Visa Consulting & Analytics

Integrated Payments

Strategy Considerations for Acquirers

Summary

An important trend within the merchant acquiring space over approximately the last five years has been the rise of integrated payments, which is the seamless integration of payments functionality into business software solutions. Integrated Software Vendors (ISVs) are the principal actors in the integrated payments space, and their emergence is one of the key growth drivers for acquiring revenue. In the last five years, acquiring revenues derived from integrated payments have grown considerably. As integrated payments originated in and is mature in the U.S. market, but is in its infancy outside the US, developing a comprehensive ISV strategy is critical to building and growing a successful global acquiring business.

Integrated Software Vendors

Business software solutions themselves are nothing new. Enterprise Resource Planning ("ERP") solutions that enable businesses to manage their entire enterprise in a tightly integrated manner have been available for decades, and software focused on simplifying specific aspects of a company's functions (e.g., accounting software) has been widely available. What is relatively new is the proliferation of software vendors that serve the needs of small businesses coupled with the integration of payments functionality into their offerings. ISVs typically focus on the needs of small- and medium-sized businesses in a given industry, and their solutions enable merchants within that industry to perform many, if not all, of the functions needed to manage a company within that vertical. While some ISVs have built solutions that appeal to the needs of most segments within a given industry (e.g., "medical providers"), many ISVs have chosen to specialize their software on the needs of specific segments within the industry (e.g., "dentists"). As such, there are thousands of ISVs across industries, resulting in significant fragmentation.

Importance of Integrated Software Vendors to Merchant Acquirers

Integrated Software Vendors are critical to acquirers on at least two fronts. First, they are an important sales and distribution channel. While a direct-to-merchant sales force remains an important component for acquirers, increasingly a growing share of new merchant accounts are being obtained through the ISV indirect sales channel. Second, ISVs offer opportunities to improve core acquiring customer metrics. The ISV impact on merchant retention with acquirers is measurable. Not only do U.S. merchants that process payments with an ISV remain processing with the ISV's integrated acquirer for 34 months on average, compared to 30 months for all other merchants, U.S merchants that process payments via an ISV have, on average, four percent less account attrition with acquirers than all other merchants .

The figure below illustrates these points.

ISVs have a significant value proposition to merchants	Merchants are increasingly embracing ISV solutions to better manage their business	Merchants have a difficult time replacing their ISV [ii]	Merchants are seeking greater value from their partners
Therefore, there are benefits from partnering with ISVs	ISVs and VARs **sign 9% of all merchant accounts**[iii]	ISVs have strong merchant relationships driving retention	ISVs provide an opportunity to differentiate solutions
These benefits tie to the key success metrics for Merchant Services	Increased Merchant Acquisition	NPS Increased Merchant Retention	Increased Merchant Growth

I Electronics Transaction Association & The Strawhecker Group, Software: The Future of Payments is Integrated Infographic, 2018. (https://www.electran.org/publication/transactiontrends/wp-content/uploads/tsg-eta-software-infographic-2018.pdf)
ii Digital Transactions, The Complicated World of Integrated Software, 2015. (http://www.digitaltransactions.net/magazine_articles/the-complicated-world-of-integrated-software/)
iii Digital Transactions, They May Account for a Sliver of Acquiring, But ISVs and VARs Are Poised for Fast Growth, 2016. (https://www.digitaltransactions.net/they-may-account-for-a-sliver-of-acquiring-but-isvs-and-vars-are-poised-for-fast-growth/)

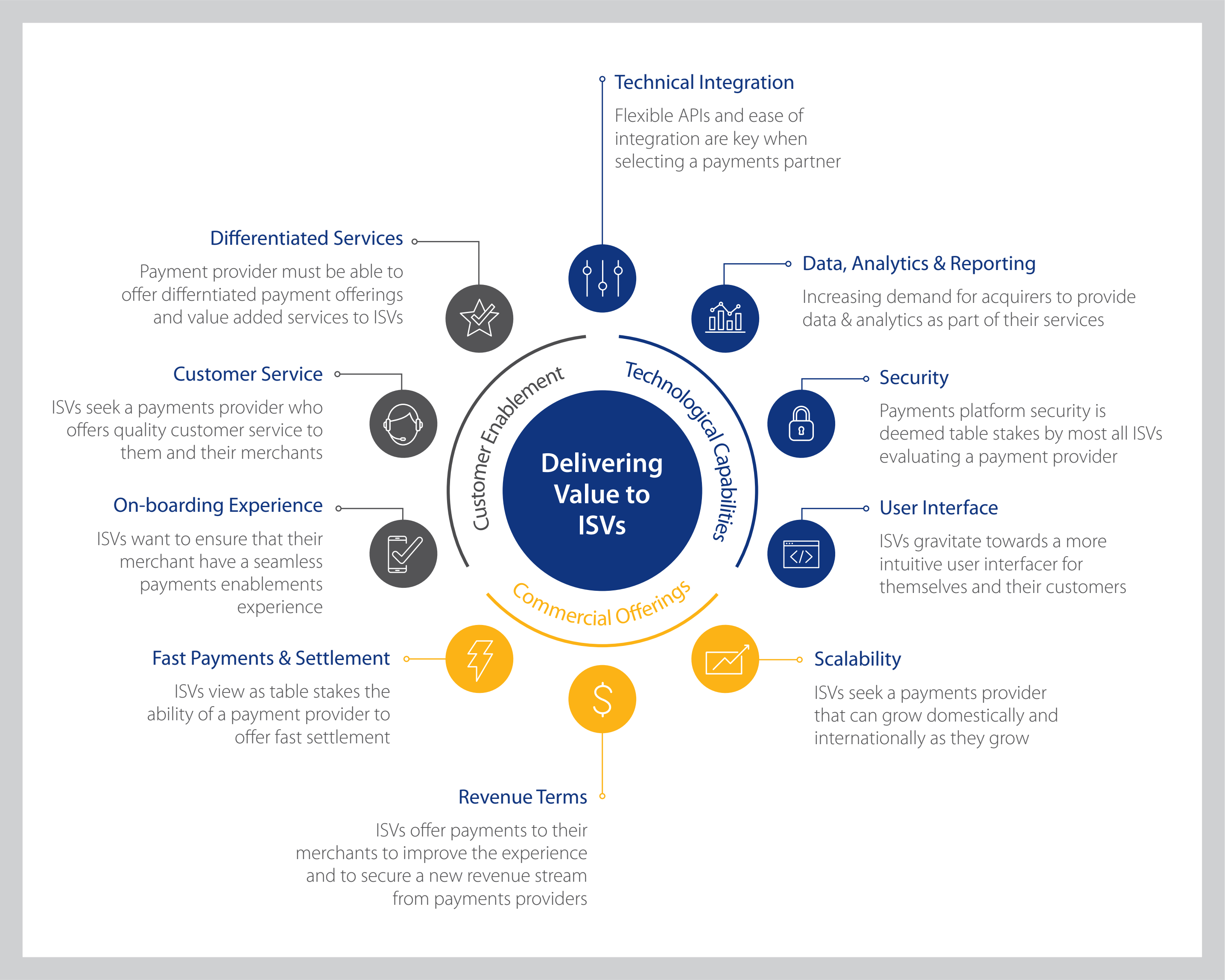
Defining an Integrated Software Vendors Strategy

Having a clearly defined strategy with respect to ISVs is critical to the success of today's acquirers. There are at least four core components to a well-defined ISV strategy.

1. Define an Integrated Software Vendors value proposition

The integrated payments space presents an interesting question for acquirers: who is your customer?

Traditionally, acquirers thought of merchants (and, to a real extent, ISOs) as their customers. ISVs to a certain extent disintermediate the traditional acquirer-merchant relationship. Thinking of the ISV as the customer, and having a compelling value proposition that makes the acquirer an attractive partner for ISVs, are critical foundational elements of a strategy. As shown in the figure below, there are at least three dimensions to an ISV value proposition: Customer Enablement, Technological Capabilities, and Commercial Terms.



2. Identify which Integrated Software Vendors will be strategic partners

The ISV industry is large and fragmented, with thousands operating across various industry verticals. Selecting an ISV as a strategic partner could be based on a host of factors, to include:

- Does the ISV have significant share in an industry in which the acquirer too has a strategic advantage?
- Does the ISV's solution set offer a unique and compelling value proposition to the acquirer's merchant customer base?
- Is there overlap between the merchant customer sets served by both the acquirer and the ISV?
- Has the ISV expressed openness to customizing their solution set to offer unique, differentiated solutions to the acquirer's base?

3. Define a range of partnership models

What type of relationship does the acquirer seek with ISVs? There are generally three types of partnership models acquirers can choose when partnering with an ISV. Deciding which partnership will depend on a couple of factors.

- **Acquire / Equity Investment:** In the case of those ISVs deemed "strategic" by the acquirer, some merchant acquirers have made outright purchases of ISV companies. While this approach offers the acquirer exclusive control of the merchant customer experience, it comes at the potential price of extending the acquirer into business areas that may be well outside its core competence. Additionally, this model may create "channel conflict" for the acquirer, where the acquirer is now competing with other ISVs in a given industry vertical. Short of purchasing an ISV, some acquirers have entered into strategic partnerships through the lens of "Fintech Investment", where the acquirer takes an equity stake in the ISV.
- **Exclusive Partnership:** Acquirers wanting to be independent from ISVs, but remain commercially tied to an ISV, have entered into exclusive partnerships where the ISV refers merchants exclusively to that acquirer for a given vertical or sector.
- **General Partnership:** Perhaps the most prevalent partnership model is one where acquirer and ISV refer their respective customers to one another. Many acquirers seeking to broaden their base have entered into non-exclusive partnerships with multiple ISVs.

Finally, while not every ISV relationship will be deemed "strategic", it is nevertheless important for acquirers to enable "the long tail" of ISVs to offer payment solutions within their software. Here, flexible, open technical architectures that expose easy-to-consume APIs/SDKs are central to attaining scale across a host of ISVs.

4. Define which payment models you want to enter into with Integrated Software Vendors

Some ISVs want full control of all aspects of the merchant customer experience, and they have sought partnerships with acquirers open to enabling them to become payment facilitators (PayFac).

Most ISVs, however, have neither the willingness nor the skill sets needed to operate as payment facilitators, and they normally seek relationships with acquirers based on more traditional "referral models". An interesting model that has emerged of late splits the difference between the two extremes of, on the one hand, an ISV becoming a PayFac and, on the other hand, an ISV having a simple referral relationship. This model, typically referred to as "PayFac Light" or "PayFac in a Box", is one where the acquirer cedes control to the ISV for the majority of merchant-facing functions while the acquirer retains control over the most sensitive functions of underwriting and distribution of monies. This model enables an acquirer to appeal to the ISV's desire for control over the merchant customer experience while not requiring the ISV to extend itself well beyond its core competence of building great software.

In Summary

Having a cogent strategy for partnering with Integrated Software Vendors is critical to the success of today's merchant acquirers. Equally important is having a clear plan as to how the acquirer will bring its integrated payments strategy to life. Where in the acquiring organization will responsibility lie for executing the strategy? What resources will be dedicated to executing the strategy? Will the sales, servicing, and marketing for the ISV channel be part of existing team structures, or will they form a separate and distinct business unit? While each acquirer will have its own unique response to each of these questions, one fact remains true: thinking of Integrated Software Vendors as customers and defining a value proposition attractive to them is foundational to success in today's industry.

For more information, please contact your Visa Account Executive or email Visa Consulting & Analytics at **VCA@Visa.com**. You can visit us at **Visa.com** or on **YouTube**.