The Fintech Spotlight

A look at what's happening across the fintech ecosystem
Welcome to the Fintech Spotlight, a quarterly report that provides insights and analysis on trends across the fintech ecosystem.

The report is divided into six sections:

- **Personal financial management (PFM):** The next frontier of rewards
- **Wealth:** Blending traditional wealth management and robo-advisors
- **Lending & Advance access to funds:** Targeting consumer needs
- **Consumer payments:** Tender steering to ACH payments
- **Business financial management (BFM):** Untapped opportunities among SMEs
- **Banking:** A future in embedded finance

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**A WORD FROM PLAID**

The three months since the last edition of the Fintech Spotlight might as well have been three years. Multiple COVID vaccines were approved, a new administration was sworn into office, and a third stimulus package was passed by Congress (not to mention, Reddit paid a visit to Wall Street⁴).

While the Biden–Harris administration faces a great number of challenges as 2021 continues to unfold, two particular areas of focus stand out beyond the immediate concerns over vaccine roll-out. First, there’s the mammoth task of rehabilitating the economy in a post-COVID world. Given the changes to both consumer circumstances and behavior over the past twelve months, this economic rebuild represents a continued opportunity for fintechs to meet consumers’ evolving needs and expectations. The ability to tap a screen and instantly have a car at your door or the latest movie on your TV has upped the expectations for every aspect of life—including banking. The assumption is that money should now be sent instantly, mortgages applied for in minutes, and the overall experience friction-free. Those who fail to meet these consumer expectations risk being left behind.

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⁴ *New York Times*, 2021

"The ability to tap a screen and instantly have a car at your door or the latest movie on your TV has upped the expectations for every aspect of life—including banking."

**ERIC SAGER**

*Chief Operating Officer, Plaid*
Second, there’s increased opportunity to address societal and financial inequalities head on. Here again, the fintech industry can offer an important piece of the solution, blazing a path towards the adoption of financial services like earned-wage access, balance checks to avoid overdraft fees, and cash-flow underwriting. Solutions like these particularly benefit nontraditional and underserved financial-services profiles and have the potential to apply market pressure to the industry as a whole, leading it away from many of its socioeconomically biased practices. As consumer expectations evolve, so will the industry’s accepted norms.

The key lies in ensuring people can easily access and securely share their data in order to take full advantage of the products and services now available to them. Until recently, US laws governing data sharing focused almost exclusively on protecting people from the harm arising from its unauthorized access and inappropriate use. Concern has now shifted to concentrate on the harm arising from a lack of access to consumer-permissioned data and the related narrowness of options in financial services that often impact populations disproportionately.

Through this move toward open finance, fintech is helping to create a more connected and accessible financial ecosystem—one that gives consumers greater freedom and control. The massive shift in consumer adoption creates an opportunity, and an urgency, for all of us to accelerate innovation to deliver the digital experiences that people now expect.

ERIC SAGER
Chief Operating Officer, Plaid
From consumer credit cards to a range of apps and services, rewards have been proven to attract and retain customers. But their focus is shifting.

According to a report by the Consumer Financial Protection Bureau, the share of overall purchase volume on rewards credit cards has been steadily climbing since 2015, with 60% of new accounts in 2018 offering rewards. At the same time, research by Cornerstone Advisors indicates that consumers who choose a digital bank do so in part for better rewards.

SURVEY: REASONS CONSUMERS OPEN A DIGITAL-ONLY BANK ACCOUNT

<table>
<thead>
<tr>
<th>Reason</th>
<th>Millennials (21-29 y.o.)</th>
<th>Millennials (30-38 y.o.)</th>
<th>Gen Xers</th>
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<tbody>
<tr>
<td>To get better financial management tools</td>
<td>44%</td>
<td>25%</td>
<td>23%</td>
</tr>
<tr>
<td>To get better debit card rewards</td>
<td>28%</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>To try it out</td>
<td>24%</td>
<td>29%</td>
<td>23%</td>
</tr>
<tr>
<td>To get better interest rates on deposits</td>
<td>23%</td>
<td>29%</td>
<td>35%</td>
</tr>
<tr>
<td>Other reasons</td>
<td>9%</td>
<td>20%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Source: Forbes, 2019 (Cornerstone Advisors survey, respondents could choose all that applied)

With physical movement severely reduced due to the COVID-19 pandemic, rewards have shifted from flight miles and travel perks towards offsetting everyday purchases like groceries, food delivery, and even streaming services. A PayPal study underlines this change: 66% of US consumers now see credit card reward balances as a means to buy the things they need. And though this may have begun as a temporary way for credit card issuers to encourage spending and offset pandemic declines (see Citi, Bank of America, Capital One, Wells Fargo and more), it’s evolved into long-term offers and permanent strategies on some of America’s most popular rewards credit cards.

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66% of consumers see credit card rewards as a means to buy necessities.

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8 CFPB, 2019
9 Forbes, 2019
10 PR News Wire, 2020
11 Next Advisor, 2020
12 Next Advisor, 2021
Take Chase’s new Pay Yourself Back program, for example. It allows their Sapphire cardholders to redeem points at the increased rate they normally would receive on travel redemptions, in order to help pay for grocery, dining, and home improvement purchases. Amex, too, recently added new rewards for both their consumer and small business cardholders following an uptick in proprietary billed business year over year in Q3 2020, which was largely driven by updated rewards offerings.

Substantial focus on rewards is being seen elsewhere, as well, with competition driving innovation:

- Walmart-controlled Flipkart Group, an eCommerce marketplace with 300 million customers, is now allowing its users to leverage rewards points alone to pay for products—online and off—via the Flipkart app and QR codes displayed in partner stores.

- Upgrade mobile banking has launched a debit card rewards product with 2% cash back on everyday expenses like groceries, drugstores, restaurants, deliveries, and gas, as well as monthly subscriptions like cable or their streaming services of choice.

- Rental management app Stake is providing tenants with data-driven rewards, offering them property-specific cash-back if they make their rent payments on time.

- And in perhaps the most forward-thinking bet: cryptocurrency-based lender BlockFi announced a new rewards credit card that offers Bitcoin in place of cash back, points, or miles. The only credit card of its kind, it joins a handful of crypto-focused debit card reward programs that could eventually disrupt the industry.

Plaid’s take:

More and more, rewards are being treated as a financial asset rather than a bonus. That means they must reflect authentic consumer need and behavior while offering genuine value. A substantial opportunity remains to develop a real-time (rather than end-of-statement) scenario in which rewards arrive instantly with every swipe, customized to each user’s unique data.

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11 Next Advisor, 2020
12 Business Insider, 2021
13 PYMNTS.com, 2021
14 PYMNTS.com, 2021
15 Millionacres, 2021
16 Investopedia, 2021
$68 trillion in wealth is expected to be transferred to Gen X and Millennials over the next two decades.

WEALTH

While the traditional advisory model increasingly borrows from automated investment management, the reverse is equally true. A wealth of opportunity lies in the space between.

The past eighteen months have seen a notable rise in autonomous wealth management solutions that can be accessed directly from investors’ pockets. The proof: 1 in 7 Americans who have investment accounts now use a robo-advisor. Moreover:

- 58% of Americans expect to use a robo-advisor by 2025.
- And 45% think robo-advising will be the technology with the biggest impact on financial services.

These largely younger customers, previously shut-out from wealth management services, should not be undervalued. Roughly 70 million Baby Boomers, who control around 70% of all disposable income, are expected to transfer $68 trillion in wealth to Generation X and Millennials over the next two decades. And the latter (43% of whom are already investing) are projected to have more disposable income than any other generation in less than eight years. The financial services firms in whom they put their trust today are likely to reap rewards tomorrow.

That’s why behemoths like Fidelity and Charles Schwab now offer their own versions of robo-advising. Goldman Sachs, too, is slated to debut its Marcus Invest solution by the end of this quarter in a bid to appeal to the young and mass-affluent consumers of the growing retailer investor market. In 2020, individual investors made up 19.5% of U.S. equity trading volume, up from roughly 15% the year before.

17 NerdWallet, 2020
18 Nasdaq, 2021
19 Cerulli Associates, 2018
20 Yahoo! Finance, 2019
21 Fundstrat, 2018
22 Fortune, 2021
23 Investopedia, 2020
But all is far from lost for traditional wealth advisory. To the contrary: out of the $43 trillion North American wealth management market, it’s estimated that robo-advisors held only $330 billion in assets under management (AUM) at the end of 2019, though this number is expected to rise to $830 billion by 2024.²⁴

More importantly, given the option, 84% of Americans would still rather work with a human financial advisor to invest their money.²⁵ Indeed, robo-advisors are not fully able to provide tailored and holistic financial planning services for their clients—particularly when dealing with the complexities around large sums, which call for more personalized advice. These include questions around taxes, estate structuring, and insurance needs, all of which cannot currently be automated.²⁶

Likewise, robo-advisors lack the ability to keep clients calm—a strong reason to believe advisors will hold even greater value in the aftermath of the pandemic, which has caused markets to become volatile.

Plaid’s take:

Driven by fintech’s disruption of the industry model, advisory firms have transitioned from a commission-based to fee-based structure. Their challenge to attract tomorrow’s customers means operating with more agility and speed, while identifying key areas where technology is lacking and human experience can be leveraged.
LENDING & ADVANCE ACCESS TO FUNDS

A combination of fintech innovation and regulatory oversight is driving the industry forward by addressing specific consumer needs.

Take earned wage access, also known as “on-demand pay”. It allows employees to satisfy short-term liquidity needs that may arise between pay cycles, which have remained unchanged for decades due to cash flow constraints and payroll processing inefficiencies.²⁷

Given the economic instability of 2020, the ability to access income as it is earned has become essential for many Americans:

- A study by the Financial Health Network found that 38% of respondents cited misaligned timing between income and expenses as a reason for using short-term, small-dollar credit.²⁸
- A Harris Poll survey showed that 36% of employees currently rely on their employer for financial assistance programs.²⁹
- A user survey by on-demand pay provider DailyPay indicated that one in six job seekers are searching for an employer who offers earned wage access,³⁰ making it a competitive recruitment tool.

The growth of these providers prompted the Consumer Financial Protection Bureau (CFPB) to issue regulatory guidance at the end of 2020 in an effort to provide more structure to the ecosystem. The framework it laid out strongly supports an employer-based approach in which the provider partners with an employer to provide the service as an employee benefit.³¹

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³⁷ CFPB, 2020
³⁸ CFPB, 2020
³⁹ PR Newswire, 2020
⁰ Yahoo! Finance, 2021
¹ Fintech Times, 2021
Buy now pay later (BNPL) is another example of how focus on a specific consumer need has sparked larger movement within the industry. Having begun as an e-commerce trend squarely focused on Gen Z and credit-averse consumers, it’s increasingly becoming accepted for payments in physical stores as well—all while spurring on major e-players like Shopify and PayPal to launch their own installment services.

- BNPL is enabling a new kind of consumer behavior, normalizing the use of point-of-sale loans for everyday purchases as low as $35.
- BNPL purchases totaled $24 billion in 2020, despite estimates indicating that just 7% of consumers used installment payment services in the first three quarters of the year.³²
- Niche versions of the service are popping up, such as startup PrimaHealth Credit, which is specifically designed for credit-challenged patients seeking elective healthcare treatments.³³

US PURCHASES USING BUY NOW PAY LATER (BNPL)

![Chart showing US purchases using BNPL]

Source: Forbes, 2020

**Plaid’s take:**

Addressing specific consumer needs and/or niche markets that traditional financial services have missed means big potential returns. For these untapped markets, targeted solutions equate to more options and greater regulatory protections—to the benefit of the consumer’s financial health.

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³² US Chamber of Commerce, 2020
³³ TechCrunch, 2020
CONSUMER PAYMENTS

For online services and subscriptions, the benefits of ACH payments over credit cards are clear. Nonetheless, customer conversion remains elusive.

For consumers making a purchase or signing up for a paid service online, the credit card is king: it’s fast and convenient, allows them to buy now/pay later, and often offers attractive rewards. However:

- Credit card payments are expensive for merchants, who pay up to 3.5% of the purchase sum in processing fees.
  
  In 2018, for example, merchants paid an estimated $64 billion in interchange fees.

- Moreover, credit cards are known for causing involuntary churn, which makes up between 20-40% of overall payment churn. Think lost or stolen cards, changes to billing addresses, maxed-out credit limits, and—the biggest culprit—expired cards. Reports have shown that these unnecessary declined payments cost retailers $40 billion every year.

On the other hand, bank-to-bank payment types such as ACH mitigate many of these recurring payment issues, offering very low fees and little-to-no churn (a checking account can’t get left behind in the backseat of a taxi, for example). This translates into a mere 1-2% decline rate, as opposed to a 15% decline rate for credit cards. ACH fraud risk can also be reduced when the payment type is paired with account connectivity, by verifying important user identity details.

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20-40% of overall payment churn is involuntary.

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34 Bankrate, 2020
35 Business Insider, 2020
36 ProfitWell, 2017
37 Chargebee, 2020
38 Fin, 2019
But there's a catch: consumers lack a natural incentive to enter their account and routing numbers rather than their credit card details. They also lack a compelling reason to make the switch once their means of payment has already been set up. Therefore, a bolder approach is needed.

Businesses are beginning to think about how they can guide their customers toward ACH payments by using tender steering, in which incentives are employed to actively drive customers towards a particular form of payment. In the case of subscriptions, this could take the form of a meaningful incentive around ACH payments (e.g., a free month of service) or a strong disincentive around credit card payments (e.g., a 3% convenience fee). This would ultimately enable businesses to expand their menu of payment options and push their customers towards a stickier solution.

**Plaid’s take:**

*Consumer behavior doesn’t change overnight, and certainly not without a nudge. Only when recurring ACH payments benefit the customer’s wallet in a meaningful way—and not just a business’s bottom line—will they become the go-to for online subscriptions and services.*
As small businesses begin to think strategically about a post-COVID future, business banking and financial management services have a golden opportunity to give them what they need.

Small businesses account for more than 99% of all U.S. firms, making them a critical part of the American economy. But from February to April of 2020, 3.3 million permanently shuttered. Of those who’ve weathered the storm, many are considering how best to position themselves in the post-COVID economy.

Yet while the challenges they face have been exacerbated by recent circumstances, they’re hardly new. These include things like day-to-day financial management across multiple platforms and—in particular—access to capital. The numbers speak volumes:

- As of November 2020, small business loan approval percentages at big banks had dropped to 13.3%. Pre-COVID, this number was already concerning at 27.5%.
- The rate of approval at small banks landed at just 18.3%—down from 50.5% the previous year.
- This is not an America-only phenomenon. Even before the pandemic, a global gap of over 5 trillion USD existed between the financing needs of micro, small and medium-sized enterprises (MSMEs) and the institution-based financing available to them.

Only 13.3% of small business loans in the US are approved at big banks.

**RATE OF SMALL BUSINESS LOAN APPROVAL AT SMALL BANKS**

![Graph showing rate of small business loan approval at small banks](image)

**Source:** Global Newswire, 2020

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39 Forbes, 2021
40 Stanford Institute For Economic Policy Research, 2020
41 Crowdfund Insider, 2020
42 Bank Automation News, 2019
43 Global Newswire, 2020
44 Entrepreneur, 2018
There are other unmet needs, as well. A Doblin survey showed that small businesses need help reducing expenses (41% of the sample) and generating revenue (40%). But in a telling statistic, research by Accenture indicates that 42% of small and medium-sized businesses believe that alternative providers can offer better service than traditional banks.46

This is why many fintechs, who've had success with dedicated business products targeting specific needs, are now looking to expand to a full range of business financial services. Among them:

- Shopify continues to add new services dedicated to small businesses, such as payments and lending.
- The Square ecosystem now includes Square Capital, a business lending offer, and is working on launching its own bank.
- Intuit has been building out credit and deposit/payment functionalities among the existing users of its Intuit QuickBooks products.
- Companies like these have the added advantage of seeing real-time data around their existing systems, enabling them to better serve their customers.

But traditional banking services have a role to play, too: a poll showed that 62% of SMEs currently receive or would consider receiving access to remote advisory service—and that assistance with operations, sales, marketing, and business development is also top of mind.46 This represents an opportunity for banks to lean into the personalized human expertise that they’re well positioned to provide.

Plaid’s take:

When it comes to financial services, small businesses are highly underserved. They require products and services which address their most pressing concerns, providing the efficiency and turbo-charged growth the current economy demands. Those companies that already have a strong foothold in their ecosystem will be best positioned to deliver all-encompassing solutions.
With embedded finance poised to reshape the financial services industry, companies should build their strategies around their place in the ecosystem.

Until recently, fintech’s focus has been on standalone apps that improve traditional financial services. With embedded finance, these tools are on track to become integrated into digital companies across all sectors of the global economy. At its core, embedded finance involves the integration of one or more financial services into non-financial products, enabling companies from a diverse range of industries to layer in banking capabilities—and significantly broaden their overall value propositions. At the same time, it provides consumers with access to financial services right at their point of need, often in the form of payment solutions.

This has fueled massive growth at companies like Stripe and Square—estimated today at a worth of $36 billion and $57 billion respectively. Along with others, they’re now moving beyond payment services into other more complex capabilities like lending, insurance, and wealth management.

This is particularly attractive to digital brands and merchants, as it creates new revenue opportunities at very low marginal cost while making the most of their existing customer base. It also enables new customer experiences that drive loyalty, allowing merchants to capture additional economics. Shopify, for example, makes over $500 million per annum from embedded financial services to its merchants.

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47 International Banker, 2020
46 International Banker, 2020
49 Fintech Futures, 2020
50 Fintech Futures, 2020
A study shows that the embedded finance market will reach just under $230 billion in terms of new revenue volume by 2025 in the US alone—an increase of 922% over 2020.51 Three interconnected categories of companies are driving the bulk of this growth, according to a report by Lightyear Capital:52

- Embedded service providers like Affirm who plug financial offerings into platforms with the goal of increasing distribution and bettering customer retention.
- Firms (like Plaid) who offer data infrastructure and connectivity through APIs and banking-as-a-service platforms.
- Companies (like Amazon and Shopify) who provide platforms that allow customers to access a range of solutions in a frictionless manner.

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**EMBEDDED FINANCE MARKET: FORECASTED GENERATED REVENUE**

<table>
<thead>
<tr>
<th>Category</th>
<th>2020</th>
<th>2025</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wealth management</td>
<td>$0.0</td>
<td>$2.6</td>
<td>$2.6</td>
</tr>
<tr>
<td>Consumer lending</td>
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<td>$15.7</td>
<td>$14.3</td>
</tr>
<tr>
<td>Insurance</td>
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<td>$70.7</td>
<td>$65.7</td>
</tr>
<tr>
<td>Payments</td>
<td>$16.1</td>
<td>$140.8</td>
<td>$124.7</td>
</tr>
</tbody>
</table>

Source: Business Insider, 2021

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51 Business Insider, 2021
52 Forbes, 2020
The third group also includes big names like Apple and Walmart, who only recently announced a partnership with investment firm Ribbit Capital to create their own fintech startup—adding banking to their existing financial services like installment financing, credit cards, and money transfers.\textsuperscript{53}

The same report projects that an especially profound impact will be felt over the next decade in four specific areas—wealth management, consumer lending, insurance, and payments\textsuperscript{54}—offering a range of opportunities for companies to position themselves to ride the next wave of innovation.

**Plaid’s take:**

*More and more, consumers are looking for—and finding—financial services in places other than banks, at the exact moment they need them. While this spells a win for consumers, it also means traditional financial institutions are increasingly finding their business models disrupted and their services relegated to the background.*

*To avoid becoming seen as a utility, incumbent banks must ensure the interoperability of their customers’ bank accounts with countless apps and platforms, while also expanding their own digital products and services through partnerships, acquisitions, or internal creation. Doing so now ensures keeping up with mainstream tech players whose technological and user-experience edge, along with built-in user base in the hundreds of millions, gives them a marked advantage.*

\textsuperscript{53} Banking Dive, 2021

\textsuperscript{54} International Banker, 2020
Plaid is a technology platform that enables applications to connect with users’ bank accounts. We focus on lowering the barriers to entry in financial services by making it easier and safer to use financial data.