

How Do Software Companies Fit Into the Payments Revenue Food Chain?

As software companies become a larger part of the payments world, they will have to determine how much of a role they want to play and how far up the payments revenue food chain they want to go.





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Every time a credit card, debit card or any other type of electronic transaction is processed, a small percentage is taken out of the total amount and distributed among the companies that make that electronic transaction possible. As software companies are increasingly becoming the platform this payment takes place on, and therefore a part of the overall payment journey, many are looking for ways to maximize the revenue they make from payments. However, they are not the only ones involved in the payments revenue food chain.

Every time a buyer uses a credit or debit card to make a payment, this transaction then has to go through all of the companies and steps in the payments flow for the buyer to effectively pay, for the money to be taken out of their bank account and for the merchant who sold the good or service to receive that money. In this whitepaper we will explain who these entities are, how they fit into the payments revenue food chain, and how software companies are increasingly becoming a more important player in the payments space.



THE REAL WORLD EXAMPLE



When a seller of goods or services, known as a merchant, wants to begin accepting electronic payments they have to start a relationship with a payment provider in order to make that possible. The payment provider is in charge of dictating what fee they will charge to the merchant every time they take in an electronic payment. The amount of this fee will vary depending on the payment provider they use, what industry they are in and other factors that make the merchant unique.

This fee is commonly represented as a certain percentage of the overall transaction amount plus a small “per transaction” fee. For simplicity sake in this whitepaper we will use the example of the fee being 3% of the total transaction amount.

Suppose a clothing store sells a shirt for \$100 using a software company’s point-of-sale system. Taking into account the 3% fee means that the merchant will receive \$97 from that sale while the \$3 taken out from the fee is what is considered the overall payments revenue. This payments revenue will then be split up between the software company and all of the other different entities involved, including the banks, card brands, and the payment processor.



Many businesses around the world are relying on software companies to help them run their business more efficiently and effectively. By delivering these solutions, software companies are frequently providing the platform on which these businesses take payments from their customers. When a software company provides payments functionality within their platform, they must partner with payments companies to make this possible.

There are many different types of partnerships and agreements a software company can have with the payments companies in order to earn money from the payments taking place on their platform. The amount of money they earn typically correlates to how involved in the payments process the software company is, versus what they outsource to the traditional payments companies. For this whitepaper we want to focus on the two ends of the spectrum for software companies, the referral model and the payment facilitator model.



REFERRAL MODEL

In the referral model, the software company simply refers their customers to the payments companies to handle the entirety of the payments flow and process. The payments companies get the merchant approved to begin accepting payments, set the fee the merchant pays, handle all of the steps in the payments process, and are in charge of servicing the merchant for any payments questions and needs.

Since the software company is simply handing off the payment provider role to 3rd parties, they do not need any infrastructure to handle payments nor are they involved in the process. However, on the flip side, this means they have very little control over the customer experience, support, and also earn a smaller share of the overall payments revenue.

What percentage of the payments revenue the software company makes in the referral model depends on the agreement they make with the payments companies they are referring the business to. However, a rough average of this is about 10% of the overall payments revenue. This means in our example of a \$100 transaction with a \$3 fee to the merchant, the software company would earn about \$0.30 on that transaction.

“...this means they have very little control over the customer experience, support, and also earn a smaller share of the overall payments revenue.”

To put this into perspective, if the software company has \$100 million of payments taking place on their platform, their share of the overall payments revenue would be \$300,000.

The other 90% of the revenue is split up between the payments companies that handle the payment such as the payment processor, banks, and card network (refer to section below for more details).

““ *This increased control and ownership of payments gives the software company a much larger share of the payments revenue.*

PAYMENT FACILITATOR MODEL

It is becoming increasingly popular for software companies to begin taking more control of the payments process on their platform by becoming payment facilitators. When a software company becomes a payment facilitator, they take ownership of the payments portion of their software and handle many of the payments responsibilities that previously were held by 3rd parties. This increased control and ownership of payments gives the software company a much larger share of the payments revenue.

When acting as a payment facilitator the software company is responsible for payments functions, such as:

- Getting the merchant approved and set up to begin accepting payments
- Determining the fee the merchant pays for each transaction
- Funding of the merchant (getting the appropriate amount of money into the merchant's bank account)
- Ongoing monitoring for fraud or other suspicious activity to ensure a safe payments ecosystem
- Handling chargeback requests

In this model the software company begins taking on the role of the payments company, allowing them to tailor the customer experience to their specific set of customers. This added responsibility also gives them more opportunity to earn significant payments revenue.

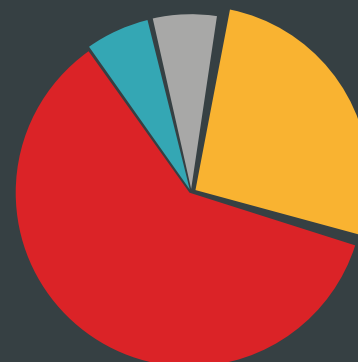
Once again, the exact revenue for a payment facilitator will depend on the agreement set with their sponsoring bank, as well as, other outside factors, but at Infinicept we typically see that software companies that become payment facilitators earn about 30% of the overall payments revenue. This is 3x more than they would earn in the referral model.

This means in our example of \$3 of payments revenue, the software company would earn about \$0.90 on that \$100 transaction by their customer. If the software company's customers have \$100 million of transactions taking place on their platform, the software company's share of the payments revenue would be \$900,000, compared to \$300,000 in the referral model.

WHERE DOES ALL OF THE OTHER PAYMENTS REVENUE GO?

Given that software companies who become payment facilitators earn 30% of the overall payments revenue, you may be asking: where does that other 70% go? This is where the payments world starts to get a bit murky and tricky as there are a lot of different ways this 70% can be split up. In each unique situation there may be different types of companies involved in different ways, all wanting a piece of the payments revenue pie.

For the sake of this example, we want to highlight one of the most common scenarios for what happens to the remaining 70% of payments revenue, after the payment facilitator has taken their share.



30% Payment Facilitator
60% Interchange
5% Card Brands
5% Acquiring Bank & Processor

INTERCHANGE

Regardless of the scenario, the bank that issues the credit or debit card used in the transaction, known as the issuing bank, will typically get the majority of the payments revenue. The fee they charge is called interchange and is a complicated fee that varies depending on a wide variety of factors.

Even though the revenue goes to the issuing bank, the major card networks, such as Mastercard and Visa, dictate what these fees will be when their cards are used. The interchange fee varies depending on:

- The merchant's industry – higher risk industries will require a higher interchange fee
- Whether it is a card-present transaction, such as an in-store purchase, or a card-not-present transaction, such as an online purchase.
- Type of card used (credit card vs debit card)

On average this interchange fee represents about 60% of the overall payments revenue and is given to the issuing bank. In our \$3 example, this means that the issuing bank would get about \$1.80 on a \$100 transaction.



NETWORK FEES

These are the fees charged by the card brands themselves. In the United States the primary card brands are Mastercard, Visa, Discover and American Express.

For their cut of the payments revenue pie they typically receive 5% of the payments revenue whenever their card brand is used. In our \$3 of payments revenue example, the card brand that was used for the purchase would receive about \$0.15.

ACQUIRING BANK & PAYMENT PROCESSOR


Software companies who become payment facilitators will always need to set up an agreement with an acquiring bank and a payment processor, who are collectively referred to as the “sponsor”. It is common that these entities are bundled together when the payment facilitator gets up and running.

The exact amount they get for each transaction will be dictated by the contract that is signed between the new payment facilitator and the sponsor. On average, the fee they typically receive will be about 5% of the overall payments revenue, similar to the card brands.

This means that in our previous example, the acquiring bank and processor would together receive about \$0.15.

CONCLUSION

As Software companies become a larger part of the payments world, they will have to determine how much of a role they want to play and how much of that payments revenue pie they want to take.



The payment facilitator model allows software companies to own the experience their customers and the end consumers have when making a payment on their platform, while also allowing them to generate significantly more payments revenue compared to the referral model or any other type of integrated payments model.

ABOUT INFINICEPT

Infinicept is a FinTech company that provides embedded payment solutions. Its PayOps software-as-a-service (SaaS) platform offers underwriting, onboarding, and merchant management solutions to software providers, payment companies, and financial institutions, that allow them to scale their payments operations and have total ownership of their payments strategy. By embedding payments into their products, Infinicept enables customers to exponentially amplify growth and increase revenue by tapping into the \$585 billion embedded finance marketplace. More than 300 leading software companies, payment processors, sponsor banks, and others rely on Infinicept to help them transform to the new era of software-led payments.