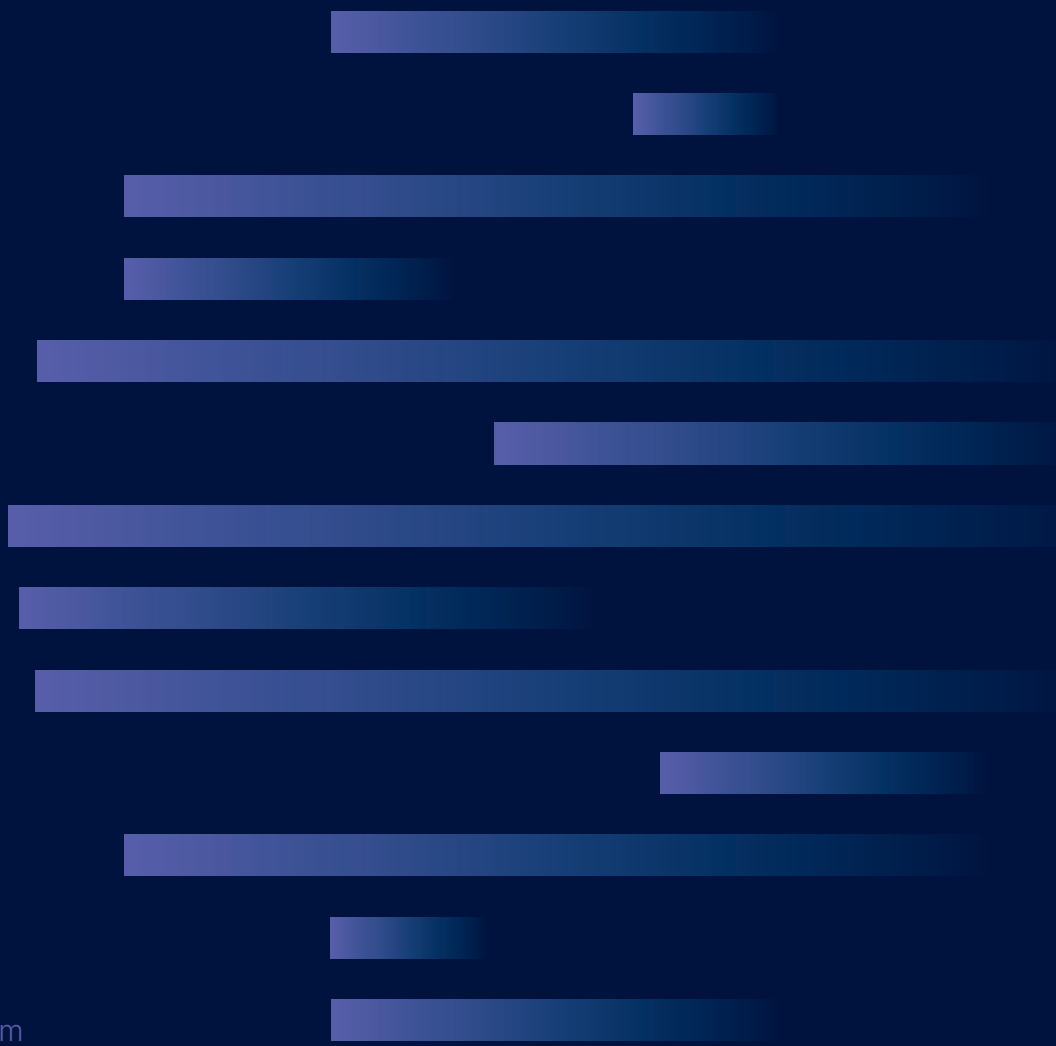


VODENO

Market Research

The Rise of Embedded
Finance in Retail



Introduction

The growing trend of financial services being offered by non-financial entities is changing the way we interact with brands and banking products. Most of our financial interactions were previously exclusively facilitated by our banks, but today, through Banking-as-a-Service (BaaS), brands across all sectors have access to innovative embedded banking solutions that are cost-effective and easy to integrate.

BaaS is the infrastructure for banking products and services. It encompasses the tools and capabilities to take financial products and services built upon a provider's platform and embed them in experiences offered by fintechs and consumer brands. The value proposition of BaaS is to make it quicker, easier, and cheaper to launch, operate and scale products and services.

BaaS providers who offer an API-based technology solution, access to a banking licence and compliance and regulatory expertise allow non-

regulated organisations to offer tailored financial services directly to their customers. Unlike financial products offered by independent third-party providers, BaaS solutions are white-labelled and keep customers in the brand's own ecosystem throughout the customer journey. As a result, BaaS is opening new commercial opportunities and driving innovation in customer experience to the whole host of businesses worldwide.

Reimagining Retail

Embedded finance is a disruptive trend reshaping many industries. Underpinned by the rise of Banking-as-a-Service (BaaS), non-regulated organisations can now offer financial products and services directly to their customers, opening up new commercial opportunities and customer experience innovation.

Brands can now deliver payments, cards, loans, insurance, investments and more, transforming their customer experience and creating new ways to attract and retain business. Embedded finance is a trend that has gained momentum over recent years, and the pace of disruption is set to accelerate markedly in the years to come.

In payments alone, embedded finance revenues totalled \$16.1 billion in 2020. By 2025 they are forecast to reach \$140.8 billion. Meanwhile, according to Lightyear Capital, embedded finance in its entirety will generate \$230 billion in revenue by 2025. Elsewhere, analysts predict that the embedded finance market will be worth over \$138 billion by 2026, from just \$43 billion in 2021.

Of all the industries benefiting from the rise of embedded finance, perhaps none can rival the advances taking place in retail. Here, traditional retailers, brands and eCommerce firms are reimagining the customer's journey and diversifying their business models thanks to BaaS and, more specifically, embedded finance.

The adoption of embedded finance solutions is not limited to large, multinational retailers; examples abound of small, innovative businesses embracing this trend for competitive advantage.

Here at Vodeno, our mission is to revolutionise the financial services industry and extend opportunities to non-banking brands. Combining a modern cloud-native, API-based platform with access to a European banking licence and deep banking experience, we are uniquely positioned to help regulated and non-regulated entities offer compelling and unique financial products.

Vodeno believes everyone should have access to the best banking products and is helping retailers, small and large, to take advantage of all that embedded finance has to offer. But, what should retailers thinking about dipping their toe in financial services understand about BaaS? To answer this, first we must analyse the current state of the market: the level of adoption across the sector, the challenges and opportunities that retail companies are currently facing, and their plans for future investment in embedded finance.

To delve deep into these important topics, in February 2022 Vodeno commissioned independent research among 753 senior decision-makers from retailers across Europe. This included 251 respondents from the UK, 250 from Germany and 252 from Belgium. All the respondents worked in senior positions relating to finance, technology, customer experience or innovation within their respective companies.

In this report, we present the findings of our research. It provides valuable, timely insight into how Europe's retailers are embracing the disruptive potential of embedded finance, and what the future holds for this trend.



Key findings at-a-glance

State of the market

74% of retailers currently offer embedded financial services or products to customers



The UK has a higher adoption rate than Germany and Belgium

56%
of retailers intend to invest in new embedded finance solutions in the coming 12 months

Just 5% of retailers say they do not offer embedded finance and have no plans to start doing so in the year ahead



Demand for embedded finance

65% of retailers noted more competitors adopting embedded finance solutions in 2021



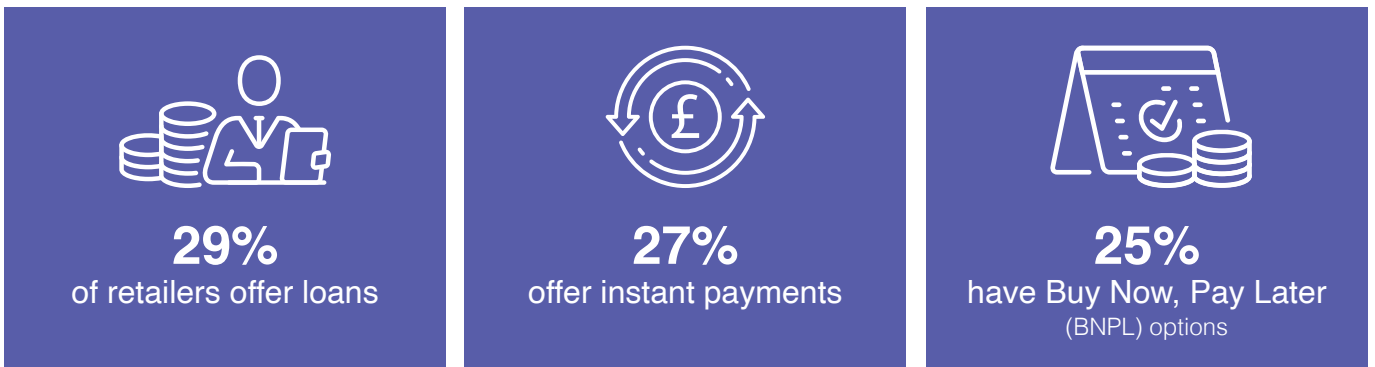
67% of retailers have seen greater demand for embedded finance from their customers



What solutions and why

Among the retailers currently offering embedded finance...

Cashback and loyalty schemes, credit cards and debit cards were the most common solutions currently on offer – each currently being provided by 32% of respondents



69% expect their brand reputation to improve by offering embedded finance

68% believe they will provide a better customer experience

66% predict their revenue will increase



Significant rate of adoption

Vodeno's research revealed that a significant proportion of European retailers have already embraced embedded finance.

Just under three quarters (74%) of the 753 companies surveyed said they were already offering some form of financial product or service to customers, as of February 2022. However, there is a marked difference when analysing the figures by country; the UK (82%) has a higher adoption rate than Germany (75%), with both countries well ahead of Belgium (64%).

Further, the majority (56%) of companies intend to invest in new embedded finance solutions in the coming 12 months. This is made up of 34% that intend to make further investments on top of the financial products and services they already provide, and 22% that do not currently offer embedded finance but plan to by February 2023.

In total, just 5% of the senior decision-makers said that their retail company did not offer embedded finance and had no intentions to do so in the year ahead.

The data demonstrates that embedded finance is a rapidly maturing market; with fast adoption across the retail industry. Moreover, in the coming 12 months, this trend is set to become almost ubiquitous, with 19 in 20 retail firms choosing to embrace the opportunity to embed financial products or services into their offering.



Meeting customer demand, keeping pace with rivals

It is clear that European retailers are becoming acutely aware of the pressure on them to react to the proliferation of embedded finance solutions.

For example, two thirds (65%) of respondents to Vodeno's survey said that they saw more of their competitors adopting embedded finance solutions in 2021. In line with the adoption figures noted above, this view was more common among retailers in the UK (74%) than in Germany (65%) or Belgium (57%).

It is not just the need to keep pace with competitors that will be encouraging retailers to explore the embedded finance trend. Even more (67%) companies stated that last year they saw greater demand from their customers for financial products and services to be built into the customer journey. Once again, this is more prevalent in the UK (73%) and Germany (71%) than Belgium (58%).

Retailers will need to remain abreast of this cyclical process. As most companies embrace embedded finance, customers are increasingly seeing it as normal for their favourite retailers and brands to now offer easily accessible financial products and services. In turn, those retailers which do not act fast enough risk being left behind.

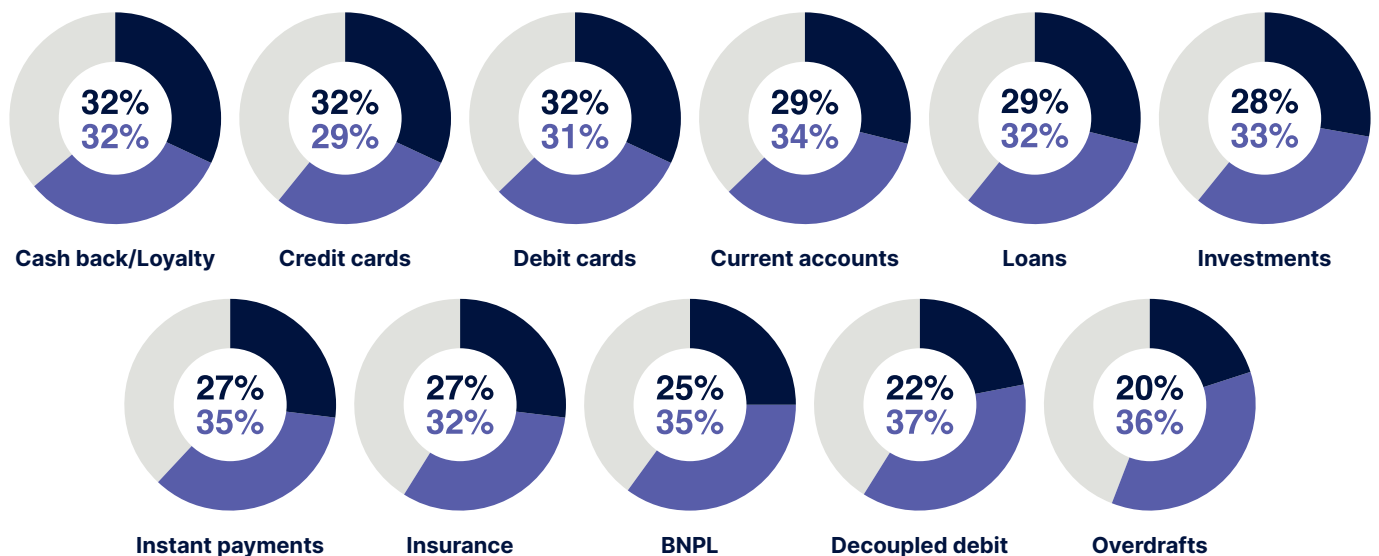


The most common solutions

Embedded finance is a broad term that encompasses a wide range of products and services, from loans and credit cards to deferred payments and insurance. As such, Vodeno’s research delved into the specific embedded finance solutions that are currently on offer.

Below is a full list of the most commonly offered embedded finance solutions, along with forecasts for the number of European retail companies planning to roll out each solution over the coming 12 months. Here the data pertains only to the companies that have already adopted embedded finance or intend to in the year ahead.

■ Number of European retailers currently offering it
■ Number of European retailers planning to start offering it by February 2023



The figures show how varied the embedded finance market is. There is no single product or service that accounts for the majority of use cases; rather, there is a relatively even spread of retailers embracing different offerings.

Indeed, despite 74% of European retailers saying they currently offer embedded finance, the most common solutions (cashback and loyalty, credit cards and debit cards) are only being provided by 32% of those companies.

In a recent report, Juniper Research predicted that between 2021 and 2026, the embedded finance market will grow in value by 215%. Moreover, it stated that the growth will be spread across five areas: embedded payments, embedded banking, embedding investments, embedded insurance and embedded lending. While lending is expected to account for the most significant growth, each of

these five areas is expected to see a notable uptick in demand from non-banks.

Vodeno’s research supports the findings from Juniper’s study, highlighting how retailers’ interest in embedded finance solutions spans multiple product verticals. The figures are largely consistent, whether looking at the number of retailers planning to roll out BNPL (35%) in the 12 months, or those targeting insurance (32%) and investment (33%) products.

Every retail company will differ in terms of what product it sells, to whom it sells, and how it sells to them. It is natural, then, that the areas of embedded finance that interest a retailer will vary based on their particular market, as well as the customer journey and experience they want to offer. Vodeno’s research illustrates just how broadly spread the embedded finance trend is.

BNPL

Retailers have long sought out ways to earn their customers' trust and attention in a competitive market. The shift to digital, particularly since the onset of the Covid-19 pandemic, means that brands today are under mounting pressure to deliver seamless, end-to-end customer experiences online.

Their goal is to make the customer journey and checkout as easy and frictionless as possible. This has driven innovation in embedded financial products in order to meet customer expectations, and it explains the recent rise of BNPL - split-payment loans at the point of sale. The appeal for shoppers is clear: they can divide payments into manageable chunks, usually interest-free, and don't need to sign up for a credit card to do so. Retailers, meanwhile, can increase conversion and basket size - they can expect a 20-30% increase in conversion - while reaching new customers and enticing repeat visits.

Ensuring that every step of the purchasing journey takes place within the brand's own platform, rather than forcing their users to leave their environment, also gives retailers the ability to understand their customers better. Armed with these insights, they can launch new commercial models, bolster revenue streams and ultimately deliver products and services that their customers want to see.

To date, most retailers have relied on third-party providers when integrating BNPL solutions into their offering. However, the rise of embedded finance means that any retailers today can create their own bespoke, white-labelled BNPL product. Merchants do not have to understand the ins and outs of delivering financial services directly to their customers - today, BaaS providers offer all the right tools they need to deliver fully compliant products with ease.



BNPL giants have already influenced customer expectations: shoppers now expect to see this offered at checkout. But, when retailers rely on third-parties for BNPL, the third-party provider is the ultimate winner. Instead, retailers can differentiate themselves by partnering with a BaaS vendor to create their own offering, keeping customers in their own ecosystem.

Motivating factors

Earlier in the report, it was noted that the majority of European retailers are witnessing greater demand from their customers for embedded finance products and services, with similar numbers also seeing competitors embrace these opportunities. Both these factors will no doubt influence senior decision-makers within retail companies to consider their own options for investing in embedded finance.

Vodeno’s study went further, exploring the key motivations for those retailers that have already adopted embedded finance solutions, or which plan to do so by February 2023. **This is what the survey uncovered:**

What motivates you to offer embedded finance?



As with the findings relating to the specific solutions that retailers are offering, the data shows that there is a wide variety of reasons why a retail company would choose to offer such products and services. No single factor stands out as being significantly more important than the other.

Creating new revenue streams (selected by 41% of retailers offering embedded finance as a major motivating factor for doing so), growing the customer basket and enhanced customer loyalty (both 40%) ranked as the three most important considerations. However, they did so only marginally. Gaining improved customer

loyalty (39%), having a faster or more convenient checkout, and increasing satisfaction with the brand (both 38%) followed closely behind.

Again, it is evident that different retailers are approaching embedded finance as a means of achieving their preferred commercial goals or outcomes for their customers. Indeed, the high proportion of respondents that selected each of the potential motivating factors suggests they are expecting embedded finance to have a transformative impact on their company. This point is supported elsewhere in the research.

What retailers expect from embedded finance

Further questions were put to the companies that offer embedded finance or intend to start doing so in the year to come. Namely, Vodeno sought to understand what retailers expect to achieve by embracing the trend.

The results are clear: the vast majority of retailers predict that embedding financial services and products will have a significant impact on their company. For example, 69% of senior decision-makers expect their company's brand reputation to improve as a result of offering embedded finance. Similar numbers believe they will provide a better customer experience (68%), while two thirds (66%) predict their revenue will increase thanks to embedded finance.

Elsewhere, 66% said they think their operational costs will reduce as they begin offering embedded finance solutions. Most (64%) also expect they will be able to acquire new customers in the next 12 months as a result of embedding financial services into their offering.

The study shines a light on how integral embedded finance is becoming critical to business goals, such as boosting revenue, improving brand reputation, lowering costs and attracting new customers. Embedded finance is not seen as a means of achieving either operational efficiencies or commercial gains; it is clearly regarded as a means of achieving both.



CEO Q&A - How embedded banking drives customer experience innovation

1. BaaS offers brands the ability to embed financial services directly into their ecosystem, giving them the opportunity to?

2021 accelerated the trends that were already emerging in 2020, including eCommerce, digital access to services and instant payments. Consumer expectations have evolved; they now expect completely seamless and frictionless online experiences, particularly in the checkout journey. Conversely, brands recognise the value of creating the perfect customer journey in order to drive conversion and revenues.

Here is where the promise of Banking-as-a-Service meets brands' needs when it comes to achieving their digital experience innovation goals.

BaaS offers brands the ability to embed financial services directly into their ecosystem giving them the opportunity to focus on their customer experience in order to create new commercial opportunities and develop personalised products and services.

2. Which use cases are on the rise, and what does the future have in store?

Embedded finance is driving customer loyalty innovation. Loyalty programs that directly link rewards to payment cards is the holy grail in retail. This allows customers to make use of rewards instantly, and loyalty programmes can also incentivise further purchases and help generate additional revenue streams.

We offer a product called decoupled debit cards. This enables retailers to link their own branded debit card to a customer's preferred bank account – giving them the ability to seamlessly pay for purchases using the card, with payment of funds automatically processed via the customer's bank of choice.

Decoupled debit eases the friction of adopting a new debit card because the user does not need to top-up funds in order to use the card, and brands can layer on additional benefits like cash back and loyalty incentives when the card is used.

3. What common mistakes do retailers make when setting up their first embedded banking solutions?

The biggest mistake a retailer can make is to outsource their banking product to a third-party. When your customer needs to leave your environment to complete a purchase, the third-party vendor controls that customer relationship. BaaS providers offer retailers a more powerful alternative to deliver embedded banking solutions, with the customer staying completely within their ecosystem.

It is also important to find the right partner: the companies providing BaaS solutions must be not only experts in the underlying technology, but also have a deep understanding of banking and the end use cases in sectors like retail.

This is what we offer at Vodeno, a fully API-based, cloud-native banking platform that covers all aspects of Retail and SME banking with access to a European banking licence and regulatory and compliance expertise.

What to know when partnering with BaaS vendors

With embedded finance evidently an integral part of most retailers' plans, either at present or for the year ahead, the question arises of how these solutions are delivered from a practical perspective.

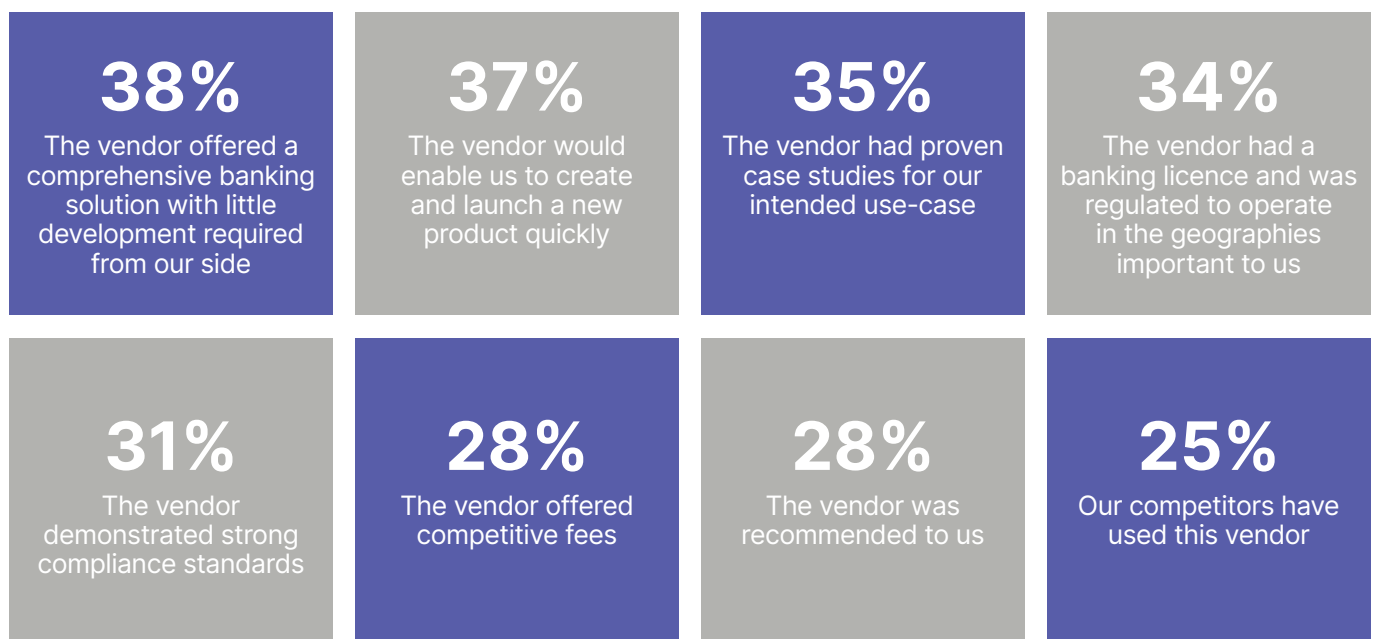
As noted at the start of this report, the rise of embedded finance is underpinned by the rapidly growing BaaS market. When working with retailers, a BaaS provider typically acts as an invisible third party, offering the underlying technology and often taking care of the compliance and balance-sheet requirements in the background, allowing businesses to focus on delivering a seamless shopping experience and creating new value-adding products.

In this way, finding the right BaaS partner is key in the delivery of embedded finance solutions. Indeed, according to Vodeno's research, in 2021 two thirds (66%) of European retailers engaged

with technology vendors to help them create and embed financial products into their business model. The figure was even higher in the UK and Germany (both 71%), but markedly lower in Belgium (58%).

The study also uncovered what retailers are prioritising in their search for a technology vendor that will support the rollout of embedded finance solutions. Speaking to those 66% of companies that had engaged with vendors in the preceding 12 months, this is what they selected as the most important considerations when choosing a firm to work with:

Key factors when choosing a BaaS provider or technology vendor for the rollout of embedded finance solutions



What to know when partnering with BaaS vendors

Speed and ease of implementation were critical factors, along with demonstrable experience of working on projects specific to the desired use case. Retailers are evidently seeking swift, painless ways of launching new financial products and services within their business; the ability to do so at pace outweighed costs or word-of-mouth recommendations when choosing a vendor.

The need for a technology vendor to have the necessary licencing and compliance protocols were also deemed important by many retailers, if not always their primary focus. As the BaaS and embedded finance markets grow and mature, there is likely to be a further shift in this regard.

Experienced BaaS providers that have access to a European banking licence can offer quick implementation with no upfront costs and low business risk. Businesses can focus on serving their customers, while the legal and regulatory requirements of offering financial services are covered by the BaaS provider.

An out-and-out technology vendor cannot typically offer those additional services or arrangements for retailers. There is, therefore, an important distinction to be made between BaaS providers that have access to banking licences, and those that just provide the technological solution.



The views from Vodeno

“ The retail sector is undergoing one of the most profound periods of transformation in its history. The ability to embed financial products and services into the customer journey is elevating the way brands, retailers and eCommerce firms operate.

“Payments, cards, loans, insurance – the fact retailers can deliver much-sought-after financial solutions within their own ecosystem in a completely seamless way is a monumental shift. It opens up an entirely new world to businesses that have hitherto traded only in physical goods.

“Our timely research offers a fascinating insight into this rapidly evolving space. Without a doubt, there are many important findings to take away from the study, not to mention some lessons for BaaS providers and retailers to learn.

“Perhaps most notable is just how many of Europe’s retailers are already actively offering or pursuing embedded banking. Indeed, it is already becoming common that when buying an item, a retailer will allow the customer to split or defer payments, or perhaps offer insurance for the product at the point of sale. While, at present, this is primarily taking place via third-parties, embedded finance offers the opportunity for retailers to keep everything in-house without needing to rely on an external provider.

“Retailers today are alert to the fact that customers will quickly expect such services from their favourite vendors or brands as table stakes. There is a definite sense of urgency, as shown in the findings detailed in this report; Europe’s retail companies know they cannot be left behind

– this is not a technological fad, but rather a fundamental paradigm shift in how the sector can and will serve consumers in the future.”

“For decades, compliance and regulation were significant barriers that prevented retailers from offering financial services. It is only thanks to modern BaaS providers that these barriers are now gone. Yes, having the right APIs, technical infrastructure, connectivity and partnerships are all crucial for retailers seeking out a BaaS partner. But these technological considerations can only take a project so far – it is the access to a banking licence and banking know-how coupled with regulatory expertise that will enable truly revolutionary ideas to become reality.”

“Vodeno is proud to be at the forefront of BaaS and embedded finance. We offer instant access to one of the most comprehensive BaaS platforms on the market. Today, our clients are able to deliver innovative, state-of-the-art financial solutions to their customers with complete peace of mind, powered by our cloud-native, API-based technology and access to a European banking licence with all the regulatory and compliance assurances it provides. As the retail sector transforms into its next stage, we offer retailers the technology, tools and expertise in order to move their business forward and stay competitive. ”



Wojciech Sobieraj
CEO, Vodeno



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