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# **Embedded Finance Is Driving Innovation and Differentiation in Banking**

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## Embedded Finance Is Driving Innovation and Differentiation in Banking

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Initiatives: Financial Services Digital Business Strategy and Innovation

Embedded finance's threats and opportunities are influencing strategic thinking in many banks and nonbanks across the globe. Bank CIOs can use this framework to better understand embedded finance and prepare technology infrastructure to support new demand- and supply-side threats and opportunities.

### Overview

#### Key Findings

- Embedded finance is reshaping the banking industry. It is enabling new nonbank competitors to enter the market and transforming the delivery of banking products to retail and corporate customers alike.
- An embedded finance strategy includes two intents — the enterprise's consumption of an embedded service, or the enterprise's distribution of an embedded service.
- The embedded services consumed or distributed by banks can be financial or nonfinancial in nature.

#### Recommendations

Bank CIOs looking to support digital business strategy and innovation can:

- Initiate planning and brainstorming sessions with executive and line-of-business colleagues, using Gartner's framework to highlight strategically important financial and nonfinancial components for the immediate market.
- Incorporate those components into a series of scenarios, using the bank's appropriate scenario planning methodology. In addition, incorporate both consumption and distribution options, describing bank options as well as scenarios available to competitors.
- Define the key role that technology such as APIs and architectures will play in facilitating the bank's strategic response to embedded finance.

## Introduction

Bank products and services are rarely exciting for retail customers. And for corporate customers, they are too often delivered through fixed portals or delivery channels. They are a means to an end, enabling customers to transact, acquire products and consume services that they need to live and operate. However, that status quo is being disrupted, as financial services are embedded at the consumption level, in the very products, services and supply chains that they are supporting. The financial services components are being distributed to the points at which customers need and consume them. As a result, access to a payment solution or a line of credit doesn't require the customer to engage with the bank-owned distribution channels.

At first sight, the concept of embedded finance represents a significant threat to existing bank business models. And that threat is real, enabling new agile partners to step in between traditional banks and their customers to deliver embedded financial services directly to the customers. Regulators, such as the European Banking Authority (EBA), have started to recognize the extent of this threat to traditional banks. <sup>1</sup> However, embedded finance also offers a unique opportunity for innovative banks to reinvent their distribution strategies and engage customers across multiple new service environments.

And beyond the extensive client inquiries on the subject, banks are also telling Gartner that the concepts of embedded finance are central to much of their strategic thinking. Several key findings from the 2021 Gartner Legacy to Digital Platform Survey include:

- Sixty-two percent of banks said they viewed creating new products and services in partnerships with fintech operators within the banking industry as a high priority.
- Importantly, 42% placed that same high priority on collaborating with nonbanking startups to provide new products and services.
- And 40% of them were prioritizing the distribution or integration of nonbanking products into their customer offerings.

So is embedded finance a threat or an opportunity for bank CIOs? The view depends very much on how the traditional banks establish their embedded finance strategies. Consequently, Gartner's embedded finance framework has one very simple aim. It is to clarify these threats and opportunities, and enable bank CIOs to work with executive colleagues on a clear strategic vision and technology prioritization for embedded finance's role in the bank's overarching digital banking strategy.

## Analysis

### Use Gartner's Embedded Finance Framework to Support Planning and Brainstorming Sessions With Executives

Embedded finance leverages open technology principles and strategies, with API-led financial and nonfinancial product and service components combining to address specific customer wants or needs. Mainstream thinking on embedded finance focuses on the central principle of enabling customers to consume their chosen product or service, with minimum friction or resistance. Placing the financial component of the transaction in front of customers, at the exact point in which they need it, causes customers to be better able to complete the transaction. So mainstream embedded finance examples include the ability to insert specific payment or credit products into the sales transaction.

However, Gartner has now expanded the mainstream view of embedded finance to encourage a wider perspective on the threats and opportunities. Gartner's view now includes the integration of financial and nonfinancial capabilities to enable fundamentally new customer experiences and business models for banks. This view enables banks to think innovatively on how they source and distribute the financial component, and how they will need to partner with external stakeholders to access and orchestrate the nonfinancial components.

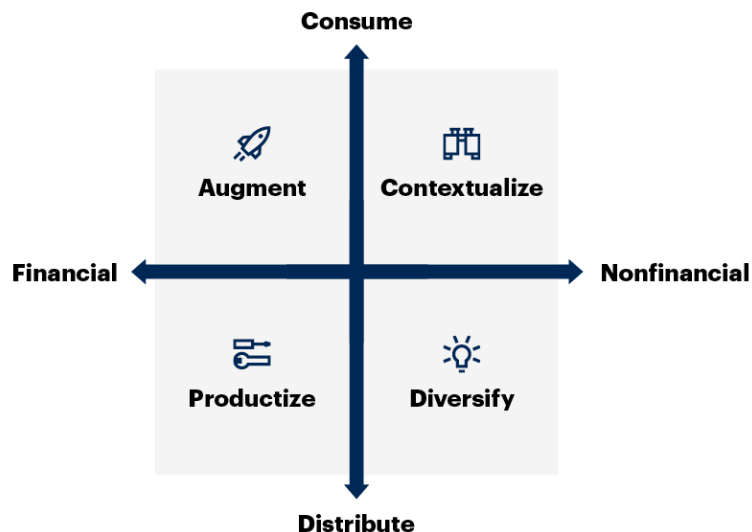
Gartner uses an embedded finance framework to help describe the embedded finance market space, focusing on components that combine to address the customer need or want. The framework then offers a perspective on whether banks should consume a component from an external provider, or distribute those components themselves. The framework uses two axes to describe:

- On the x-axis** – The nature of the embedded services and the types of financial and nonfinancial components that can be combined. Financial components might include anything from a payment to an anti-money-laundering capability. Nonfinancial components may include an ability to organize transportation and mobility (for example, ride hailing or renting a car), a digital commercial capability (for example, online ordering services and ticketing), or a carbon footprint dashboard.
- On the y-axis** – The source of the embedded services and the options to source or distribute those financial and nonfinancial components. Nonfinancial components would include a bank consuming services provided by an external banking-as-a-service provider, or distributing those components itself as the service provider. Equally, a bank might be sourcing a range of external nonfinancial components, and orchestrating an ecosystem to help a customer buy a property or a car. Equally, a bank might be distributing financial accounting or e-invoicing solutions to its small midsize corporate clients (see Figure 1).

More-detailed analysis of use cases is described below and in *Embedded Finance Use Cases for Your Digital Transformation*.

**Figure 1. Gartner Embedded Finance Framework**

### Gartner Embedded Finance Framework



Source: Gartner  
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## Incorporate Those Components Into a Series of Scenarios

This approach enables four distinct strategy approaches to evolve: augment, productize, contextualize and diversify.

### Augment

This is where existing or future financial services offerings are augmented with financial components sourced externally, or from other parts of the enterprise. This segment would describe scenarios where a product marketplace approach has been adopted, such as Starling Bank's eponymous product marketplace <sup>2</sup> or the more distributed offering from Revolut. <sup>3</sup> Or the scenario is where specific financial capabilities have been added to an existing portfolio, such as the integration of Wise's foreign payment capability by Stanford Federal Credit Union <sup>4</sup> or Dutch digital bank bunq. <sup>5</sup>

This strategy segment may also be useful to enterprises where internal-facing APIs are already described as products. In this instance, the sourcing of these financial components may be viewed in much the same way whether they are sourced internally or from external providers.

### Productize

This approach describes how financial components may become products in their own right, and the bank looks to distribute those functional components as products to other enterprises that might wish to offer that functionality to their own customers. This approach will encompass many of the developing banking as a service (BaaS) models that are being more commonly offered by many banks and technology providers. One example is Solarisbank's know your customer (KYC) as-a-service offering <sup>6</sup> (see Embrace Banking as a Service and Help Unlock New Revenue Streams) . However, it will also include wider distribution models – for example, where the financial component is integrated into the back-office environments of customers, such as those provided by Nordea to its customers. <sup>7</sup>

The wider flexibility of the model – expanding thinking on BaaS to include capabilities consumed directly by customers – is illustrated when looking at another KYC offering. The Nordic banks have collaborated to offer a utility KYC service supplied by a collective, Invidem, <sup>8</sup> accessible by both banks and their customers. In the context of its consumption by their corporate customers, the KYC component becomes a product, and sits in this productize segment. However, as the Nordic banks will also consume these KYC components, the model enables the user to describe those contexts in the augment approach.

## Contextualize

Moving into the nonfinancial half of the framework, we start to describe components that either individually, or in combination, address specific customer issues or problems. The immediate intellectual challenge for many banks will be that these components address customer problems or issues that do not immediately align to “traditional” banking products or services. One example is the storage and analysis of a digital receipt generated by a payment transaction, such as that offered by Flux.<sup>9</sup> Another example is the provision of a carbon tracking application to enable retail customers to understand the impact of their day-to-day payments, such as those offered by Cogo,<sup>10</sup> Doconomy<sup>11</sup> or Svalna.<sup>12</sup>

Combined examples would include offerings from the likes of DBS in Singapore, with its “buy a car” marketplace.<sup>13</sup> This helps customers find and purchase an appropriate motor vehicle, and embeds insurance, maintenance and funding components in the purchase transaction. Similar examples from DBS exist to help customers purchase property, arrange holidays and travel, or even make regular e-commerce-type purchases.

## Diversify

The diversify approach supports banks that have developed clear insight on the opportunities that derive from nuanced and sophisticated ecosystem strategies. With this approach, banks will distribute nonfinancial components to third parties. This may be in a proxy BaaS model, through provision to other banks – for example, Ålandsbanken’s provision of its Åland Index carbon tracking product.<sup>14</sup>

More commonly, the components may be provided directly to customers, where the components are offered as part of the ongoing customer relationship. For example, invoicing software is integrated into the banking package provided to small and midsize business clients, from the likes of Mettle in the U.K.<sup>15</sup> and DBS in Singapore.<sup>16</sup> Similarly, carbon tracking analytics is integrated into customer dashboards, by the likes of BBVA in Spain,<sup>17</sup> or operational business data is integrated into a customer-facing dashboard by Barclays in the U.K.<sup>18</sup>

## Facilitate Your Bank’s Strategic Response to Embedded Finance

Gartner’s embedded finance framework should be used in two very simple ways:

## Facilitate Your Bank's Strategic Response to Embedded Finance

Gartner's embedded finance framework should be used in two very simple ways:

- As a brainstorming and discussion framework to enable business and technology executives to deepen their understanding of embedded finance models, and begin to describe an embedded finance strategy for their organizations. CIOs can initiate a number of such brainstorming sessions, focusing initially on the axis, and then on specific capabilities, to understand the appetite of the business to develop products or services enabled through embedded finance. This should include initial views on business value generation – not full business cases – and highlight any appetite and potential for the bank to provide BaaS capabilities itself.
- As a way to describe the technology enablers that will be required to support the consumption or delivery of such capabilities. These enablers would include API architectures, data governance rules, digital business platform capabilities and the like. Again, the objective would not be to define these technology needs at a high level of granularity – rather, the objective is to provide a sense check on the scale of the technology requirements to support the business.

Populating the framework with real-world examples will help this discussion process. Gartner has developed Embedded Finance Use Cases for Your Digital Transformation, which provides a range of examples to more clearly illustrate how the framework might be used.

One final point. The framework design enables CIOs from all types of banks to develop this insight. For banks still at the early stages of digital innovation, with CIOs focused more on process and operational cost optimization, it will expose opportunities to leverage external financial components. In these instances, CIO focus will likely be around augmentation, with some limited opportunities for contextualization.

For more digitally mature banks, the framework enables their CIOs to envision the delivery of everything, including optimized customer experience, through quite fundamental changes to the business model. In these instances, CIOs will be challenged to address all four segments, albeit with contextual decisions on the timing for each one.

### Evidence

2021 Gartner Legacy to Digital Platform Survey asked, "As part of the design of your digital banking platform, which of the following options is the most important priority for your organization to grow your digital and mobile banking channels and applications?"

<sup>1</sup> EBA Sees Rapid Growth in the Use of Digital Platforms in the EU's Banking and Payments Sector and Identifies Steps to Enhance the Monitoring of Market Developments, EBA.

<sup>2</sup> Starling Marketplace.

<sup>3</sup> Revolut.

<sup>4</sup> Wire transfers at Stanford Federal Credit Union.

<sup>5</sup> Wise transfers in the bunq app.

<sup>6</sup> KYC Platform at Solarisbank.

<sup>7</sup> Nordea Open Banking API product family.

<sup>8</sup> Invidem.

<sup>9</sup> Flux for Banks.

<sup>10</sup> Cogo.

<sup>11</sup> Doconomy.

<sup>12</sup> Carbon calculator by Svalna.

<sup>13</sup> DBS Car Marketplace.

<sup>14</sup> Åland Index.

<sup>15</sup> Mettle invoicing.

<sup>16</sup> DBS InvoiceNow.

<sup>17</sup> BBVA, the World's First Bank to Use Data Analytics to Calculate Companies' Carbon Footprint, BBVA.

<sup>18</sup> SmartBusiness Dashboard by Barclays.

## Recommended by the Authors

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