Uncovering value in embedded finance

Challenging assumptions to chart new growth

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As consumers' appetite for frictionless financial services increases, re-examining prevailing attitudes within the industry reveals new opportunities to create value.

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Once limited to white label services, like rental car insurance and store cards, embedded finance is now central to innovation and future growth in the financial industry. Use cases abound: payments buried deep in the buying process for online stores and apps, hyper-personalised insurance, instant payment and credit propositions, and a myriad of pay-per-use service models. With the increasing integration of savings, credit, insurance and investing tools into non-financial apps or websites, the market for embedded finance applications is projected to grow fivefold, from US$54.3 billion in 2022 to US$248.4 billion, by 2032.

The speed and scale of innovation in the market creates an opportunity for incumbents to reconfigure their business models to achieve new growth. So far, new applications have largely been driven by a cohort of entrants and non-banking organisations responding to consumers' bottomless appetite for frictionless financial services.

Branchless neo-banks and digitally agile insurers are just some of the players seeking to disrupt and democratise traditional financial services, from underwriting to overdrafts. Buy now, pay later (BNPL) schemes, which allow customers to split large purchases into smaller payments and drive conversion for retail brands, are exploding in popularity. These models are estimated to reach a global transaction volume of US$596.7 billion by 2026, up from US$141.8 billion today.

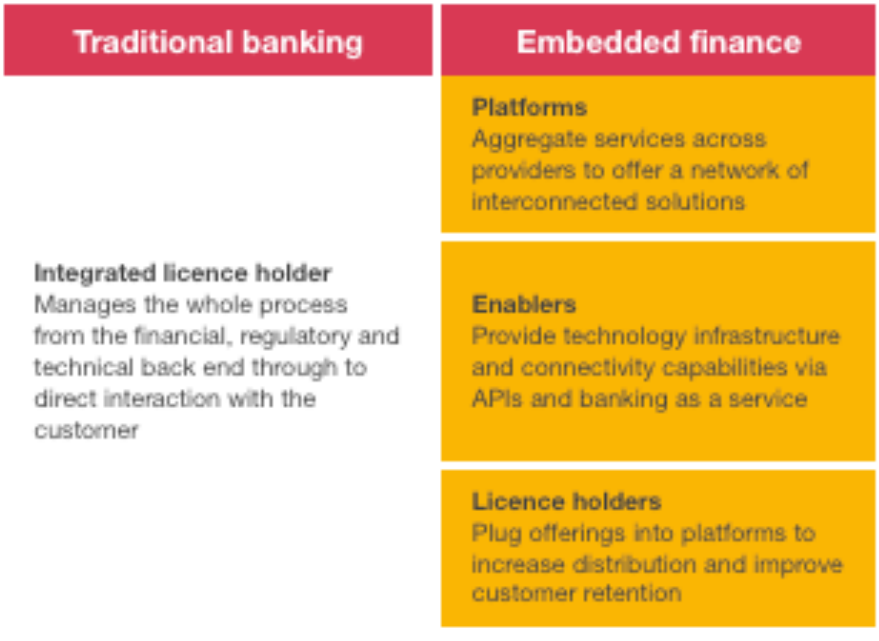
Others are getting in on the act. Fintech enablers, such as those providing application programming interfaces (APIs), are facilitating increasingly complex communication between financial and non-financial entities. But embedded finance presents arguably the greatest opportunity for big-tech platforms with the reach and financial liquidity to make bold integration plays. These include extending their customer ecosystems through digital identity and payment wallets—the total number of which is estimated to exceed 5.2 billion globally in 2026, up from 3.4 billion today. The most ambitious platforms, including some fintechs, are now vying for—and winning—banking licences.

Expanding the banking business model

Non-banking platforms that serve as the primary touchpoint for customers through a range of easy-to-use, instantaneous and customisable applications are causing significant implications for banks' business models. In our report **Retail Banking 2025 and Beyond**, we discussed new pathways that have developed in the embedded finance landscape, which provide consumers with a frictionless experience when they access financial services.

In contrast to traditional banking, where a single integrated licence holder operates the end-to-end process, embedded finance relies on several distinct roles and players, including platforms, enablers and licence holders.

Key roles involved in traditional banking vs embedded finance



Source: PwC

Some banks are already making clear moves towards participating in and partnering with non-banking platforms. However, they must consider the pricing pressure these platform providers can exert and carefully evaluate the benefits of such partnerships. By committing only to run the back office financial infrastructure for ecosystem partners, banks may be left with the most capital-heavy and regulatory-intensive activities, resulting in less contact with the end users of their products and services. We are seeing banks address these issues by opening up their own platforms to non-banks, or by branching out with their embedded insurance and concierge services into banking-adjacent sectors like travel, mobility, and more.

Challenging the prevailing attitudes

It has been clear for some time that embedded finance is defying conventional wisdom surrounding banks by surfing a wave of very powerful trends: increasing digitisation, a focus on customer-centricity and the growing power of ecosystems. As applications reach into areas previously ring-fenced by traditional financial infrastructure—payments, lending, savings, and banking licences—the opportunities and implications for business model transformation have also quickly intensified.

Embedded finance is outperforming four common assumptions that were prevalent across the industry for more than a decade. These are:

- 'Banks will always own the payments infrastructure.'
- 'New entrants won't enter into lending like they did with payments.'
- 'Non-financial players won't apply for banking licences.'
- 'Banks will continue to own the primary banking account—and thus the customer relationship.'

There are some good reasons for these beliefs. Banks are integral to national and regional economies; since the global financial crisis, ever-increasing rules and regulations have led to an immediate compliance burden, drawing banks' time and attention away from a longer-term consideration of business models. Ultimately, this

has contributed to a form of inertia at some banks, delaying progress and innovation at a time when the fastest movers are already building the banking tools of tomorrow.

Still other factors complicate matters. Firstly, banks have been slow to acknowledge that customers are far more wedded to the product or service they want and need (such as groceries and a house) than they are to the financial product that underpins them (such as payments and mortgages). At the same time, many of the projections about the size of the embedded finance market were seen as inflated, which made actual market developments easier to overlook as banking bosses were consumed by the pressures of daily operations and necessary cost-cutting. Lastly, innovations in financial services generally develop slowly and on a regional basis (with significant divergence, such as the explosion of e-money in Africa and the comparably slow uptake of credit cards in Germany). Therefore, it was easy to underestimate the impact that fintechs and embedded applications were having on the industry.

The persistence of the four assumptions underscores the need for a fundamental change of mindset. In order to capitalise on the significant growth opportunity that embedded finance represents, banks and other players will need to reconceive their business models and reset how they will play in evolving customer journeys. What follows is an analysis of four common assumptions about embedded finance, and how they are eroding before our very eyes.

‘Banks will always own the payments infrastructure’

The payments playing field has been redefined over the past 20 years by new entrants, including a strong shift towards cashless transactions and the need for instant, cross-border payment solutions—among **other key trends**. Despite this, payments have generally been viewed by incumbent banks as relatively safe. They have relied on their earned reputation as trusted financial intermediaries, best positioned to handle the advent of digital currencies and wallets, cross-border payments, and financial crime.

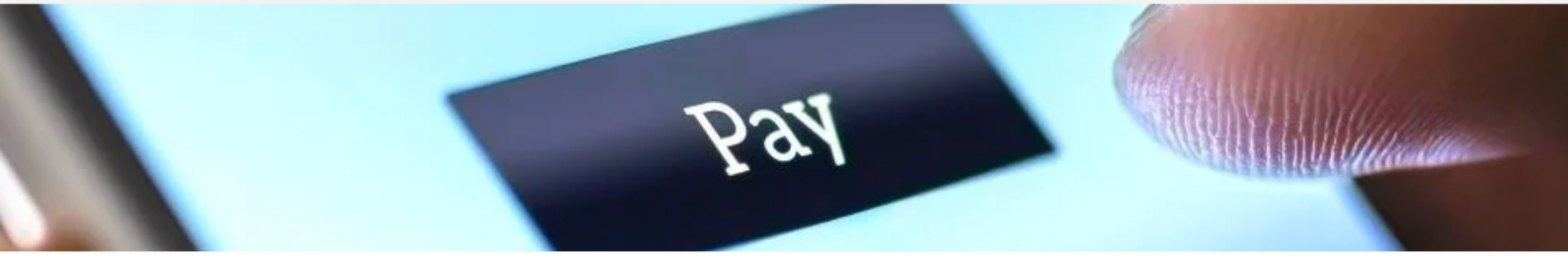
In the coming years, **payments are estimated to** make up a third of banking revenue and roughly 90% of useful customer data. But in the battle of the rails, banks have emerged as only one of a host of important players. In the US, where

payments are regulated state by state, PayPal leads a diverse landscape of companies that both process payments and provide payment gateways. Big-techs are also active in the payment space, where Apple Pay, Google Pay and Alipay (from China's Alibaba) have established huge customer bases—accumulating **more than 3.2 billion users** worldwide across all three platforms.

In Asia, a variety of currencies and a highly fragmented payment landscape back up the processing of more non-cash payments than any other region. For example, the National Payments Corporation of India (NPCI), an umbrella organisation for operating retail payments and settlement systems under the Reserve Bank of India, has developed unified payment interface (UPI), a highly successful mobile-only instant payment system. According to NPCI data, UPI was processing more than six billion transactions (worth US$100 billion) per month by mid-2022 and had expanded to another seven countries in Asia.

The continuing growth of embedded finance could further accelerate a shift away from incumbent banks in the payments space. With the rise of global decacorn payment service providers (PSPs)—companies valued at US$10 billion or higher—we have seen players offering better solutions for both merchants and payers, despite recent decreases in private-market values. These go beyond just embedding the payment into the overarching transaction in a safe way, thus lowering friction and conversion loss. A broader number of PSPs are also embedding transactions, reconciliations, data analysis, the flow of goods, and return flows into the accounting and enterprise resource planning (ERP) systems of merchants—adding significant value.

> PSPs that offer comprehensive services can charge a higher price per transaction than banks and gain market share at the same time. They're also obtaining access to immense volumes of customer data that can potentially enrich relationships and drive new product offerings. Incumbent banks are increasingly missing out on revenue opportunities and data streams.



‘New entrants won’t enter into lending like they did with payments’

For many banks, consumer or business lending is the most profitable part of their business. Many have assumed that regulatory hurdles or concerns about risk would deter new entrants—but this is already proving false. Big-techs and large retailers, who have made inroads into embedded finance, largely through payments and white-label credit offerings, are now expanding into embedded lending. This involves partnering with banks and credit card issuers, making strategic acquisitions of fintechs or even acquiring entire banks.

BNPL offerings, embedded directly into online platforms, are predicted to reach US$437 billion globally by 2027, a 291% increase from US$112 billion in 2022. This is partly driven by the success of fintech players such as Klarna, Affirm and Afterpay/Clearpay.

One high-profile example is Apple’s forthcoming BNPL offer, which will allow US shoppers to pay for purchases in four instalments. This facility will be directly integrated into the Apple Wallet infrastructure, with payments managed by a third-party provider. Notably, Apple will take over credit decisions for the loans—normally undertaken by a third-party loan issuer, like a bank—and it will reflect loans on its own balance sheet via a financing subsidiary.

Large retail banks and credit card networks are poised to take advantage of anticipated changes in the regulation of BNPL schemes. Since BNPL loans are generally offered interest-free, they haven’t been regulated in the same manner as other financial products. However, this is expected to change, as consumer protection advocates in the US, UK, Germany, and other countries have raised issues around indebtedness and lack of transparency.

Embedded lending is also showing great appeal for other types of non-financial institution new entrants. Software providers, in particular, are offering embedded finance services by leveraging external customer data, next-generation decisioning models and API-enabled technology. For example, financial software provider Intuit has expanded from providing accounting tools, to offering small business loans through a subsidiary with a commercial banking licence, using financial information and credit histories inputted into the accounting software.

Incumbent banks risk losing market share in the credit space to new entrants, particularly as lending becomes more embedded into consumer sales journeys or small and midsized business operations. Many of these non-traditional players, especially from the technology industry, are upending conventions about how to determine who gets credit, by drawing on data rather than credit reports. They’re also offering clear value to customers and helping them grow. Incumbent banks will need to do more than just copy BNPL products to keep pace, and remain vigilant about pressure on interest margins as the source of credit migrates away from them.

‘Non-financial players won’t apply for banking licences’

As recently as 2020, it was common to hear the opinion that big-tech companies didn’t pursue full-fledged banking licences because tech bosses feared it would entail too great a risk. Indeed, how regulators respond to this happening is currently being worked out and may require international cooperation. However, many big-tech players already hold a lesser form of banking licence in Europe, known as an electronic money institution (EMI) licence, which allows them to issue electronic money—and potentially signals their intent to enter regulated financial environments.

Banks have long believed that they have inherent advantages in terms of scale, customer trust, and regulatory savvy—and are therefore uniquely qualified for full regulatory licensing. But this assumption is clearly coming under pressure; in addition to potential incursions from big-techs, the number of fintechs with a banking licence playing in the embedded finance space is growing.

For example, Dutch payment platform Adyen and Swedish BNPL fintech Klarna already hold European banking licences. In the UK, regulators granted two banking licences to fintech companies in 2022; one went to Kroo, a mobile-only bank/app and the other to Fiinu, a company offering a plug-in overdraft that can help consumers weather tough financial times without needing to switch banks. Many of these fintechs are part of a broader shift towards financial services ecosystems that have the potential to disintermediate incumbent banks.

Banking executives should consider how their institution can stay relevant and profitable if more fintechs, and especially big-techs, secure banking licences. Some of today’s key compliance challenges, like know your customer (KYC), are becoming more manageable thanks to the savvy use of AI, and regulators are beginning to take notice. As data-driven compliance solutions become more commonplace, fintech and big-tech players who excel in making the most of data may find some of the hurdles to achieving compliance with regulatory requirements easier to master. And the potential rewards in a **winner-takes-all** scenario may become great enough to encourage a full-on move into licensed banking

‘Banks will continue to own the primary banking account—and thus the customer relationship’

As a site ripe for disruption, the primary bank account should not be underestimated. Customers’ use of embedded financial services has often been interpreted as supplemental to core banking activities, or purely to reach new consumers. The assumption is that banks, through their ownership of the primary bank account, will retain their current role with their core customer base.

Bank accounts offer an important source of customer data. They are attractive to a range of new entrants, which can use this data to improve the frictionless delivery of their products and services. As customers grow more accustomed to payments linked to a mobile phone number—with less thought to the bank account in the background of the transaction—the scene is set for future disruptions.

Financial players that expect fintechs and big-techs to backtrack from their initial efforts to gain market share or to enter the financial services space in the first place, will likely be disappointed. Manufacturers of film were sceptical of digital photography, and digital camera makers didn’t believe “good enough” cameras could be integrated into cell phones—both assumptions proved to be very wrong. Photography is still going strong, but the technologies used to create it and the companies that produce them have changed dramatically. In coming decades, banks may travel a similar path and occupy a very different role in the financial system.

There is one possibility that could stop this trend in its tracks—radical market intervention by legislators and regulators. We explored this potential scenario, and why it’s not likely to come to pass in the near term, in our recent work on the **future of retail banking**.

Banks should take a close look at the true cost of doing nothing versus getting their business ready to meet the challenges posed by embedded finance. Especially given today’s pressures in the banking sector, making the right investments can boost competitiveness in numerous ways, from increasing customer-centricity to enhancing overall data capabilities and encouraging efficiency, leading to simpler and more effective operations.

Looking ahead

Excitement around embedded finance is growing—and overpowering the conventional wisdom surrounding banks. In other articles in this series, we'll explore some of the concrete actions banks and other financial institutions should consider as they transform their businesses to deliver on the promise of embedded finance, diving deep into a new framework for risk management within embedded finance ecosystems.

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