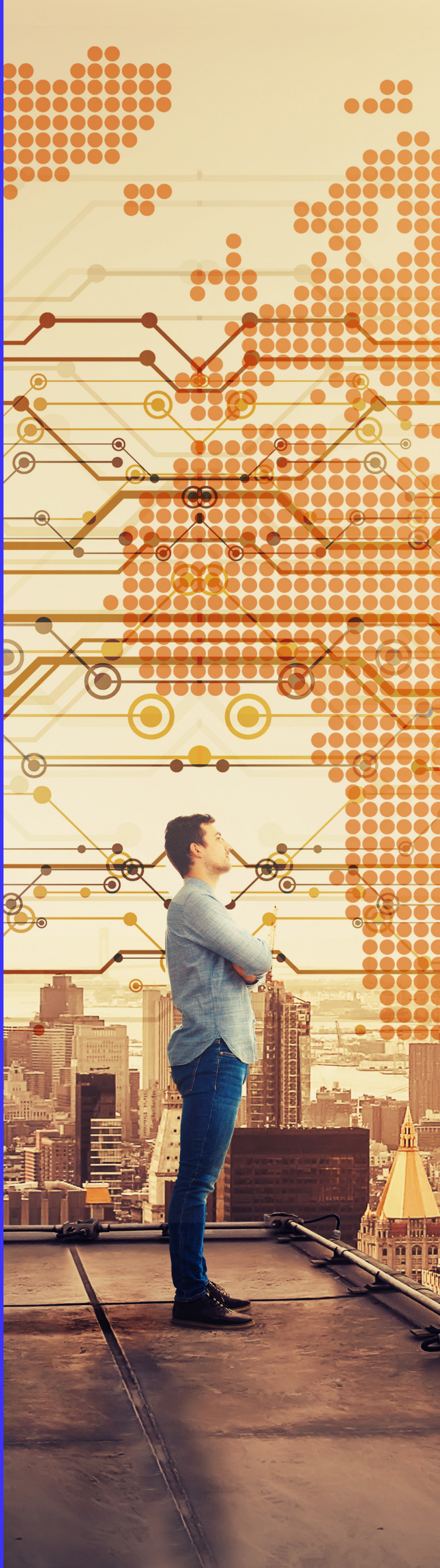
WHITE PAPER

As demand for integrated payments rises, acquirers, ISOs and PayFacs should reconsider their ISV strategy



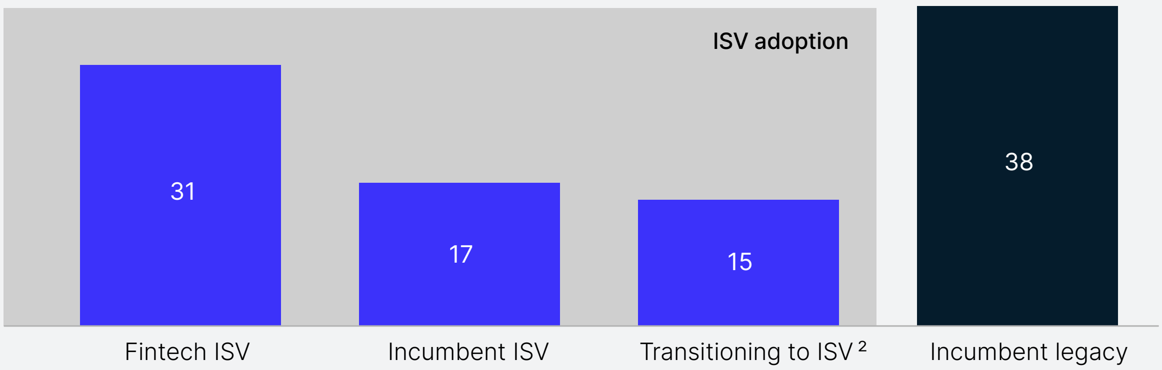
Beginning in the United States and spreading worldwide, the capacity to enable a multiplicity of payment forms in-store, online or by app is big business. With integrated software vendors (ISVs) rapidly disrupting the traditional merchant-acquirer relationship, *Kolja Reiss, General Manager USA* at RS2, considers how acquirers, ISOs and PayFacs should approach this continued and fast growing shift in market demand especially as ISVs are now also becoming ISOs and PayFacs themselves.

The digital revolution has changed payments beyond all recognition. As recently as ten or fifteen years ago, merchants were OK with an acquirer offering stand-alone terminals. Fast-forward a decade and today's merchants are looking for a whole lot more – not just in-store and online card acceptance, but the capacity to handle a wide and growing range of physical and digital payment types within their Point-of-Sale system and business management system with functions such as inventory management, invoicing and others. And all this at a competitive price with full security and 24/7/365 uptime.

Integrated software vendors (ISVs) have seized this opportunity in the US market – and their influence is increasingly being felt around the world. McKinsey & Company estimate[1] that two-thirds of US small and medium enterprises (SMEs) are either currently using an ISV to fulfil their payments needs or are planning to do so. Meanwhile across the Middle East and Africa, Ernst & Young say[2] more than 50% of all payments will be run through ISVs by 2030. What's more, merchants appreciate the specialized services offered by ISVs, with US merchants remaining with their ISV longer than they do with traditional acquiring providers, according to research from Visa[3].

65% of US SMEs working with or switching to ISVs

Level of ISV adoption, % of small-business point-of-sale merchants[1]



[1] Small business defined as <$10 million in revenue; midsize as $10 million to <$250 million; large as >$250 million.
[2] Transitioning to ISV represents merchants that use a combination of modern devices and legacy solutions to process payments and have not fully transitioned to software solutions providers.

Another factor enhancing the value of ISVs to merchants is the trend towards embedded payments – in which payment becomes part of the product selection, onboarding, invoicing or delivery process. Juniper Research estimate[4] that embedded payments as a category is set to grow by 84% over the next three years to reach about $60 billion by 2027.

[1] McKinsey & Company, 22 September 2022, "As ISVs disrupt payments, can acquirers stay relevant?"
https://www.mckinsey.com/industries/financial-services/our-insights/as-isvs-disrupt-payments-can-merchant-acquirers-stay-relevant
[2] Ernst and Young, 14 October 2022, "The Rise of Integrated Payments Platforms":
https://www.ey.com/en_lb/banking-capital-markets/the-rise-of-integrated-payments-platforms
[3] Visa Inc, 2019, "Integrated Payments: Strategy Considerations for Acquirers":
https://www.visa.co.uk/content/dam/VCOM/global/services/documents/vca-thought-leadership-considerations-for-acquirers.pdf
[4] Fintech Finance, 22 February 2023, "Study Predicts Global Growth for Embedded Payments":
https://ffnews.com/newsarticle/study-predicts-global-growth-for-embedded-payments/

Although most acquiring providers, from acquirers to wholesale ISOs, ISOs, payment facilitators (PayFacs) and even 1099 agents, have recognized the need to have a strategy that targets ISVs, many are unaware of their vertical's growth ambitions. ISVs are now looking beyond the delivery of quality services to their merchants, seeking out acquiring partners that understand the complexities of the vertical, sub-vertical or niche vertical in which they operate and that are capable of serving its specific needs.

"Beyond quality merchant services, ISVs want payments partners that understand the complexities of their target vertical segment or niche vertical and can deliver to those complexities."

To date, most discussions about how acquiring providers should address ISV needs have focused around monetization, including the optimal revenue share models providers should employ to win ISVs and generate revenue in an intensely competitive market. A paper from TSG[5], for instance, discusses the monetization models that ISVs can implement to generate significant new revenue. However, such debates are to a large extent missing the real opportunity when it comes to delivering on ISVs specific needs.

Specialize for profit

As ISVs seek to differentiate their offering to merchants by specializing in specific verticals, the delivery of a unique omnichannel solution tailored to their merchants' needs has assumed paramount importance. ISVs operating in specialist sub-verticals or niche verticals with high growth potential are looking for acquiring partners capable of delivering a unique solution that simplifies their technology needs and allows them to create and control the smooth end-to-end experience they want to deliver to the end user. Outdated, generic or complicated solutions simply won't work.

"Apart from having access to platforms that can add and switch capabilities rapidly to meet growth ambitions of ISVs, acquiring partners should be in complete control of their cost structure."

By implication, acquirers, ISOs and PayFacs, and for that matter ISVs that are ISOs or PayFacs, should ensure that they are working with vendors who enable them not only to be flexible with their payment solutions – but also give them complete control of their cost structure in order to optimize profitability in the specific verticals they are targeting.

For instance, acquiring providers looking to attract ISVs in high-growth niche verticals should have access to platforms that can rapidly add new capabilities and expand the range of services they offer to meet ISV needs as they position themselves for rapid growth.

The fact that ISVs are becoming increasingly specialized in specific niche verticals suggests that acquiring providers themselves can enhance profitability by focusing on payment needs in those verticals and providing appropriate service packages which can be tailored to meet individual ISV and merchant needs.

[5] TSG, 22 February 2023: "Options Abound for ISVs in the Payments Space": https://thestrawgroup.com/options-abound-for-isvs-in-the-payments-space/

Scale for growth and increasing sophistication

As they continue to grow at pace, ISVs need reliable, always-up services that can evolve and scale to match their ambitions. Their selling proposition to merchants depends on a modern platform that meets both their growth plans and those of the merchants they serve.

As they expand, ISVs are becoming very knowledgeable and selective, asking critical questions that go beyond front-end gateway functionalities or a platform's capabilities for merchant onboarding. In addition to providing details on data analytics and reporting capabilities, acquiring providers should be ready to answers questions about how they connect to the card networks for authorizations, questions about interchange optimization, clearing and settlement capabilities. ISVs are also asking what tools are available for risk and dispute management or demanding that they use their own tools.

The scope to deliver fast – and well

"ISVs want their acquiring partners to be able to onboard them efficiently with full end-to-end implementations and get them to market as quickly as possible."

Today, modern ISVs are technology-centric organizations offering Software-as-a-Service (SaaS) platforms. Given the fast pace of the modern digital economy, ISVs want to know how quickly a partnership can be implemented from both a technical and a commercial standpoint, whether the scope is only a front-end gateway integration or a large project including much more complex back-end implementations. Mindful of the old adage that "time is money", ISVs are looking for their acquiring partners to work closely with them and have the right processes, systems and/or vendors to efficiently onboarding them with full end-to-end implementations so that they can get to market as soon as possible.

Move beyond legacy to full control

More than ever, ISVs have unique and complex needs and are looking for acquiring partners with modern front-end and back-end platforms that feature a full range of digital-first services capable of rapid evolution and scaling and that can get them to market quickly. If your sales strategy for ISVs relies on legacy systems or vendor partners that are either inflexible or incapable, then you are unlikely to succeed however aggressively you shape your pricing especially if you are not in complete control of your cost structure.

ISVs are looking for an acquiring partner that can tailor solutions with all the elements they need to deliver for the sub or niche verticals they are targeting – not just today, but for the next three to five years at least. Given the growth trajectories we've outlined above, no-one can be surprised that ISV expectations are growing as fast as their businesses are expanding.

For a discussion about optimizing your product offering to meet the needs of ISVs, contact Kolja Reiss, General Manager of RS2 USA: Kolja.Reiss@rs2.com

RS2 is a payment technology company providing managed payment solutions for card issuing and acquiring to banks, financial institutions, ISVs, wholesale ISOs and PayFacs throughout North America, Europe, Latin America (LATAM), Asia Pacific (APAC), and the Middle East.

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