Visa Insights

Why embedded finance is an untapped opportunity

Introduction

The UK credit market has been changing rapidly over the last few years. This has been driven by three key megatrends: changing consumer expectations, the growing popularity of instalment payments, and technological advancements that enable hyper-personalised credit offers. There is increased demand for enhanced credit propositions and experiences.

This e-guide explores these megatrends in detail, looking at their impact on the payments landscape. Also included is Visa's perspective on how financial institutions can respond effectively.

Embedded finance is a strategy that is increasingly becoming part of the customer journey.

Find out why we feel it helps respond to rising customer expectations and the demand for personalised, innovative credit options.

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The credit market is evolving, and evolving fast

The combination of improved technology, digital adoption, and consumer expectations is driving significant change across all industries. Retail and financial services are no exception.

While demand for credit will remain, innovative user experiences will change how consumers access and consume it.

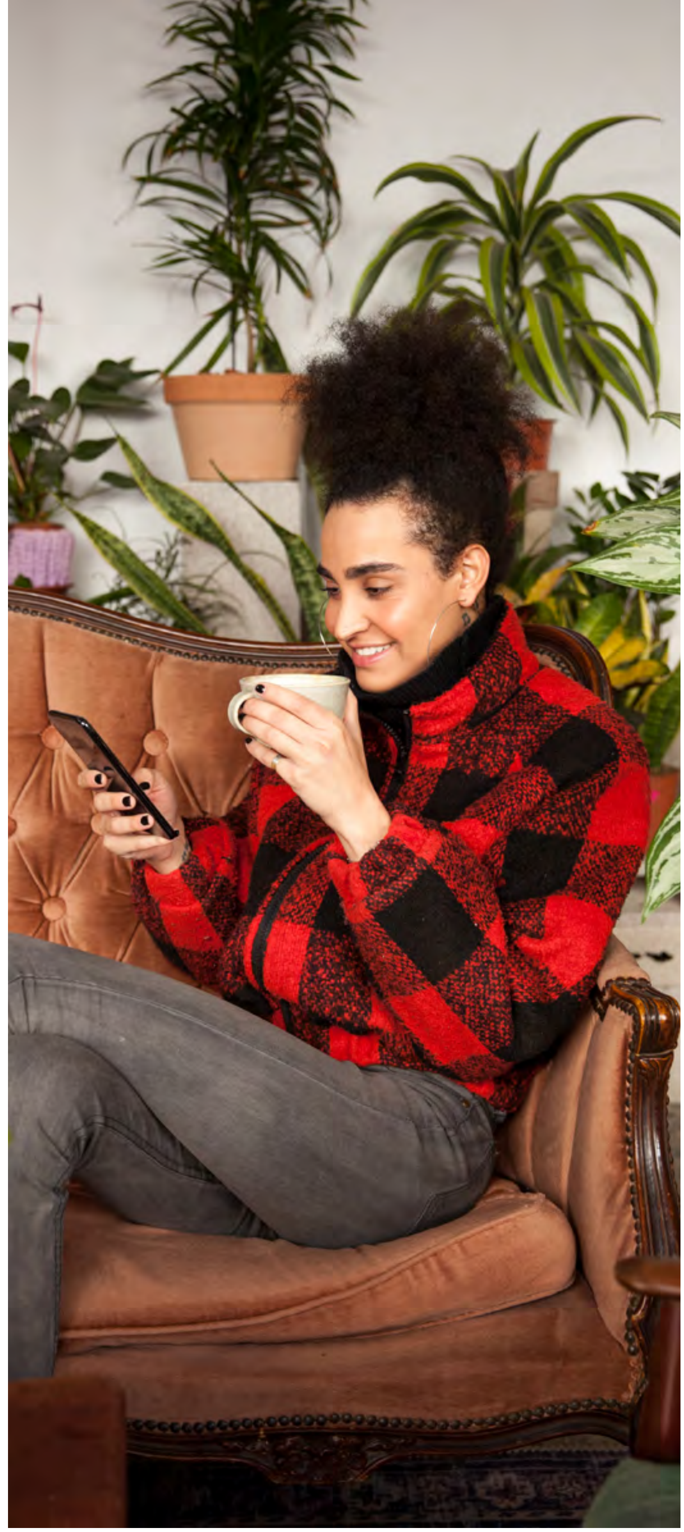
Gen-Z and millenials are increasingly preferring Buy Now, Pay Later (BNPL) solutions, citing better control over budgets (compared to revolving credit) as the reason.

As a result, we have seen a **149%** YoY increase in BNPL repayments (2021 vs. 2020)[1]

Over the next few years, we believe embedded finance solutions at the point of sale (e.g., BNPL) will drive credit growth across the UK.

In 2020, the embedded finance market generated sales revenues of $22.5bn in the US alone, a total that's forecast to increase over tenfold in the next four years.[2]

In other words, by 2026, the market could be worth upwards of $230bn![3]



Whether you're an issuer or fintech, merchant, acquirer, or enabler, the growth benefits offered by embedded finance are significant and many are already using it successfully!

1. RFI The Global state of BNPL March 22, 2. Market value of the embedded finance sector in the United States in 2020, with a forcast for 2025, Statistica, 2022, 3. 2022 Retail Banking Monitor: Repositioning for embedded finance, PwC, 2022

Market trends and drivers

Our research highlights three market trends, each impacting merchants and credit providers differently.

1
Consumer expectations are changing

2
Instalments - an innovative credit option

3
Technology is enabling hyper-personalisation

In addition, merchants face the combined challenge of increased fraud and higher overhead costs, both of which are driving them to think differently about their solutions.

We'll explore each trend in detail in the coming pages and show how they make a compelling case for embedded finance.

1 Consumer expectations are changing

The shift to digital is a well-established trend that's been accelerated by the pandemic

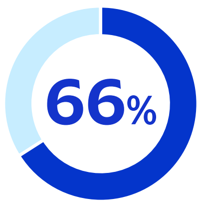
>4x

more connected devices in Europe than population by 2023[4]

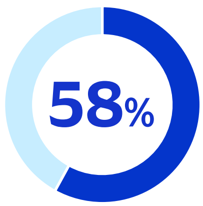
60%

of e-commerce sales are made on a mobile device[5]

Consumers want transparent, flexible, and affordable options when paying for goods and services



of consumers expect companies to understand their unique needs and expectations[6]



of consumers in digital journeys say they will use new payment methods such as BNPL[7]

To satisfy consumer demand, credit providers must improve their value proposition and invest in an end-to-end digital user experience.

Consumers expect personalised payment services that enable them to pay in a way that best suits their individual circumstances.

4. Cisco Annual Internet Report (2018-2023) White Paper, Cisco, 2020, 5. Mobile commerce in the United Kingdom - statistics & facts, Statista, 2022, 6. What Are Customer Expectations, and How Have They Changed?, Salesforce, 7. Visa Connect, October 2020,C-Space online community for Visa: All market quant survey (UK, Poland, France, Germany,Italy) n=1500(300 per market)'I will continue using alternative payment methods more' (1-5agree rating)

2 Instalments - an innovative credit option

Credit is evolving, especially in e-commerce

With the increased cost of living, consumers are adjusting their lifestyles and spending habits. They're also demanding more transparent, flexible, and affordable options when paying for goods and services.

UK consumer price inflation rose to **10.7%** in November 2022, the highest in four decades[8]

UK consumers borrowed an extra **£1.8bn** in credit in June 2022[9]

Paying by instalments has risen in popularity

Instalments are leading the way in both digital and physical retail environments. Indeed, many now prefer BNPL over traditional forms of credit.

70% of BNPL users are paying this way more often due to the cost of living crisis[10]

Use of BNPL **doubled** from 21Q1 to 22Q1, with **40%** of this growth driven by those aged 18-34[11]

"I know exactly what I'm due to pay each month, and by what date, and usually it's my pay day exactly my pay day, because that's how I've set it up."

Male, early 30s, UK*

However, while this growth is bringing significant benefits for merchants and consumers, BNPL is not yet widely regulated.

Due to its rapid growth and potential for financial exclusion, the FCA is expected to regulate all short-term agreements, including BNPL, by 2024.[12] Credit decisioning must be unbiased and transparent to end consumers. This expectation is translating into a need for banks to play a fuller role in meeting society's financial needs.

* Participant in BNPL: Exploring consumers behavior in UK & I, October 2021 by C Space Market research agency

8. Consumer price inflation, Office of National Statistics, 2022, 9. Money and Credit, Bank of England, 2022, 10. Buy Now Pay Later Usage Soars As Cost-Of-Living Crisis Bites, Forbes, 2022, 11. Buy Now Pay Later Improves Sales for Two Thirds of UK Retailers, RFI Global, 2022, 12. Watchdog 'cherry-picking' buy-now pay-later rules, fintech groups claim, Cityam, 2022

3 Technology is driving hyper-personalisation

Advanced models and data sharing are enabling hyper-personalisation

Technology is bringing to life new consumer experiences. New advancements in machine learning and AI, coupled with open access data sharing such as open banking, has been key in enabling high-quality, instant, hyper-personalised credit offers.

Key market players are realising the many benefits of this, including:

- Up to **40%** improved efficiency through using advanced credit models[13]
- **30%** decrease in credit losses through using precise consumer 'likeness' in credit modelling[14]
- Up to **15%** increase in revenue from higher acceptance rates[14]

Reduced barriers to entry mean more players can compete

The introduction of open banking has enabled fintechs and non-financial players to enter the market at pace, driving increased innovation.

New entrants are taking advantage, leveraging AI and predictive modelling to create hyper-personalised credit offers and using innovative solutions to integrate these credit offers into the user experience.

18% Fintechs increased their market share by 18% in 2021[15]

95% of underwriting processes for new entrants in the market are estimated to be automated using machine learning[16]

The combined effect of open banking and technology has enabled higher quality, hyper-personalised credit offers and more new players to enter the market with innovative new propositions.

Whilst new entrants have been trailblazers, the opportunity is there for all parties to leverage new technologies to enable innovation and create new consumer credit solutions.

13. Designing next-generation credit-decisioning models, McKinsey & Company, 2021, 14. Card Spending Update for December 2021, UK Finance, 2022, 15. Strategic Review of Retail Banking Business Models, FCA, 2022, 16. The coming opportunity in consumer lending, McKinsey & Company, 2021

So, where is this leading?

Consumers want their purchase experiences to be secure, seamless, and instant. They also want greater choice in how they pay and highly personalised credit offers, as evidenced by the rise in BNPL payments.

Therefore, providers need to satisfy the demand for integrated, personalised payment services, that enable consumers to pay in a way that best suits their individual circumstances.

Many sellers have already implemented instalment technology to offer more flexible payment options

59%

increase in merchant customers for just one BNPL provider in 2022[17]

51%

of surveyed merchants experienced an increase in revenue[17]

However, with new regulation, the market is set for more change

The key to future success and growth is for merchants and credit providers to work together to create a fully integrated, seamless, and secure payment experience.

They need to leverage new technology and innovation to improve their point-of-purchase solution offerings.

Embedded finance - a key growth strategy

When we consider these market trends together, embedded finance becomes an obvious and compelling solution.

It is the natural meeting point for merchants and credit providers to come together and form a single proposition.

17. UK Merchant Acceptance Council –H1 2022, RFI Global, 2022

Embedded finance

Embedded finance is the offering of financial products and services to consumers at a timely point in their payment experience through non-financial players. For instance, these players can be retail stores, super apps, marketplaces, government entities, or even electric vehicles.

Though embedded finance has existed in many forms for decades, its recent growth has been fueled by new digital solutions.

These solutions are changing when, where, and how consumers access banking services at the point of sale, creating opportunities and benefits for all parties.

Merchants typically partner with a financial solution provider to embed lending and credit options into their purchase proposition. Integration is done via an API, and all parties work towards providing a smooth, frictionless experience.

Instalments - the best known use case for embedded finance

A common example of paying by instalments is when a consumer purchases an expensive item, such as a new TV. During the checkout process, the customer is given the option to pay in intervals over a given time period, which is highly personalised, relevant, and easy to accept.

However, embedded finance is so much more than this

An example is **Google Maps**. It offers in-app payments for parking in over 400 cities within the US. Upon arrival at their destination, customers can use the app to pay for their parking in a few easy steps. This makes the user experience more streamlined as there is no need for customers to leave the app, and it promotes sales for Google and their partners.

Embedded finance delivers significant benefits for all parties

Responding to rising expectations for personalised, innovative credit options in a competitive lending market

Consumers

- Personalised rewards and bespoke credit offers
- Flexible credit and post-purchase instalment offers
- Greater transparency and control over spend
- Easier, frictionless, and secure access to finance options (within the merchant site)

Merchants

- Enhanced customer experience and satisfaction
- Better online sales conversion and value transaction per customer
- Differentiation from competitors
- Lower operational costs and reduced fraud
- Targeted campaigns and deeper customer relationships
- Better propositions

Issuers and lenders

- A new acquisition channel through partnerships with non-financial institutions
- Increased acceptance rates and reduced fraud
- Higher revenues and increased loan balances
- Protect market share
- Greater relevance with consumers

Taking the opportunity

Satisfying this demand will require an effective partnership strategy between the seller and provider

As a minimum, your embedded finance solution will need to work in the same way, whether it's a physical purchase or digital.

But more importantly, to succeed, it will need to stand out and be different to what is available today. Whether it's the range of solutions provided, the flexibility offered, the speed of service, or the level of personalisation, it doesn't matter – what is important is that the proposition is innovative, dynamic and delivered with a great UX.

Get in touch

Contact your Visa representative to learn how Visa can support you to develop and implement a differentiated embedded finance solution.

VISA