VODENO

Market Research

Banking-as-a-Service 2.0 – Why Embedded Finance will make its mark in 2023

VODENO

Introduction

Over the next five to ten years, the total addressable market (TAM) of Banking-as-a-Service (BaaS) providers in the UK and the European Economic Area is expected to increase notably, reaching an approximate value of between $90 billion and $105 billion by 2030[1].

With some reports indicating it will reach mainstream adoption in just two years[2], it is fair to say that BaaS is gathering pace. Non-financial brands have sought to use BaaS to embed innovative financial products directly into their customer journey in order to increase engagement and grow revenue, while banks and other financial entities have leveraged it to fast-track the speed to market of new products and services.

As competition for consumer attention online heightened throughout the Covid-19 pandemic due to the acceleration of existing digital trends, brands have looked to BaaS as a solution to retain and grow their customer base.

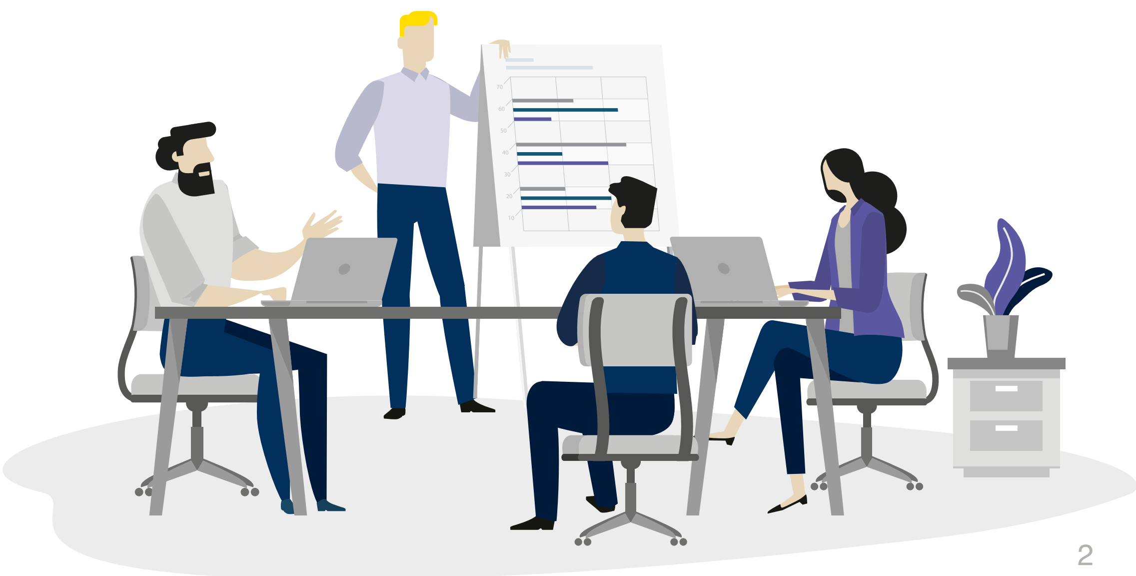
Embedded banking products, like the issuance of cards, opening new accounts and delivering built-in lending services, enable businesses to create a customer journey that is seamless with the right financial products offered at the point of need.

Enabling this in the background are BaaS providers that offer cost-efficient, API-based solutions alongside the necessary licence and regulatory expertise, so clients do not need to worry about compliance.

For banks and financial institutions, the opportunity is also clear; traditional banks run on legacy infrastructure, and cloud-native BaaS platforms offer the prospect to launch new neobank brands or services faster and cheaper.

To understand more about the course that BaaS is set to take in 2023 and beyond, we commissioned an independent body of research of over 1,000 senior decision-makers within businesses in the UK, Belgium and the Netherlands.

The research explores the wider market impact of BaaS, providing compelling insights on current and future use cases of embedded finance, and the specific verticals the technology is set to disrupt in the coming years.



Key findings at-a-glance

How businesses are implementing BaaS

64%

64% of decision-makers predict that BaaS will achieve mainstream adoption within the next five years

56%

56% think the cost-of- living crisis will be a catalyst for increased BaaS adoption

77%

The vast majority (77%) of those surveyed have either already deployed BaaS (39%), or plan to do so in 2023 (38%)

The most popular BaaS products firms are planning to implement in 2023 include: Foreign exchange (48%), Buy Now, Pay Later (48%), SME lending (47%), merchant financing (47%), loyalty (46%), and instalment loans (46%)

Reshaping financial services: examining the BaaS impact

51%

More than half (51%) of the decision-makers surveyed see BaaS making waves in the banking ecosystem, eventually making traditional banking obsolete

A further 60% see this translating into a decline in branch-based banking, while 65% expect to see an increase in consumers using banking services via non-financial brands, enabled by BaaS, rather than traditional banks

67%

The majority (67%) say BaaS is transforming financial services for the better

58%

58% believe most of their competitors will implement embedded banking services in 2023

58%

58% said BaaS providers that offer licensing alongside a tech solution are the ones that will shape the BaaS market in the years to come

65%

65% expect Big Tech firms to throw their hat into the financial service ring and deliver more financial services, powered by BaaS

How businesses are embracing the embedded finance opportunity

In recent years, BaaS and embedded finance have emerged as mainstream trends in the worlds of financial services, business and technology. Back in 2019, Angela Strange (general partner at Andreessen Horowitz) predicted that one day, "every company will be a fintech company"[3]. Today, this idea is fast becoming a reality – previous research from Vodeno shows that BaaS adoption is spreading far and wide, with two-thirds of Europe's SMEs working with tech suppliers to embed financial services into their customer journey to open up new commercial opportunities. At a granular level, this translates into significant revenue-building opportunities. According to research from OpenPayd[4], the financial services industry is expected to deliver an additional €720.78 billion in revenue for brands in Europe over the next five years[5].

As things currently stand, the majority of respondents surveyed believe that BaaS is transforming financial services for the better, with 64% believing that BaaS offers lucrative opportunities to businesses.

With BaaS demand rising and more business use cases for embedded finance emerging, new developments have largely been driven by what the end-customer wants. Many brands seek to minimise friction in their checkout journey in order to increase conversion and repeat visits. The result is more touchpoints with their brand, building trust and establishing loyalty.

With this in mind, we asked businesses about the areas they expect embedded finance to enhance their customer experience (CX) the most.

Our research uncovered the following trends:

Of those businesses that have adopted BaaS or intend to in 2023...

41% — **41% see increased revenue as the main benefit of BaaS implementation**

35% — **35% said the ability to launch new products and business models was the biggest advantage to implementation**

33% — **33% expect BaaS to boost their customer engagement**

33% — **The same number (33%) predict that BaaS products and services will bolster their conversion**

29% — **A further 29% expect to benefit from repeat visits and bigger customer shopping baskets (26%) the most**

Embedded finance in focus

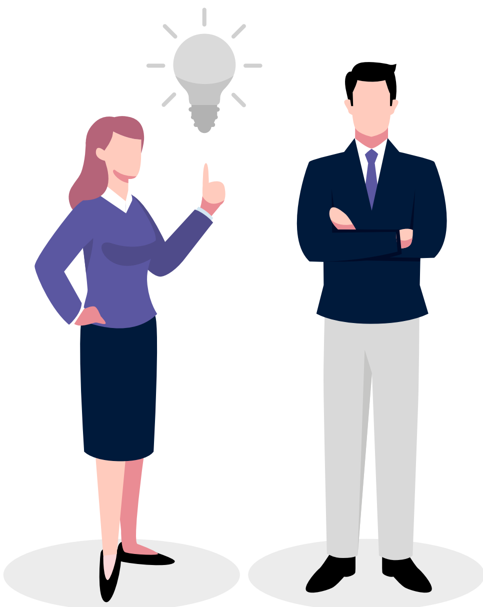
No matter their size or sector, Banking-as-a-Service provides businesses with the ability to embed complementary banking services and offer them at the point their customers need them most. Naturally, the most suitable embedded finance offerings will vary from company to company.

Based on our survey data, below is a comprehensive list of the embedded finance solutions businesses are using or considering implementing in the near future:

Product	Currently used	Intend to implement in 2023	Product	Currently used	Intend to implement in 2023
Debit card	57%	57%	Cashback	38%	43%
Insurance	54%	54%	Loyalty	36%	46%
Current account	53%	53%	Instalment loan	31%	46%
Credit card	51%	51%	Merchant financing	30%	47%
Instant payments	42%	42%	BNPL	28%	48%
Investments	42%	42%	FX	27%	48%
Overdraft	41%	41%	SME lending	27%	47%

Our research indicates that up until now, conventional banking products, such as debit cards and current accounts have proven popular among businesses. Looking ahead to 2023, with those products now better established, the research indicates that payment infrastructure, such as FX and real-time payments, is set to surge in adoption among organisations looking to boost their cash flow and transact more efficiently.

In the current climate, where the cost of living remains high and both consumers and businesses face an assortment of financial pressures, it was telling to see flexible lending solutions such as BNPL, instalment loans, SME lending and merchant financing ranking high on the list.



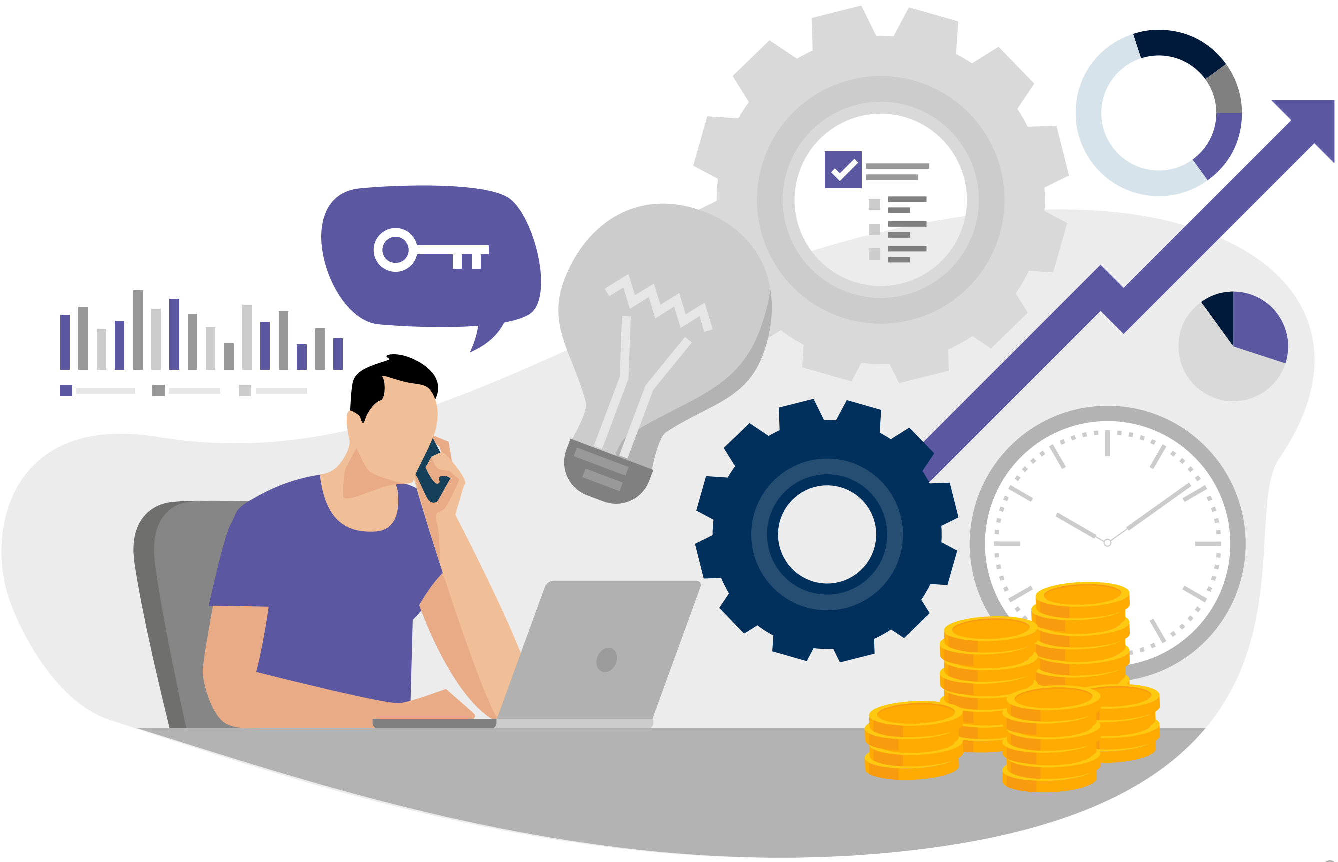
The unstoppable rise of platform banking

With BaaS already a mainstay in the retail sector, **59% of those surveyed predicted the ascent of platform banking, expecting the lines between eCommerce platforms and traditional banking services to blur this year as a result of increased BaaS adoption.**

With a greater number of non-financial brands shifting to offer financial services, 65% of respondents said that they expect to see more consumers using banking services via non-financial brands enabled by BaaS, rather than traditional banking.

60% went further still, predicting a decline in traditional branch-based banking as people begin to interact more with their favourite brands when handling their finances, rather than legacy financial institutions.

Looking to the future, almost two-thirds (65%) of those surveyed about industry trends predict that more Big Tech firms will move to deliver financial services. Already, industry giants like Amazon, Apple, Alibaba, Tencent and Meta have partnered with incumbents to deliver personalised financial services to their users. Additionally, over half (56%) believe the cost-of-living crisis will act as a catalyst for increased BaaS adoption, as businesses look for cost-effective solutions to grow revenue.



BaaS adopters value a banking licence

Any banking product, whether from a traditional bank or via a brand powered by BaaS, is ultimately a regulated product. Non-financial organisations that want to embed banking products do not have the technology nor the licence and expertise to do it themselves, relying on BaaS providers to implement products that are fully compliant.

As embedded finance continues to gain wider adoption, BaaS providers are attracting greater regulatory scrutiny. While most BaaS providers are well equipped to provide the underlying technology, not all will have the necessary licence and regulatory expertise to offer a comprehensive range of fully secure and compliant banking products. In short: not all BaaS providers are created equal where regulatory and compliance is concerned.

Our research demonstrates that the majority of businesses understand these crucial differences. When asked about their predictions for the BaaS sector in 2023, businesses underscored the growing importance that licensing is set to play in the near future –

58%
of those surveyed

58% of those surveyed said that BaaS providers that offer licensing alongside technology are the ones that will shape the BaaS market in the years to come.

Of the respondents who have not implemented BaaS to date, 27% cited compliance and security concerns as key barriers to adoption.

Differences between Electronic Money Institution and European Central Bank licenses

Today, there are many providers on the market offering Banking-as-a-Service solutions. However, not all BaaS providers are licensed in the same way. It is vital for brands to be aware of the key differences, as this may place considerable restrictions on the scope of products the provider is able to offer and the markets they can support.

	European Central Bank (ECB) licence[7]	Electronic Money Institution (EMI) licence
Payment services	✓	✓
Issuing electronic money	✓	✓
Taking deposits	✓	✗
Lending	✓	✗
Direct access to local clearing houses/IBAN	✓	✗

Key components to a winning BaaS proposition

Beyond banking licences and concerns about compliance, this report explores some of the sticking points that businesses face when weighing up a BaaS partnership. However, many of these areas can be mitigated by teaming up with a best-in-class BaaS provider that understands the distinctive requirements of each individual customer journey.

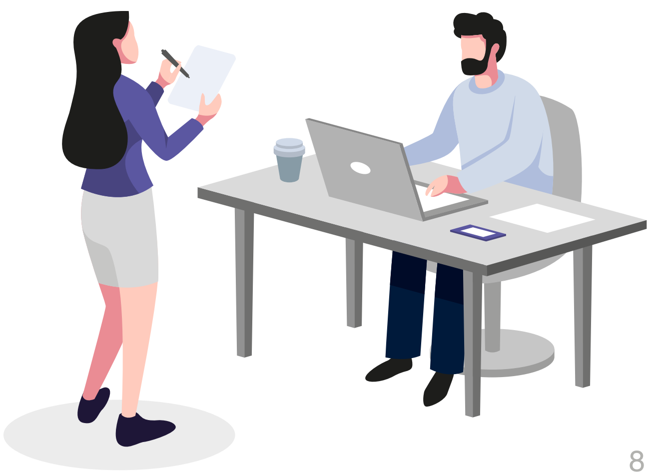
To understand more about how organisations envisage their BaaS solutions in an ideal world, Vodeno's study went further, seeking to determine the specific improvements that firms would like to see in the way providers deliver their services.

This is what the survey uncovered[7]:

Key improvement	Percentage that selected it as a priority (Respondents were asked to select their top three)
Faster implementation	35%
Cheaper cost of services	31%
More tailored products to me	29%
Access to liquidity	28%
Access to a banking licence	28%
More/different credit products	28%
Better understanding of my customer journey	23%

Speed, cost-optimisation, personalisation and financial security all stood out at the top of businesses' BaaS wish lists, suggesting that many are seeking solutions that deliver genuine value to their organisation.

Innovating the checkout experience is the key desired outcome for many BaaS adopters; previous Vodeno/Aion research highlighted businesses that implemented embedded financial products were motivated by new revenue streams (41%), growth in customer basket (40%) and enhanced customer loyalty (40%).



The technologies to watch

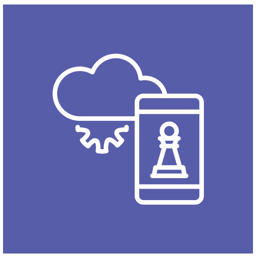
In today's world, technological progress and innovation are the linchpins of fintech development; they will continue to drive new trends and disruptive business models in the BaaS arena.

According to Vodeno's research, decision-makers see nine key technologies impacting their businesses and shaping the wider competitive landscape of finance in the years to come:

1. Payment innovations (including QR payments, digital wallets and cashless payments) – Payments are central to financial services. Businesses and their payment partners must ensure quick, cost-effective and frictionless transactions for their customers, whether they are businesses or consumers. Newer payment innovations are already gaining in popularity, with research predicting that global spend using QR code payments will reach over $3 trillion by 2025, rising from $2.4 trillion in 2022. Our research suggests 34% of businesses are looking to the payment solutions of tomorrow as a priority.

2. New fintech innovation – The fintech industry has become well-established over the past two decades, but it may be set for a new wave of innovation, according to 29% of the decision makers surveyed. The ongoing maturity of technologies like artificial intelligence and blockchain will breed new applications and this is likely to empower a new generation of fintech propositions.

3. Customer experience (CX) innovation – Many businesses know that a seamless customer journey is essential to ensuring long-term profitability, revenue growth and customer retention. To this end, 28% of businesses saw customer experience (CX) innovation as one of the most impactful financial services trends.



4. Fintech super apps – 26% of those surveyed said that they were monitoring the rise of super apps as a key trend in the financial services arena. Super apps, which bring together a range of experiences, services and functions on a single platform to provide a seamless experience, have already proven popular in Asia, with the likes of PayPal, WeChat, Alipay, Grab, and Paytm already offering integrated ecosystems and a variety of products and services.

The technologies to watch

5. Open Banking adoption – The same number (26%) of businesses said that Open Banking adoption remains high on their agenda. Thanks to PSD2 banking standards and API technology, firms can expand their banking capabilities, allowing consumers to take control of their data and access new services that can better their financial lives. Specifically, our research found that decision-makers were exploring open-banking-enabled instant payments (39%), automated cash flow management (31%), identity verification (31%) and credit assessment (29%) functionalities to better their business.

6. Blockchain technology – As blockchain and distributed ledger technology reach maturity, businesses could reap the benefits of faster and cheaper payments, as well as more secure borrowing, customer KYC and fraud prevention. As a result, 26% of the businesses we surveyed said that it is one of the most impactful trends in the industry today.

7. Cross-border instant payments – For 25% of respondents, real-time cross-border payments remain a priority. Previous research from Vodeno uncovered that businesses, particularly SMEs, often fall victim to delayed and costly payments when operating internationally. As these common pain points result in cash flow irregularities, stunting their business operations and growth, demand for instant payment technology to speed up the process remains crucial.

8. Embedded banking – Already, businesses are reaping the benefits of embedded banking to diversify their revenue streams, enhance the UX and increase customer retention. With uptake expected to increase, our research shows that 25% of respondents are keeping up with embedded banking trends.

9. Immersive retail experiences in the metaverse – A step beyond a typical embedded finance offering, 21% of businesses expect augmented and virtual reality (AR and VR) to transform eCommerce. Businesses will be able to extend their presence into three-dimensional virtual spaces, giving their customers a new way to engage and shop with them.

BaaS 2.0: Predictions for 2023 and beyond

We asked businesses about what they expect from the BaaS sector in 2023 and beyond, as well as the key drivers for adoption. Here are three of their top predictions:

60%

expect to see more consolidation between banks, fintechs and BaaS

As this report has already outlined, banks can be slow to embrace change and less innovative than nimble fintechs and BaaS providers.

However, these institutions are navigating the storm and future-proofing their operations by partnering with BaaS providers to offer embedded banking products to their portfolio of customers. Vodeno's recent partnership with retail banking giant NatWest Group is proof that established banks can meet the evolving needs of their business customers by leveraging BaaS technology combined with their licence and banking expertise.

58%

expect the majority of their competitors to implement embedded banking services in the next year

Embedded finance enables brands to provide fast and easy customer journeys that add value and encourage brand loyalty. The promise of embedded finance is now being applied to multiple sectors, both B2C and B2B.

With this in mind, it is not surprising that businesses are looking to new embedded solutions to stake out a competitive advantage.

56%

expect the cost-of-living crisis to be a catalyst for increased BaaS adoption

In the current climate, where economic growth is low, inflation is high and interest rates are rising across Europe, businesses are looking for cost-effective solutions that offer real value to their customers. For instance, flexible payment solutions and embedded loans can ease consumer purchasing decisions. For businesses, the API-based nature of BaaS offers easy integration that is both cost effective and quick to market.

BaaS 2.0: the views of Vodeno

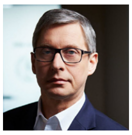
A Q&A with CEO Wojciech Sobieraj

1. Why is it important for BaaS providers to understand the client's customer journey in order to deliver true embedded finance?

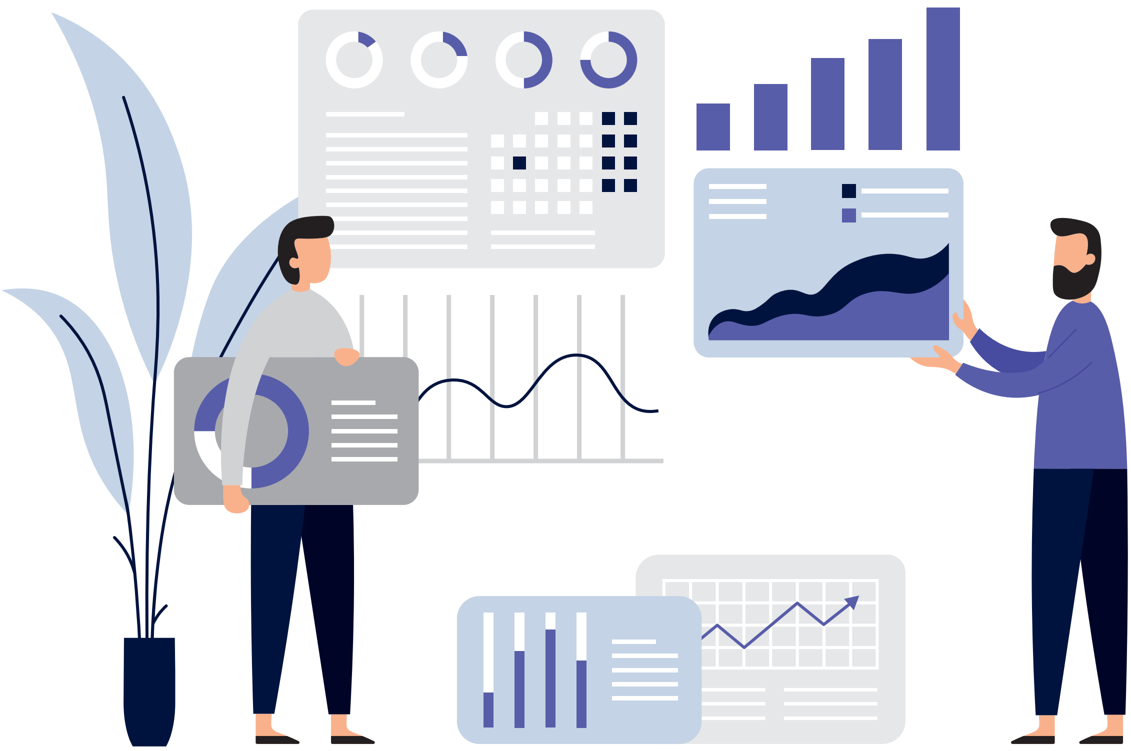
" For brands, a seamless customer journey can mean 2- 5x increases in revenue per customer. We know companies that implement BaaS products are looking for growth in customer basket, higher conversion and enhanced customer loyalty.
The only way to achieve these objectives is for financial products to be directly embedded in the brand's checkout process, so customers can access the right products at the point of need. For consumers, a seamless customer experience - one that does not require them to register or enter personal details and remain on the brand's website or mobile application throughout the process - is the perfect journey, leading to more purchases and increased visits. "

2. Why do you think BaaS will democratise better banking for consumers?

" When we launched Vodeno in early 2018, our belief was that in the near future people will not need another retail bank, but they will still need good banking. Banking transactions are shifting away from traditional banks towards 'platform-based banking' via brands. I believe that in the next 10 years, half of all banking will be done via platforms, and in this way, BaaS is helping to democratise good banking, where consumers can access the best products directly from the brands they visit every day. "



Wojciech Sobieraj

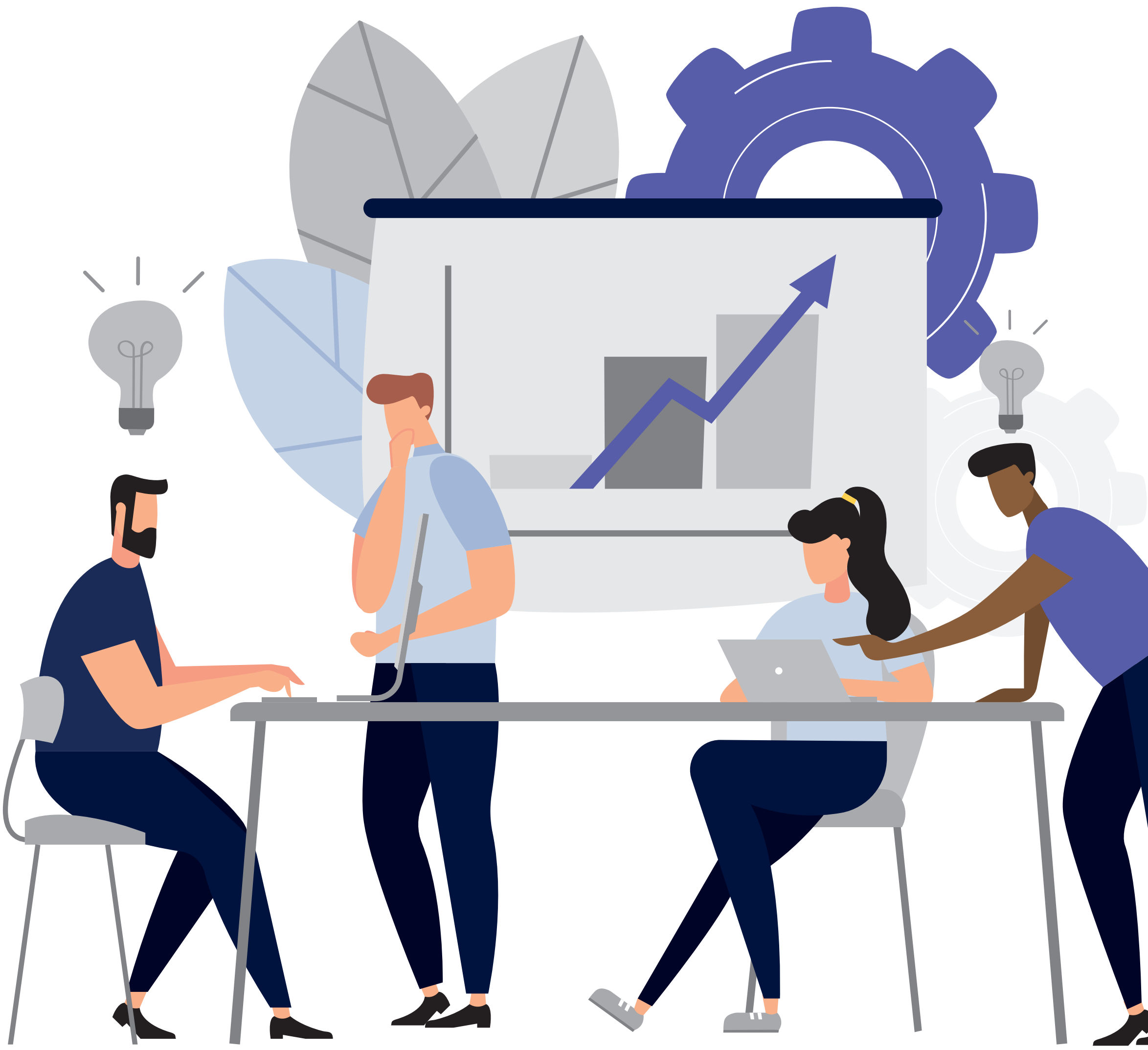


Final thoughts

“ Our findings point towards one key conclusion: more brands are embracing embedded finance, with a clear idea of the trends, products and services that will enhance their customer journey.

Consumer behaviour and market dynamics have shifted significantly in recent years, and the rise of platform banking means that customers can access the best banking products directly at the point of need, from current accounts, debit cards, embedded lending, and more. In order to offer products that are fully compliant, brands are calling for BaaS providers to have access to the necessary licence alongside the API-based technology that ensures quick and cost-effective implementation.

As BaaS is adopted by more brands in the coming years, it is the providers who can offer the regulatory and compliance assurance that a fully regulated banking licence provides that will give clients the most comprehensive range of products and services across multiple markets. ”



Footnotes

i https://www.mckinsey.de/publikationen/banking-as-a-service-baas-opportunity-europe

ii https://www.gartner.com/en/newsroom/press-releases/2022-09-12-gartner-says-banking-as-a-service-will-hit-mainstream

iii https://www.altfi.com/article/8451_why-every-company-wont-become-a-fintech

iv https://assets.ctfassetsnet/6ndujxh3wgyb/2rfnkzJAZaJoyonhgrHbkC/0c6c90b1ec1e88f11952233d96ed218e/Embedded_Finance_Research_Report_single_pages.pdf

v https://assets.ctfassetsnet/6ndujxh3wgyb/2rfnkzJAZaJoyonhgrHbkC/0c6c90b1ec1e88f11952233d96ed218e/Embedded_Finance_Research_Report_single_pages.pdf

vi This group accounted for 617 of the 1,006 European decision-makers surveyed, or 61% of the sample.

vii This group accounted for 389 of the 1,006 decision-makers surveyed, or 39% of the sample.

viii This table represents a selection of products offered by an ECB licence.

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