



The Profitable Horizon of Embedded Finance

third party payments fintechs

Summary: CFIs and other banking operations could profit immensely from creating embedded finance partnerships, where CFIs offer their digital banking services to be integrated into experiences for a third party's customers. We review the growth potential for embedded finance partnerships and how to get started.

When Amazon [acquired Whole Foods in 2017](#), no one was quite sure what would come of it. The rise of Amazon Fresh and its first shaky steps into in-person grocery stores showcased an innovative new way to shop for groceries, particularly with “Just Walk Out” shopping, where customers scan their Amazon Fresh QR code upon entering the store, and their grocery bill is tallied for them while they shop. Once they scan their QR code to leave again, they receive a digital receipt for what they bought — no cashier required.

Partnerships between two seemingly unrelated industries can create lucrative opportunities for both businesses involved, and the financial industry has taken advantage of this through the rise in embedded banking. Individuals and small businesses can do all kinds of banking these days without ever forming a direct relationship with a financial institution through embedded banking. They can log into an e-commerce or accounting platform to get a loan, transfer money, obtain a debit card, make a loan payment, or handle most of their other financial management — and financially convenient — needs.

The Impact of Embedded Finance

We began the conversation on [embedded finance's potential](#) last year, and the market for them has grown immensely since then. In particular, embedded finance offers a good opportunity for CFIs to generate revenue by simply offering their existing digital banking technology to other companies. Embedded finance is essentially a partnership between a software company, a financial provider, and a distributor of financial products on nonfinancial platforms. Through this unique partnership, financial products can be integrated within digital interfaces such as e-commerce software, online shopping carts, and digital wallets. Those using these interfaces use the financial services they're offered as a natural extension of shopping or managing a business without being actual customers of the financial provider.

Commerce, merchant and customer relationships, and technology have all changed profoundly in ways that have allowed embedded finance to evolve and grow. According to the consulting firm McKinsey, [50% of US card spending now takes place online](#). As digital natives have become adults, they have proven to be enthusiastic users of embedded finance.

The convenience that embedded finance brings is almost expected now; from buy now pay later (BNPL) to online grocery shopping to scheduling and paying for a rideshare with your phone. According to a survey conducted by EY, [94% of global financial tech leaders](#) defined success as relevant financial products that addressed the immediate, real-time needs of customers. Nothing is more fitting to this definition than what embedded finance has to offer.

The Opportunity for Revenue

McKinsey estimates that embedded finance brought in \$20B in 2021, and 55% of revenue generated from

embedded finance lending products — \$14B — went to the lender. Considering that the market for embedded finance could double in the next three to five years, community financial institutions (CFIs) and other banking operations could profit immensely from creating embedded finance partnerships.

Here are a few ways that embedded finance partnerships offer new and increased revenue opportunities for CFIs:

- **Access to new verticals.** Establishing partnerships in business sectors outside of your regular verticals, such as healthcare or utility companies or contractors, brings in new potential customers.
- **Data collection.** Open-banking innovation has allowed third-party fintechs access to consumer banking data. This process provides the opportunity to create more personalized and relevant offerings to customers.
- **Offering expansion.** Embedded finance can increase your digital product and service offerings to existing customers in the form of digital wallets, mobile payment opportunities, and even lending and insurance.

The Strategy To Incorporate

The opportunity for revenue growth and gaining a competitive advantage by tapping into these partnerships cannot be overstated. CFIs that want to take advantage of this and get a foothold in embedded finance will need to choose a strategy, build capabilities to support distributors, and develop support and underwriting. Here are a few key areas to help you develop an approach that works for your CFI and the industries that make the most sense for you to partner with:

- **Decide where to compete.** This is a prime opportunity to expand your CFI’s reach outside of its regional or vertical footprint. Your institution could differentiate itself by developing more advanced products and capabilities. Be strategic and thoughtful about where to begin that expansion.
- **Adapt to B2B2C and B2B2B sales patterns.** Most CFIs are accustomed to dealing with customers directly. Retailers and manufacturers want to use embedded finance, but their core abilities aren’t in building, selling, and servicing financial products, never mind doing so in ways that control risk or follow regulations. Be prepared to develop ways to support your distributors in selling embedded finance to customers, combining expertise and tools to deliver it in ways that are efficient and compliant.
- **Build risk management parameters.** If your offerings include lending, your CFI will need to create risk management considerations to help you ensure that distribution partners are behaving in ways that are compliant and respect your CFI’s risk parameters.

CFIs have a chance to get involved with the growing market for embedded finance. A willingness to adapt and partner will be crucial to successfully seizing this opportunity and tapping into potentially great revenue growth.

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ECONOMY & RATES

Rates As Of: 09/12/2023 05:36AM (GMT-0700)			
Treasury	Yields	MTD Chg	YTD Chg

3M	5.55	-0.01	1.13
6M	5.51	0.03	0.75
1Y	5.41	0.05	0.71
2Y	5.00	0.13	0.57
5Y	4.42	0.17	0.42
10Y	4.28	0.17	0.40
30Y	4.36	0.15	0.39
FF Market		FF Disc	IORR
5.33		5.50	5.40
SOFR		Prime	OBFR
5.30		8.50	5.32

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