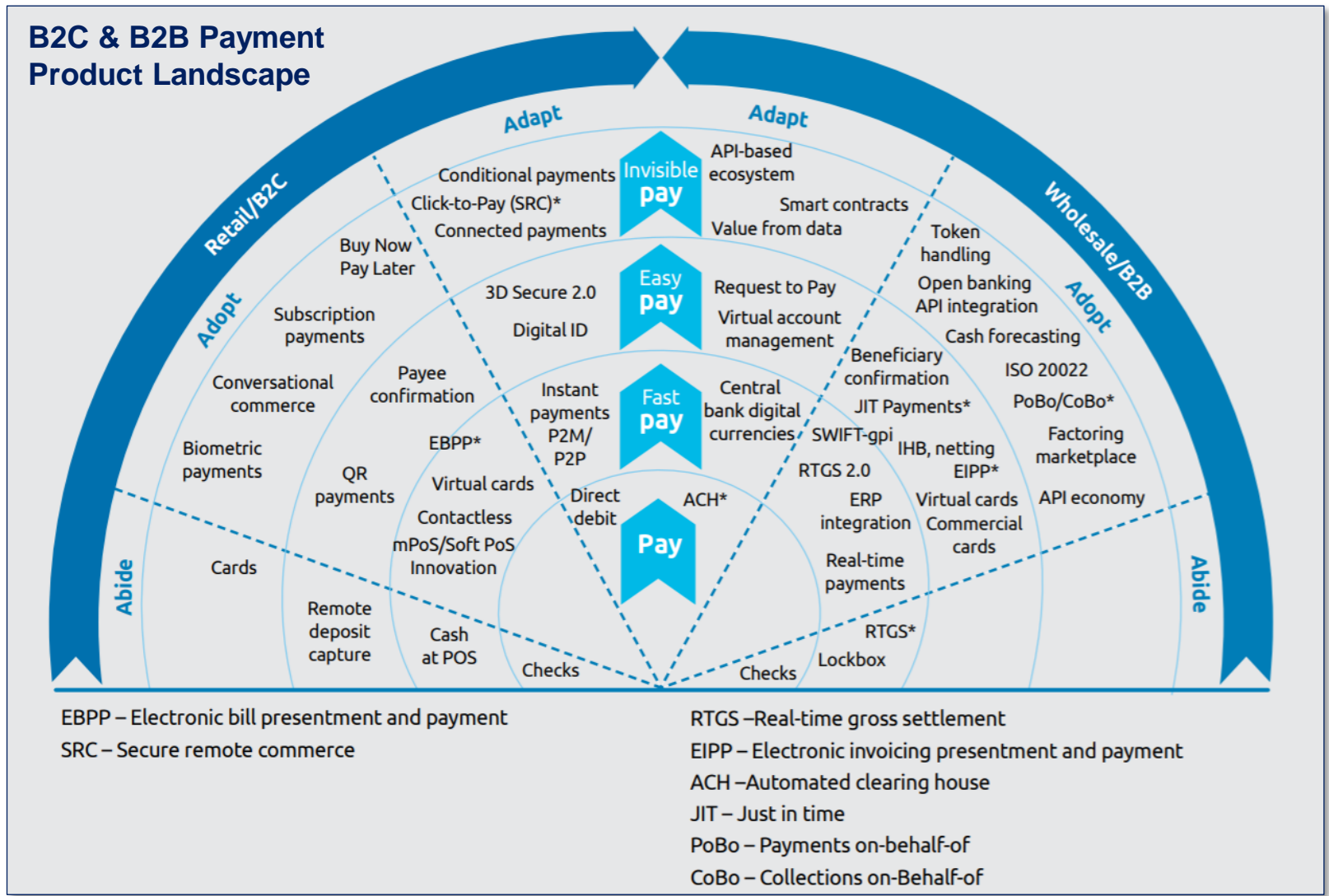


  **Banking as a Platform (BaaP):** BaaS with banking license       **Marketplace Digital Bank:** BaaP partnering with 3<sup>rd</sup> party FinTechs to offer their financial products

- **BaaS clients** own the ‘End user’ relationship and focus on the upstream open banking overlay services, while BaaS providers focus on the downstream digital platform
- **BaaS/BaaP providers** do not compete with BaaS clients for the ‘End user’ relationship
- **Marketplace Digital Banks** are BaaP providers to BaaS clients, but they as well compete for the ‘End user’ with own and 3<sup>rd</sup> party financial products

PAYMENTS & DATA INNOVATION – FUTURE OF B2C & B2B PAYMENTS (4/4)

As a result, payment product is rapidly evolving both for B2C and B2B: in the short term, from ‘Traditional Pay’, ‘Fast Pay’ to ‘Easy Pay’, in the not so distant future to fully ‘Invisible Pay’



Sources: “Global Payments Report 2020” (CapGemini; Sep.20); own analysis



## AGENDA

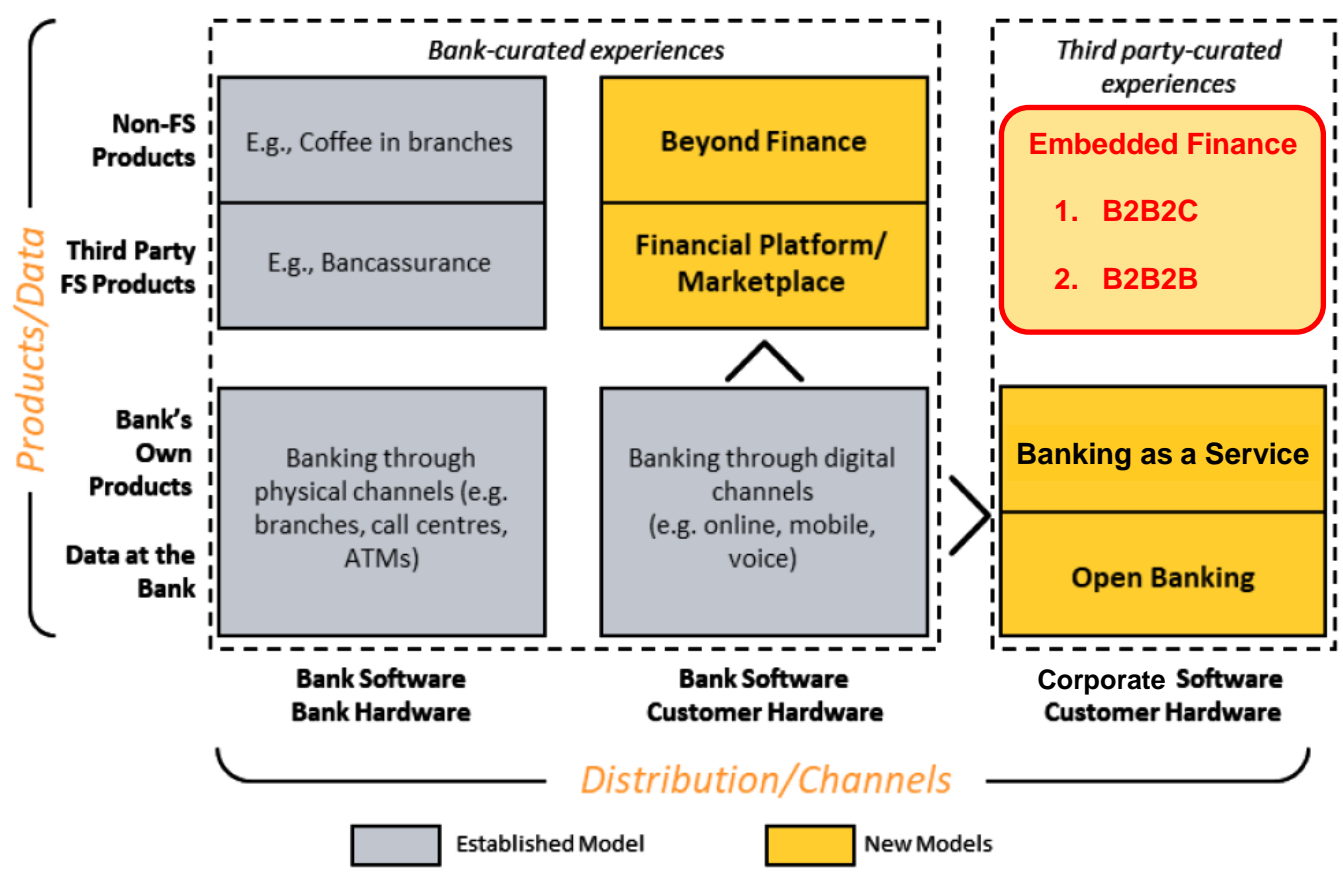
- Context: Financial Services Industry Disruption
- Payments & Data Innovation
- **Embedded Finance**



EMBEDDED FINANCE – THE ‘ULTIMATE GAME’ (1/6)

BaaS/Open Banking become the enablers of Embedded Finance, within corporate brands’ curated experiences, in a ‘next horizon’ for B2B2C and later also for B2B2B

Financial Services – Established vs New Models



‘Next Horizon’ Opportunity: B2B2C Embedded Finance

- 1. Embedded Finance** could reach, conservatively, \$1 Tr. revenue pool by 2030 between Europe and the US
- 2. Consumers** are willing to use financial services from retailers’ online stores and willing to share financial information in pursuit of a better offer
- 3. Corporates** are willing to use an open banking ecosystem to gain innovative banking services, and to reach more clients and partners
- 4. Value-added Services** will develop along the continuum of FS & non-FS products with a different mix of focus between large companies vs SMEs
- 5. Mindset shift** is the key success factor in Embedded Finance

Source: Celent

Note: Customer’s Hardware (i.e. mobile, laptop); Corporate’s Software (i.e. e-commerce or mobile portal)  
 Sources: “Demystifying Embedded Finance: Promise and Peril for Banks and Processors” (Openway and Celent; Apr. 21); own analysis

① EMBEDDED FINANCE – THE PRIZE (2/6)

**Embedded Finance could reach, conservatively, \$1 Tr. revenue pool by 2030 between Europe and the US**

**Embedded Finance – Europe**

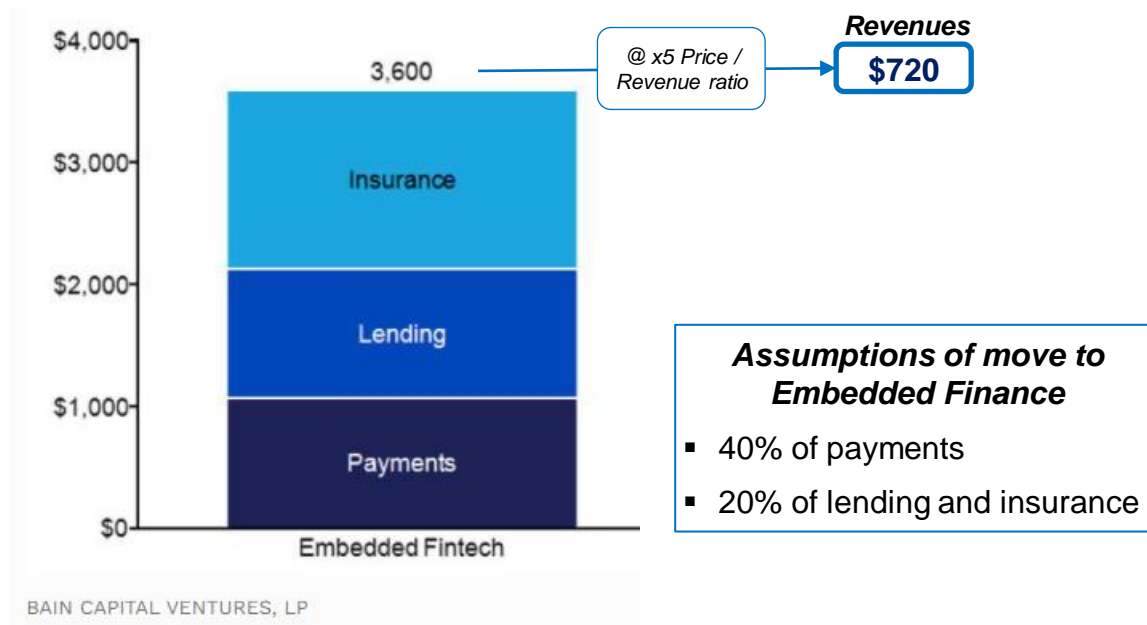
**Revenues & Growth (€bn; e2025)**

	2020	2025	CAGR in %
Wealth Management	0	2.6	-
Consumer loans	1.4	15.7	62
Insurance	5	70.7	62
Payment services	16.1	140.8	54
	<b>€22.5</b>	<b>€227.8</b>	<b>59</b>

Source: Lightyear Capital

**Embedded Finance – US**

**Market Cap. & Revenues (\$bn; e2030)**



② EMBEDDED FINANCE – CONSUMERS’ DRIVERS (3/6)

**Consumers are willing to use financial services from retailers’ online stores and willing to share financial information in pursuit of a better offer**

**Survey – German Market<sup>1</sup>**

“Would you use one or more of the listed banking/ payment products from the online stores of the following companies?”, in %

Yes, current account



Amazon Lidl dm

Yes, credit card



Amazon Mediamarkt Ikea

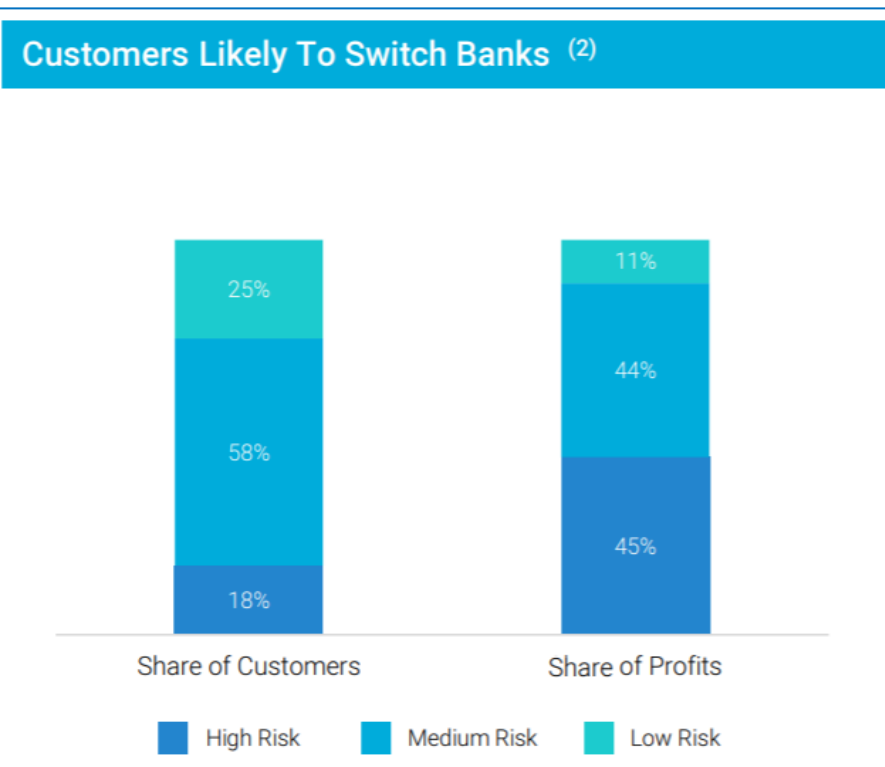
Yes, installments



Otto Mediamarkt Ikea

**Survey – UK Market<sup>3</sup>**

**63% of customers with current account were willing to share financial information with a competing bank, FinTech company or aggregator in pursuit of a better offer**



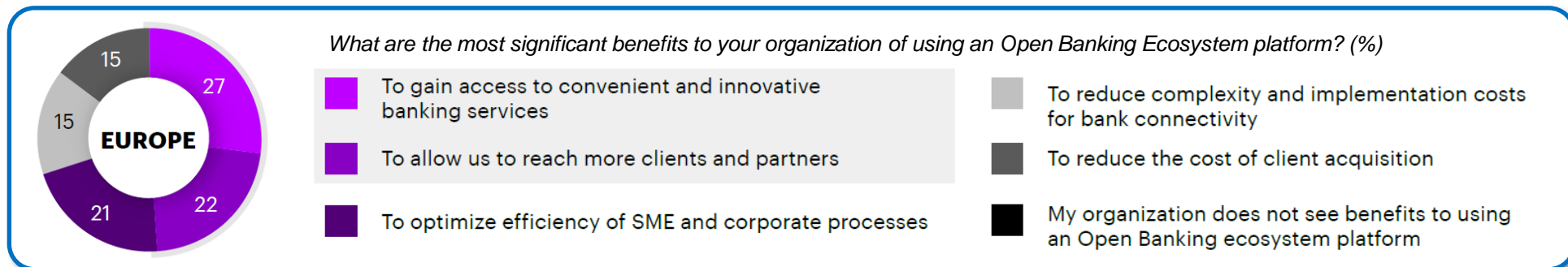
- “High Risk” group characterized to be younger than 55 years of age with annual household income above £55k

1. SolarisBank (survey by YouGov Deutschland: N=2,039 people, online stores=21, Feb.21; 2. NPS benchmarks; 3. Bain & Co (by Salesforce and Matriz/CX: N=+4,000 customers) Sources: “When Brands Become Banks” (SolarisBank and Handelsblatt Research Institute; Dec.21); “The Rise of the Challenger Banks” (FT Partners; Jan.20); own analysis

3 EMBEDDED FINANCE – CORPORATES’ DRIVERS (4/6)

# Corporates are willing to use open banking ecosystems to gain innovative services and reach more clients and partners

## Open Banking Business Survey<sup>1</sup>



### Large Corporates vs SMEs Preferences

Open Banking preferences	Large Corporates	SMEs
Prefer joining Open Banking with banks	72%	65%
Prefer joining Open Banking with our bank	69%	60%
Top-3 areas to improve with Open Banking	Finance (24%) Payments (22%) Treas. mgt. (18%)	Payments (25%) Cash mgt. (21%) Finance (18%)
Satisfied with current ERP for bkg./payments	51%	39%

- 1 Create a 360-view of the client**
  - Richer insight based on bank account aggregation, leveraging it to enhance credit scoring & pricing
- 2 Monetize APIs via revenue-sharing Ecosystems**
  - Look for network scale and mutual cross-selling by partnering with ERP providers and FinTechs for joint offering via: channel (e.g. CitiConnect), product (e.g. Bunq’s volumetric-priced SEPA payments) or data (e.g. Sterling Bank’s marketplace)
- 3 Leverage BaaS**
  - SMEs: use data to anticipate needs bringing the right offer from service providers (e.g. Xero)
  - Large Corps.: partner with their ERP to bring bespoke bkg. solutions to specific needs

Note: Open Banking is a proxy for BaaS / Embedded Finance (ref. next page for a holistic framework)

1. Accenture (global survey: N=660, 50:50 Large Corporations vs SMEs; Europe: UK, France, Germany, Italy, Sweden and Austria; 2018)

Sources: “It’s Now Open Banking” (Accenture; 2018); own analysis



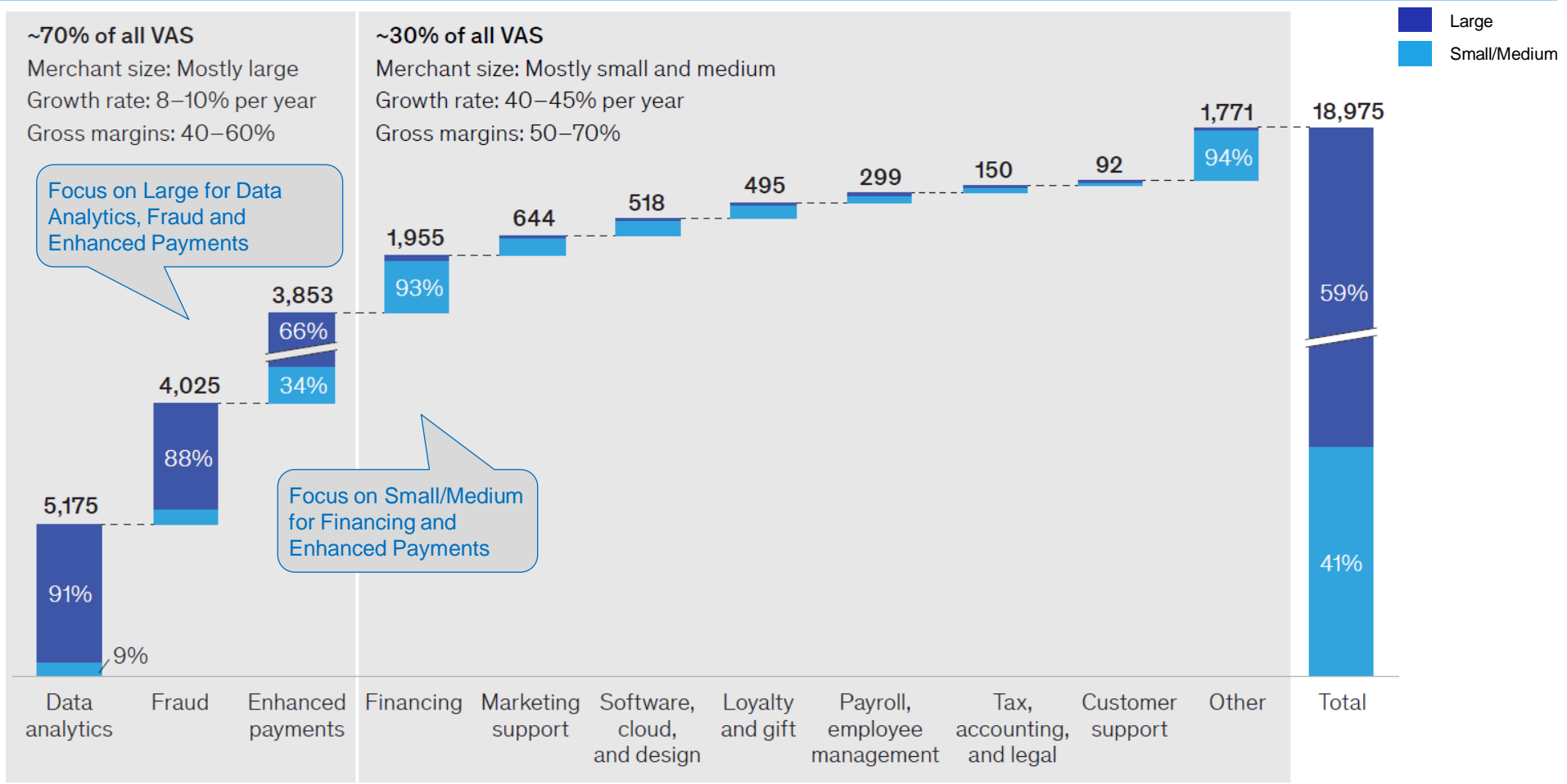


4 EMBEDDED FINANCE – VALUE-ADDED SERVICES (5/6)

**Embedded Finance will develop along the continuum of Value-added Services, financial and non-financial, with a different mix of focus between large vs small/medium businesses,...**

EXAMPLE

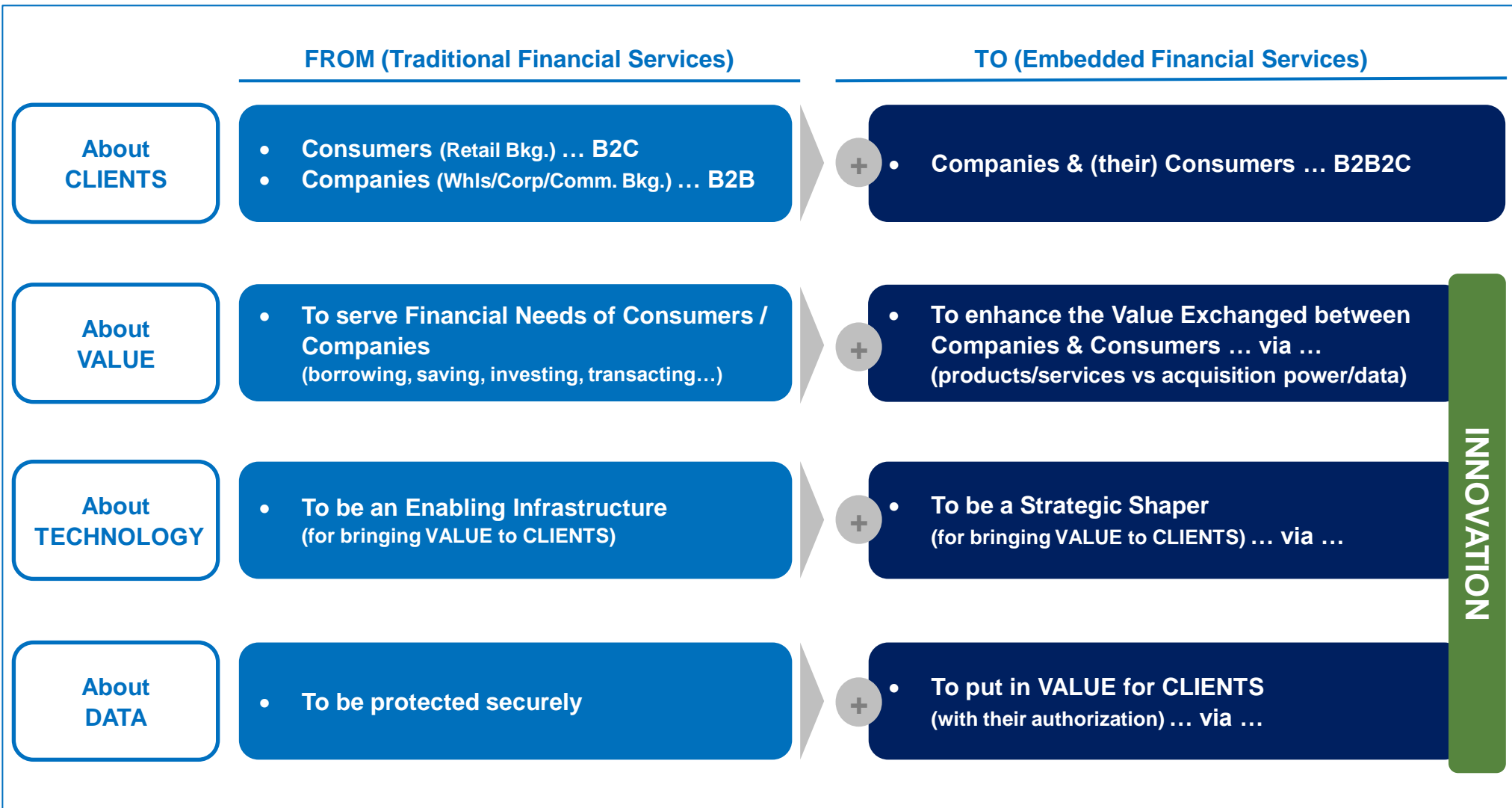
**Value-added Services (VAS) Revenues – Merchant Service Providers (2019; \$m)**



Sources: "The 2020 McKinsey Global Payments Report" (McKinsey & Co; Oct.2020); own analysis

5 EMBEDDED FINANCE – MINDSET SHIFT (6/6)

... but it requires a profound ‘mindset shift’ from Traditional Financial Services



INNOVATION



## CONTACT



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**UK            +44 (0) 777 5544 818**  
**[angel.gavieiro@ag-strategy.com](mailto:angel.gavieiro@ag-strategy.com)**

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