PROFITING FROM PAYMENTS

A Software Providers' Guide to Evolving Payment Partnerships

Integrated payment solutions have emerged as a potentially lucrative revenue stream for many independent software vendors (ISVs). Where in the past ISVs and payment providers served distinct roles in the point of sale (POS) market, those lines are blurring as POS systems evolve to incorporate new types of hardware, software, and features. As payment options become more complex, merchants are looking to their ISVs to provide more guidance and advanced solution features. At the same time, payment companies are rapidly consolidating, making it more difficult for ISVs to find payment partners that can offer the mix of customer support, flexibility, and profitability they are looking for.

AN UNDERSERVED MARKET

ISVs face a number of challenges when it comes to payments.

- Current partnership programs may not be as profitable as expected due to agreement terms.
- Merchants have failed to adopt integrated payments because ISVs receive little sales and marketing support from their provider.
- Industry consolidation has resulted in behemoth providers who no longer offer quality support, transparency, or flexibility.

For ISVs that are simply expanding with an eye on portfolio acquisition, these concerns may not matter as much. These companies aren't focused on building out high-quality solutions and support. Payments are seen as an end, not a means.

But smaller or mid-tier ISVs that aren't happy with their existing payment partnerships and don't have the resources or clout to build out their own payment infrastructure feel they have limited options.

PAYMENTS EVOLUTION

There are creative alternatives offered by boutique payments providers, and they can help ISVs evolve their payment offerings.

“When it comes to payments, the more ownership you take, the more profit you can make. Payment revenue streams can help grow an ISV’s business, provided they have the right support and operate under a model that makes sense for them. Working with an innovative provider that specializes in integrated payments can help fuel that growth,” says Eric Hoke, Paragon’s vice president of business development.

A variety of payment program structures are available to ISVs. Some companies operate under several of these structures simultaneously, or they may slowly evolve from one structure to the next as their business objectives change.

REFERRAL RELATIONSHIPS: The ISV refers merchant customers to a specific processor in return for residual fees on all credit/debit/check/gift card transactions.

AGENT: Merchant-level (ML) sales companies or agents are usually identified as an agent of a registered ISO and can sell card processing services.

ISO: An ISO is an extension of a payment processor and receives a larger share of the payment processing revenue. ISOs are generally locked in to the capabilities and features of the acquirer they work with. Becoming an ISO requires extensive expertise in payment technology and security that many ISVs don’t have. There are also significant costs associated with staffing and establishing the necessary registrations.

PayFac: PayFacs onboard merchants, which become sub-merchants to the PayFac. While they can more quickly sign up merchants with minimal risk assessment, they are also responsible for managing the acceptance of different types of payments, reconciling payments, factoring in a pricing and billing engine, etc. These companies have to invest in staying on top of payment solution advancements and regulations. PayFacs also assume a tremendous amount of risk and responsibility for the payment process – they are fully liable for fraud risk, unlike an ISO, which offloads that risk to the acquiring bank.

PARAGON®

payment solutions

While transitioning to higher-level, direct partnerships with payment processors can create new revenue opportunities, they also require the ISV to take on more risks and responsibilities. Becoming an ISO or PayFac requires significant internal support and infrastructure. While many ISVs believe there is substantial revenue in making that transition, the risks might outweigh the rewards – there has to be a substantial investment in full-time staff to handle support, underwriting, onboarding, and analysis. ISOs and PayFacs also shoulder much more liability.

ISVs that are lured into these partnerships by the siren song of fetching higher multiples for the sale of their merchant portfolios may not fully understand how difficult it is to manage payments at that level – or how difficult it can be to ensure true portability of the merchant accounts they've acquired and may hope to eventually sell to another entity.

Chasing higher multiples at the expense of taking on higher cost and liability without proper planning is the result of short-term thinking. ISVs that want to succeed in payments over the long haul need to match their payment program to their long-term business strategy. Finding a payment partner that can manage the heavy lifting while still providing an aggressive revenue-sharing program will provide higher profits, better solutions for merchants, and lower risk for the ISV.

A NEW APPROACH

This is where payment providers that specialize in integrated payments play an important role in both guiding the ISV to the right kind of program and providing the support and resources required to do so profitably and reliably.

Smaller payment providers may only support a few of the partnership models described above. They aren't invested in integrated payment solutions and don't have the internal tools to support them anyway. They may not be able to offer an agent program or ISO program, for example.

Larger processors may have all of the tools needed for integrated payments but still can't easily transition ISVs through different types of partnerships structures. That's because different divisions of the processor (which may have grown rapidly through acquisitions) don't work together or communicate. That creates internal obstacles to transitioning an ISV from one division to another.

"Choosing a partner that can help the ISV along this journey is critical," Hoke says. "Changing payment partners in order to evolve the business is disruptive and counterproductive and can ultimately impede the ISV's growth. A boutique payment provider that specializes in creative, integrated payment partnerships is better positioned to grow and evolve with the ISV over time."