

THE PAYFAC ECONOMY AND THE EMBEDDED PAYMENTS REVOLUTION



January 2024 Report

THE PAYFAC ECONOMY AND THE EMBEDDED PAYMENTS REVOLUTION

TABLE OF CONTENTS

- Introduction 04
- Why the Interest in PayFacs? 09
- The Architecture of the Embedded
Payments Ecosystem 17
- PayFacs in Action 28
- Conclusion 30
- About 32

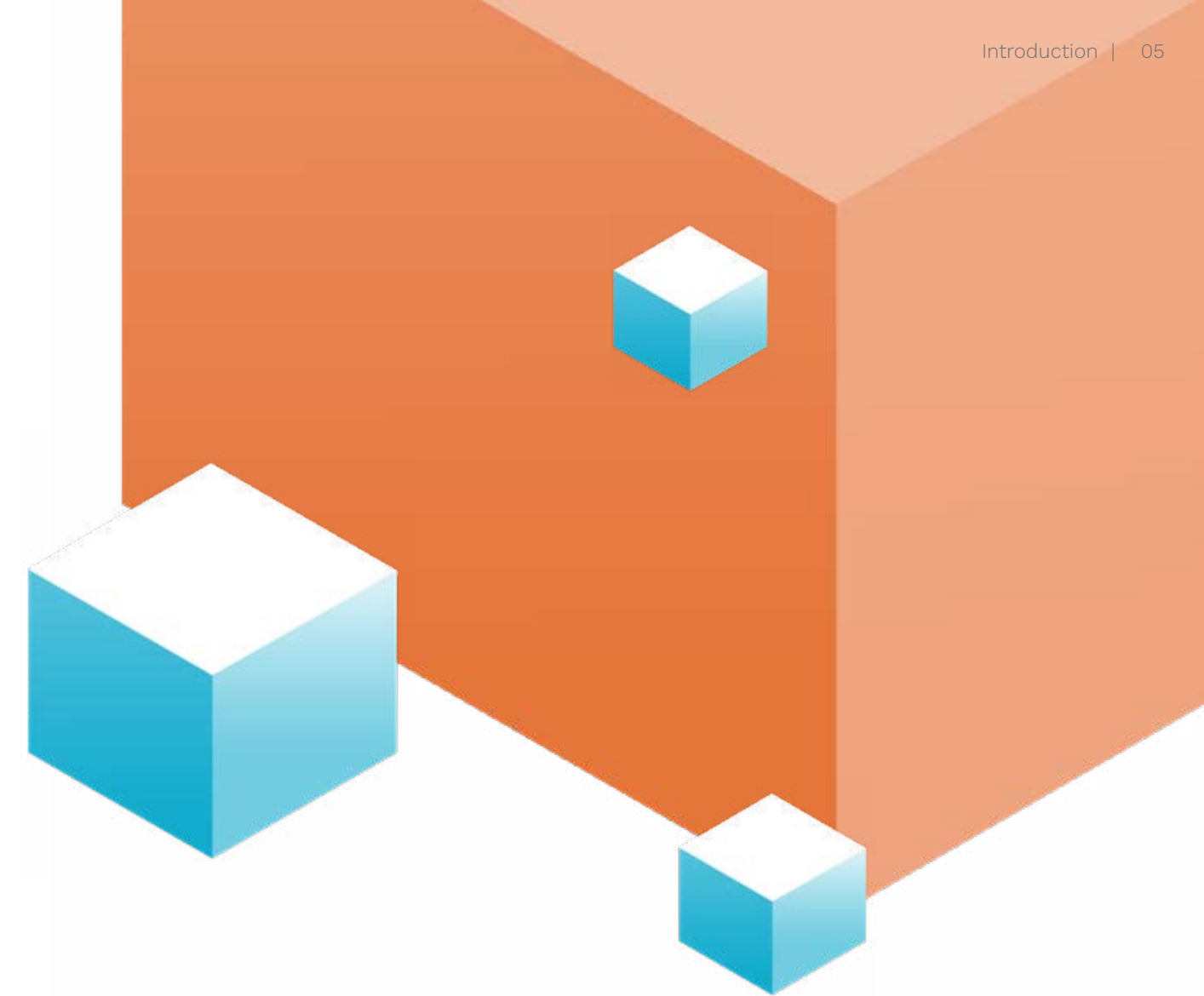
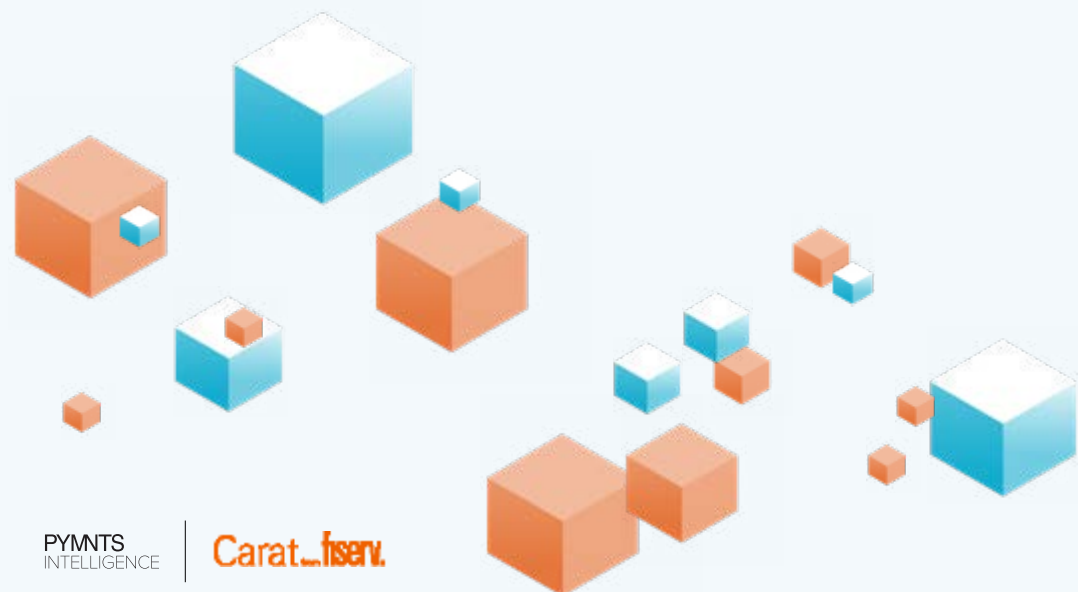


The PayFac Economy and the Embedded Payments Revolution was produced in collaboration with Carat from Fiserv, and PYMNTS Intelligence is grateful for the company’s support and insight. PYMNTS Intelligence retains full editorial control over the following findings, methodology and data analysis.

INTRODUCTION

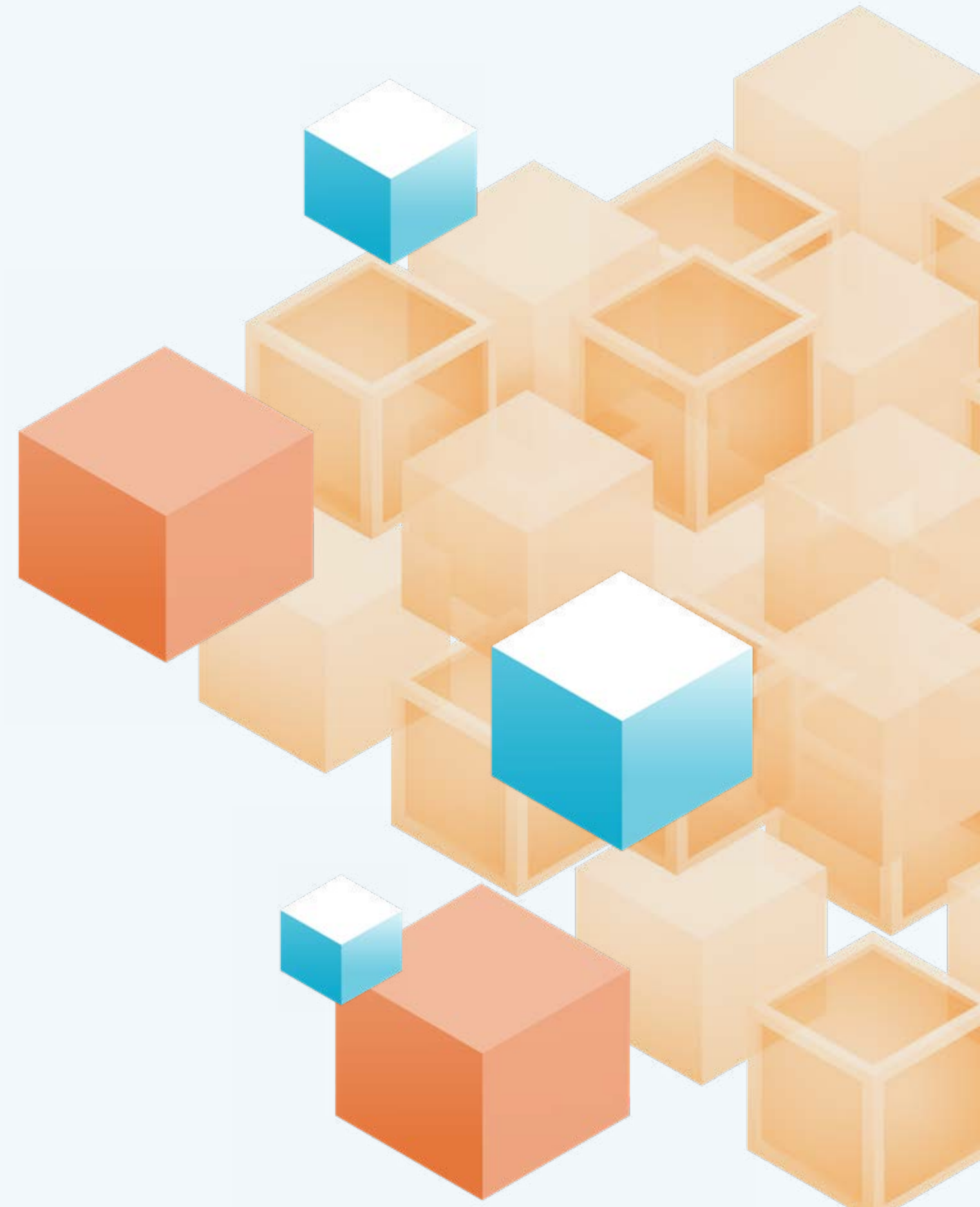
Payment facilitators, or PayFacs, are not exactly new. PayPal, the first major PayFac, launched in 1998 and has since been joined by many others, including Square and Stripe. PayFacs simplify the complexities businesses that want to accept card-based and other digital payments face by eliminating the costly and time-consuming process of establishing a merchant account directly with an acquirer to process payments.

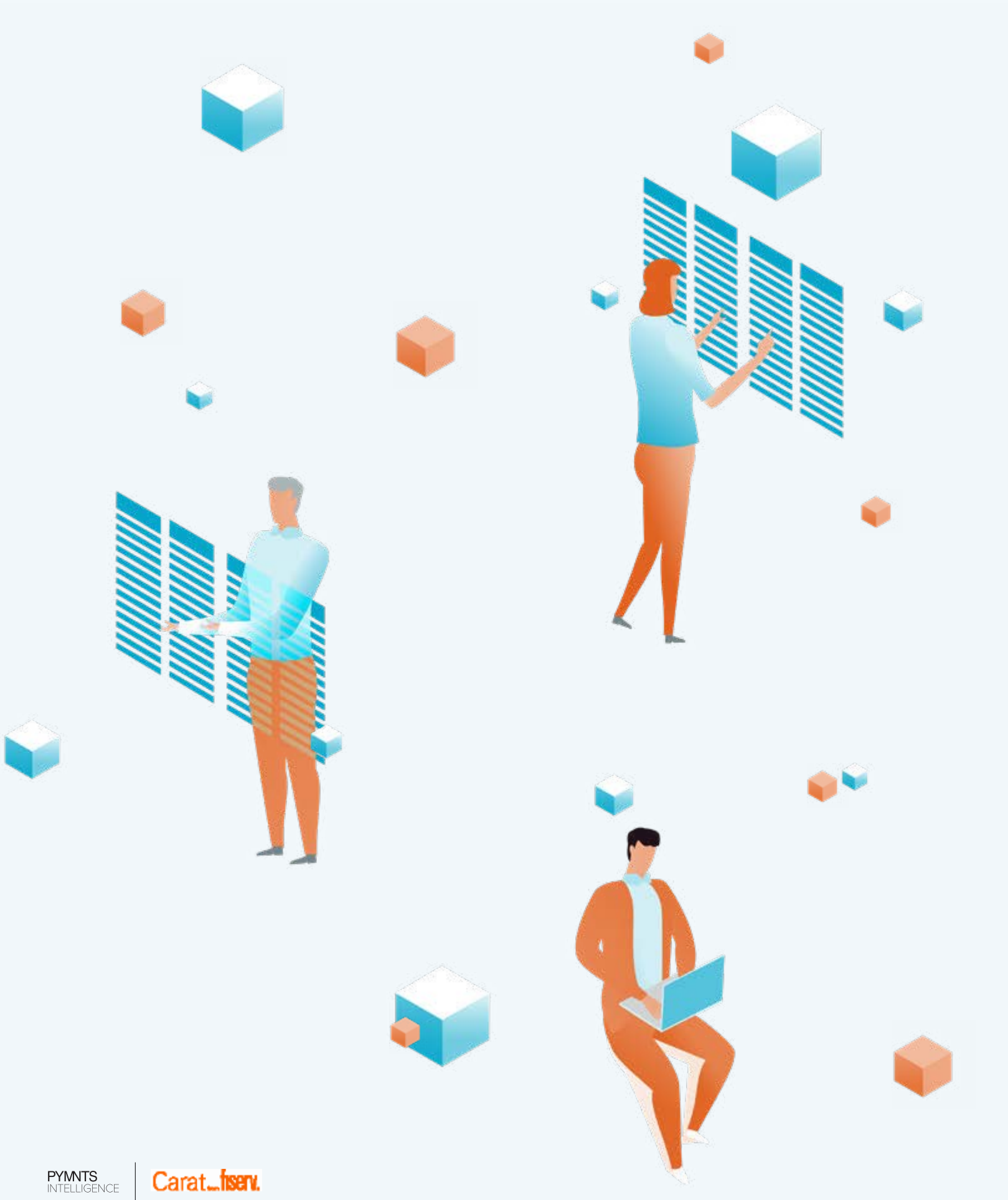
PayFacs instead use their own merchant accounts to establish sub-merchant accounts for businesses so that they can process payments and get to market quickly with payment-enabled capabilities. PayFacs can provide value-added capabilities as well, including risk management tools and compliance support, helping businesses mitigate the financial and regulatory risks of enabling the movement of money between parties.



Despite being more than two decades old, however, the PayFac model is quietly leading a revolution in how payments are powering the digital economy. At the center of this shakeup lies the ability to embed payments into nearly every workflow for customers and businesses. Under the broader umbrella of embedded finance, which encompasses the integration of payments, banking and credit solutions into retail platforms, including online marketplaces and business software solutions, PayFacs are changing how and where commerce can be conducted, the types of players that make it possible and the innovative business models that now enable it.

Once an exclusive realm of deep-pocketed tech giants and incumbent retailers with the teams and financial resources to become payments companies, PayFacs make it possible for merchants, marketplaces and software platforms to integrate sophisticated payments capabilities directly into their products. Embedded payments and finance options allow end users to transact seamlessly without ever leaving a merchant's app, website or software platform to make a purchase and/or to be underwritten and approved for credit in real time as part of the purchase experience.





WHY THE INTEREST IN PAYFACS?

The PayFac ecosystem gives businesses the opportunity to monetize payments and payments flows without being a registered payments services provider. PayFacs give businesses the ability to elevate payments from a transactional part of the business to a strategic enabler of the value-added experiences that grow customer loyalty and the top line. Businesses can introduce new ways of enabling payments, such as subscriptions or pay-later programs, and use payments data to personalize offers and develop new services and products that improve conversions and add new sources of revenue.

There are four primary ways that PayFacs unlock new sources of value for businesses, whether they are retailers, marketplaces or software platforms.

1. CREATE NEW LEVELS OF ENGAGEMENT WITH END USERS



PayFacs make it possible for business software platforms to integrate payments into customer workflows to capture new revenue sources from paying customers. In addition, business software platforms can monetize the customer relationship in new ways through subscription or membership models. Engagement can also be enhanced using loyalty programs and early or special access to unique or new products designed to encourage repeat purchases.



Salons and spas leverage the PayFac ecosystem to embed payments into the booking flow to capture payment along with the booking. In addition to creating an easier way for customers to engage with the salon, the transaction data can help businesses create tailored personalized offers and discounts. Interactive features allow businesses to provide product recommendations or options to add related items at checkout to further enhance the customer experience.



Feedback mechanisms allow customers to provide reviews and enable the merchant to understand the opinions of their customers. Businesses can also deliver exclusive content to premium or subscription customers.

2.

MONETIZE ENGAGEMENT IN NEW WAYS THAT ADD VALUE



Monetizing end user engagement is about creating a “win-win” for both the PayFac and the businesses that are part of their ecosystem. The key is to align these engagement strategies with revenue generation goals while providing added value to end users.



Airbnb is a shared economy platform that leverages the PayFac ecosystem to enable easy onboarding of hosts and provide them with a way to accept digital payments from guests, including buy now, pay later payment options. Recently, Airbnb introduced the option for its hosts to become “Experience Hosts.” Experience Hosts can embed unique activities for their guests into the booking experience, such as local tours and excursions, in addition to offering guests the convenience of paying for the booking on the Airbnb platform. Airbnb monetizes these interactions by taking a percentage of the host's earnings, creating a new revenue stream for both the host and Airbnb while enhancing the overall guest experience and increasing the odds that guests will want to book with that host again.

3. USE DATA TO DEVELOP AND MONETIZE NEW SERVICES AND PRODUCTS



Payments and transaction data are rich sources for insights on how customers use and engage with businesses. These insights make it possible to create detailed customer profiles that help businesses personalize offers and target their marketing to likely buyers. These insights also inform pricing strategies to maximize revenue across all customer groups and new product development strategies based on purchase trends.

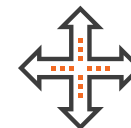


For instance, leading PC game platform Steam analyzes user purchases and playtime so it can create personalized recommendations and offers that keep gamers engaged and encourage them to make additional purchases.

4. DEVELOP NEW BUSINESS MODELS THAT REACH NEW CUSTOMERS AND BOOST THE TOP LINE



PayFacs offer businesses the ability to embed payments and credit into customer workflows to unlock new ways for those businesses to reach new markets, customers and geographies at scale.



Businesses that once relied on wholesalers and distributors to reach end users are now able to go directly to customers using the web and apps and capture payment directly from those new buyers. Software businesses that once only enabled a specific activity, such as managing expenses, can now issue one-time use virtual cards for employee expenses.

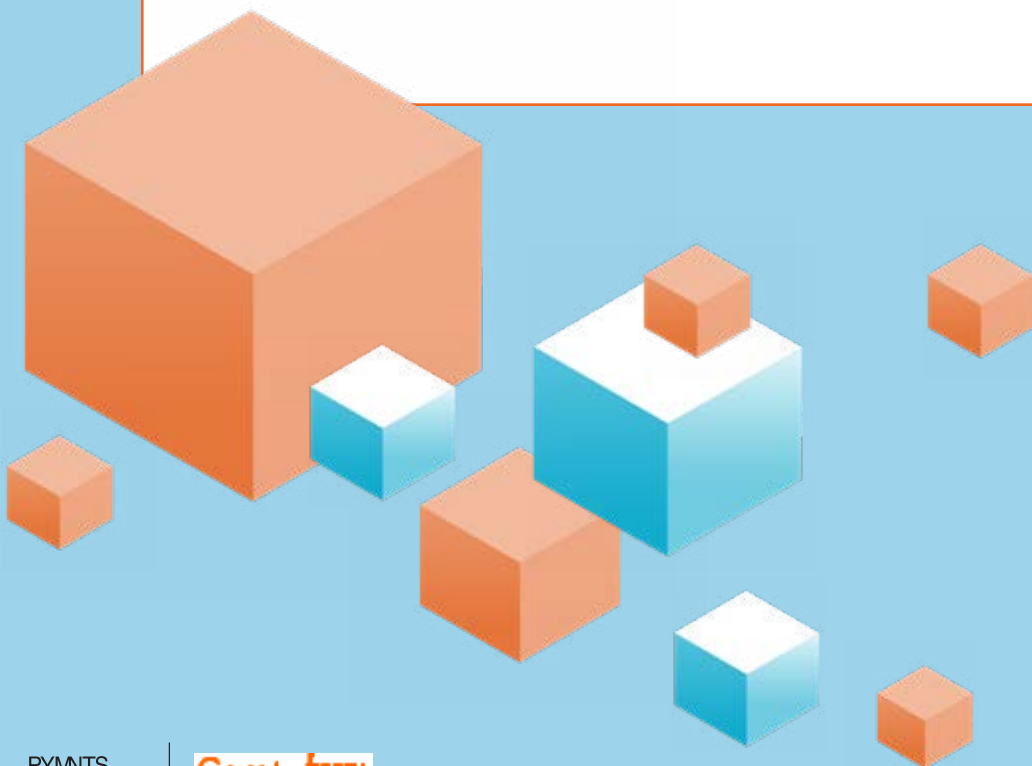


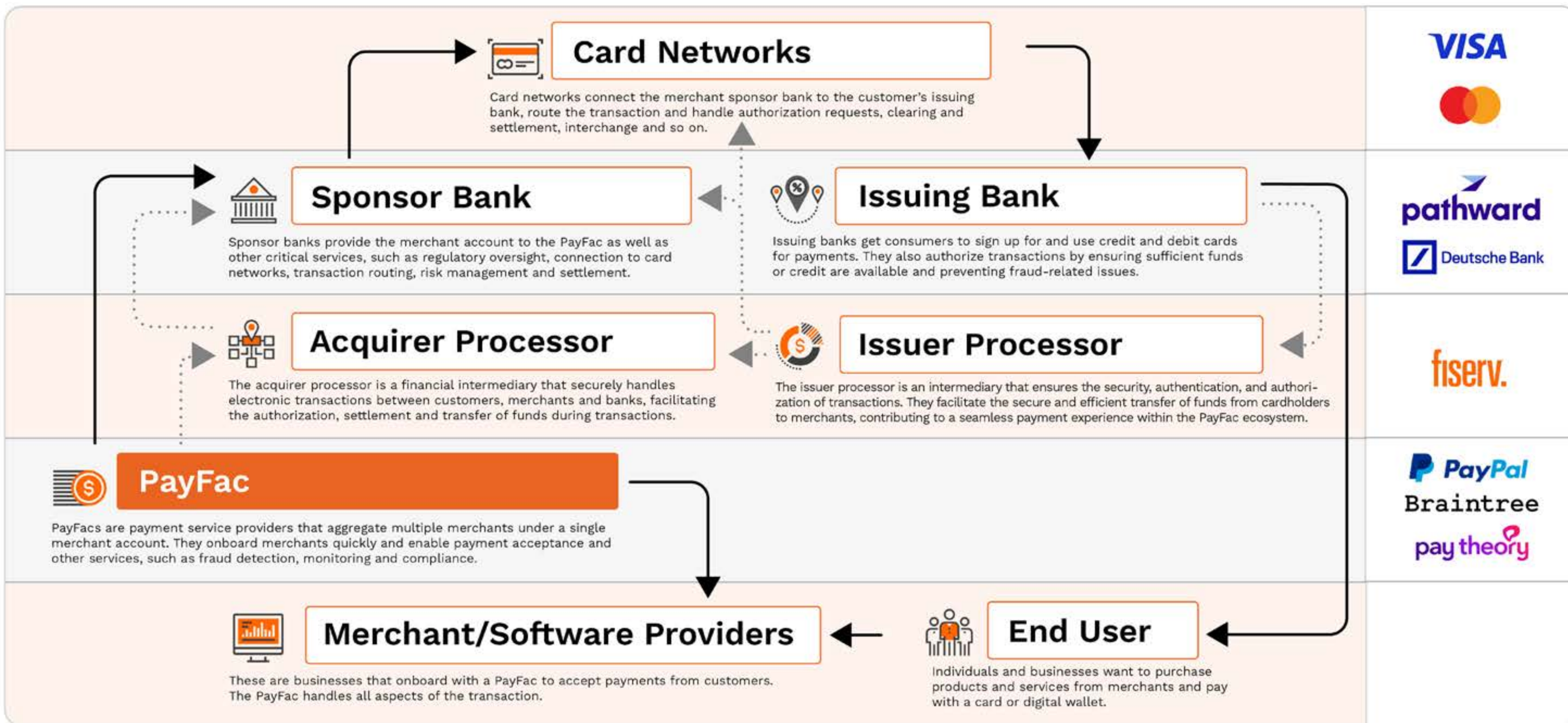
Logistics platforms can enable payouts to drivers in addition to just helping book the job more easily. Consumer product companies can turn products into platforms to build a direct relationship with consumers and learn more about their preferences and ordering behaviors. For example, consumer products giant Mars has expanded beyond its core roots as a confectionary company to become a comprehensive pet care provider. This transformation allows Mars to expand its market reach, cater to pet owners' evolving needs and explore new sources of revenue beyond traditional pet food sales.

T HE ARCHITECTURE OF THE EMBEDDED PAYMENTS ECOSYSTEM

The PayFac ecosystem orchestrates transactional, regulatory, fraud and risk requirements necessary to accept and make digital payments on behalf of the merchants, marketplaces and software platforms that want to embed payments into their businesses without taking the steps required to be a payments business. It takes a village, as the saying goes.

Additionally, the PayFac ecosystem has grown increasingly dynamic because any given entity can play multiple parts. For example, intermediaries such as marketplaces can add PayFac capabilities through partnerships with third-party solutions providers.







PLATFORMS AND INTERMEDIARIES (MERCHANTS, MARKETPLACES, SOFTWARE PLATFORMS AND OTHER BUSINESSES)

Platforms and intermediaries are the heart of the digital economy. These are the businesses that have a connection with the end user and where the core transactions that drive the need for

an embedded digital payments experience take place. These can be businesses or marketplaces connecting buyers and sellers of products. They could also be providers of business software or software platforms that provide specific solutions that solve problems or inefficiencies. These cover many different areas, including processes like invoicing, inventory management, customer relationship management or tax solutions, among other business models that serve the business-to-consumer (B2C), business-to-business and consumer-to-consumer (C2C) segments.

Examples include online marketplaces (eBay), digital content platforms (Bloomberg), shared economy players (Airbnb), aggregators (DoorDash), mobility platforms (Uber) and business enterprise resource planning software (Salesforce)



PAYFACS

PayFacs are the payments infrastructure that makes it possible for intermediaries to offer payments as part of their end-to-end experience. They play a critical role in enabling embedded payments for software providers and do so by providing payment capabilities that

are easy for platforms and intermediaries to set up and start using. Using sub-accounts, PayFacs allow individual merchants to skip the lengthy application and underwriting process to establish their own merchant accounts. Through the use of application programming interfaces, merchants can make and accept payments within their existing workflows. For example,

users can complete purchases, pay for services or subscribe to premium features without being redirected to external websites.

PayFacs provide risk management tools and compliance support to handle fraud prevention and regulatory requirements associated with payment processing. This protects the PayFac, merchants on the platform and platform users from potential security breaches while also helping merchants maintain compliance with the many regulations that govern the safe movement of money between parties. In addition, PayFacs typically provide merchants with access to reporting and analytics tools, enabling them to monitor transaction

data, sales trends and other important metrics. This is often accomplished by using centralized management tools from the PayFac that allow merchants to oversee their transactions, settlements and other financial aspects from a single dashboard.

Examples include Fiserv, PayPal, Stripe and Square.



ACQUIRERS/PAYMENT PROCESSORS

Payment processors acquire and onboard merchants and play a central role in payment trans-

actions within this ecosystem. They are specialized entities that connect merchants with card networks, acquiring banks and issuing banks. They have advanced technology infrastructure and systems designed specifically for efficiently handling payment transactions. This includes transaction routing, securing data through encryption and ensuring that transactions are authorized and settled accurately and quickly.

Payment processors also provide technology expertise. They have developed robust solutions for transaction authorization, encryption and fraud detection. They provide the technology required to allow businesses to accept payments reliably in

stores, online, via mobile or in eCommerce environments.

Payment processors offer comprehensive risk management tools and services to help businesses protect against fraud, chargebacks and other potential risks.

Examples include Fiserv, FIS, Adyen, Chase, TSYS/Global Payments, Nuvei and Checkout.com.



SPONSOR BANKS

A sponsor bank enables non-bank entities to offer financial services by providing necessary banking infrastructure, regulatory guidance and access to payment networks while facilitating compliance with financial regulations and the management of associated risks.

Sponsor banks have the banking license required to hold customer funds or directly access payment networks like Visa or Mastercard on behalf of Fin-Techs and payment processors. They help ensure that relying parties comply with financial regulations, given that the sponsor bank itself is a regulated entity, and help manage the risks associated with financial transactions, such as fraud, credit risk and operational risk.

Examples include Cross River, Pathward and Web Bank.



ISSUING BANKS

Issuing banks are an important part of the PayFac ecosystem, as they are responsible for issuing payment cards to consumers. They also manage the authorization, clearing and settlement of digital payments

for the cards they issue, while other banks partner with separate issuing processors that do so on their behalf.

Examples include JPMorgan, Bank of America, Wells Fargo, U.S. Bank and Capital One.



ISSUER PROCESSORS

The issuing processor connects the issuing bank with the card networks that authorize and settle transactions.

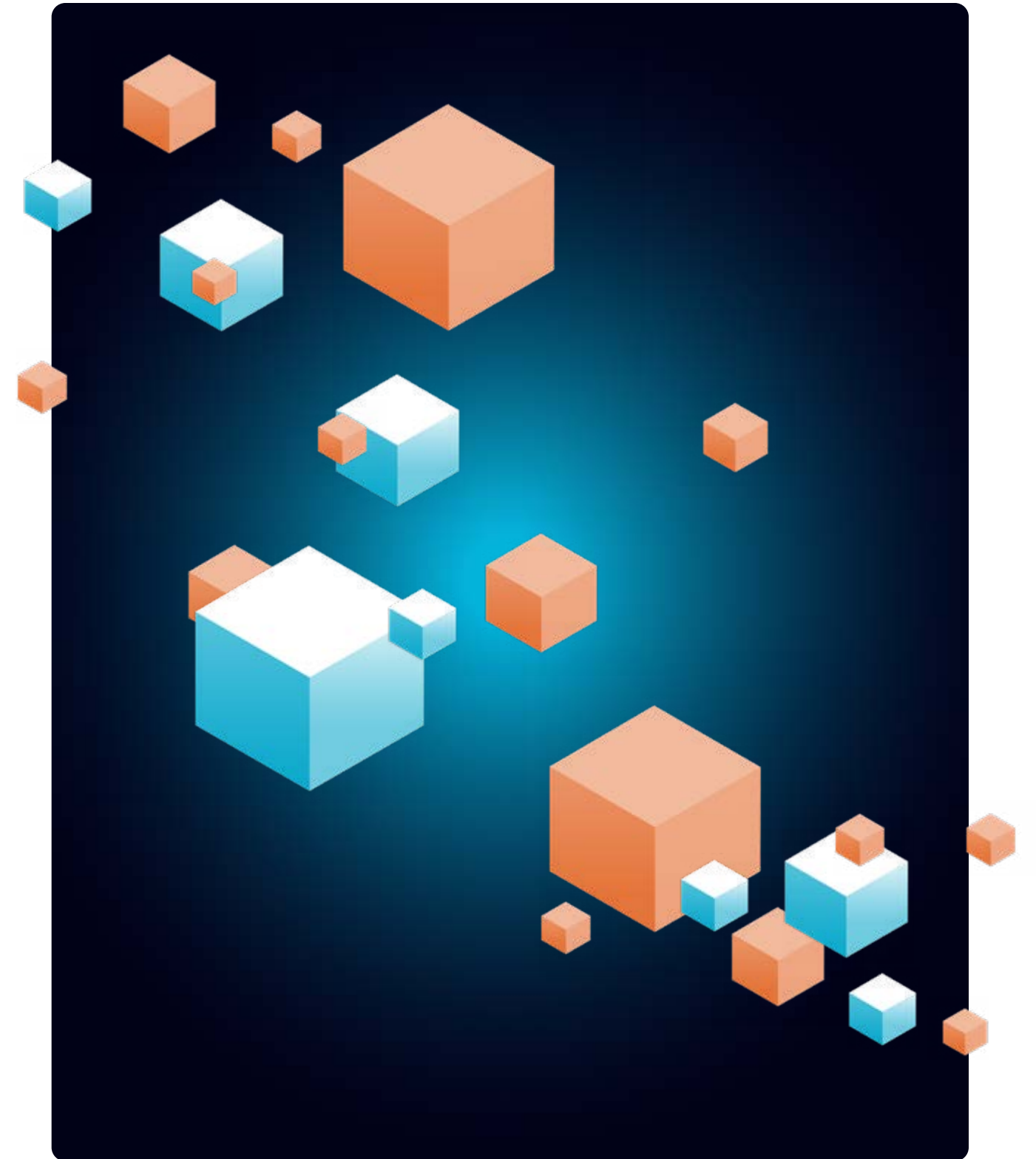
Examples include Fiserv, TSYS/Global Payments, FIS, Marqeta and i2C.



CARD NETWORKS

Card networks clear and settle transactions between banks and merchants for customers who use their card products to complete purchases. These networks provide a connection between banks, allowing for card credentials to be routed correctly from the merchant's bank to the cardholder's bank. In addition, they set operating rules that allow for authorization and approval, maintain security standards and help resolve disputes.

Examples include Discover, Mastercard, Visa and American Express.



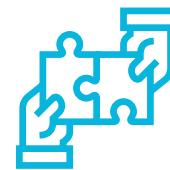
PAYFACS IN ACTION

PayFacs are helping advance commerce and expand the digital economy in several ways.



MARKETPLACES

B2C and C2C marketplace platforms can embed payments capabilities to streamline onboarding and payment processing for their trading partners. Amazon, eBay and Shopify are renowned examples that leverage embedded payments and embedded credit to make it simple for individual sellers to list products and for buyers to make purchases without leaving the marketplace. Bryzos operates an online marketplace for steel and uses embedded payments and finance capabilities to move transactions online and expedite the delivery of orders, for example.



BUSINESS SOFTWARE AND PLATFORMS

Business solutions can embed payments capabilities that expand their usefulness for the end user while capturing new revenue streams. For example, Mindbody, a business management and scheduling platform for the health and wellness industry, embeds payments to allow customers to directly book and pay for classes, studio time and other services directly within the platform. Square-space is a website builder that enables users to set up eCommerce functionality and accept payments for products and services directly on their sites by embedding payments capabilities.



GIG PLATFORMS AND AGGREGATORS

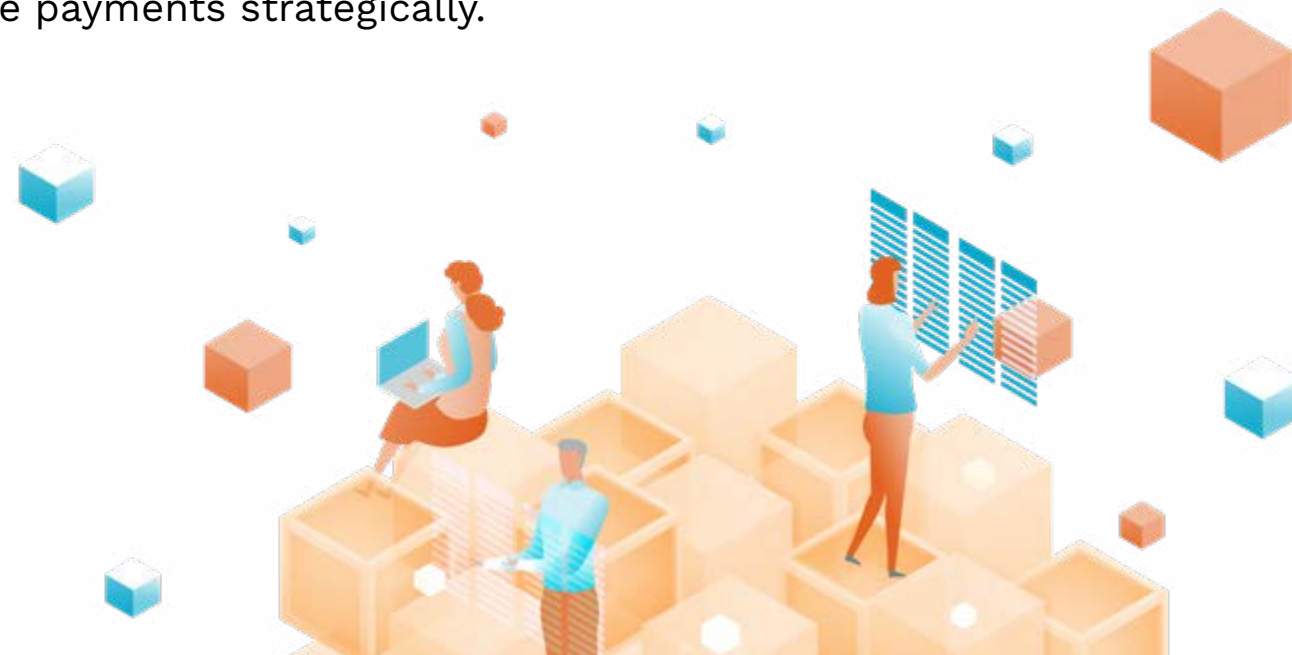
Gig platforms aggregate independent operators who provide services to platform end users and want payment for those services. Uber and DoorDash onboard drivers who, in turn, provide services to riders or customers who want food or other retail products delivered. Both platforms enable the acceptance of digital payments from end users and disburse the payments to drivers.

CONCLUSION

Pundits want to say that every company can or will be a payments company. With the PayFac model, that is surely true. The ability of any business in every sector of the digital economy to embed payments into their experience is a reality that many beyond the “typical suspects” in online retail and retail marketplaces are steadily embracing. The PayFac ecosystem levels the playing field so businesses as small as the Main Street Mom and Pops and as large as the behemoth automobile manufacturer can deploy similar payment experiences for their customers. PayFacs and the payments and value-added capabilities they enable create new opportunities to grow the top line and creatively use payments strategically.

At the same time, the PayFac ecosystem and the players providing services to these businesses are evolving too. Global technology platforms, like Fiserv, are embedding PayFac capabilities into their own tech stacks so that clients can essentially operate multiple different payments models within their business using the same processing and merchant settlement platform. As more of these all-in-one technology platforms emerge, the focus will be on building, buying or partnering to integrate more value-added features into those tech stacks.

As mature as the PayFac model is, in many ways, it has gained importance as all aspects of the economy become more digital and consumers and businesses seek more efficient ways of finding and paying for the products and services they want to buy. Technology has also evolved to make the PayFac process more secure, scalable and efficient for non-financial entities to make payments part of their experience. Innovations in artificial intelligence will only amplify the potential for PayFacs and the ecosystems they power to drive new value and expand the growth of the digital economy in the years to come.



ABOUT

PYMNTS
INTELLIGENCE

PYMNTS Intelligence is a leading global data and analytics platform that uses proprietary data and methods to provide actionable insights on what's now and what's next in payments, commerce and the digital economy. Its team of data scientists include leading economists, econometricians, survey experts, financial analysts, and marketing scientists with deep experience in the application of data to the issues that define the future of the digital transformation of the global economy. This multi-lingual team has conducted original data collection and analysis in more than three dozen global markets for some of the world's leading publicly traded and privately held firms.

THE PYMNTS INTELLIGENCE TEAM THAT PRODUCED THIS REPORT

Karen Webster

CEO

Scott Murray

SVP and Head of Analytics

Daniel Gallucci

Senior Writer

Carat *by* **fiserv**

Carat is the global commerce platform from Fiserv that orchestrates payments and experiences for the world's largest businesses. With Carat, software companies, platforms and marketplaces can unify commerce, embed payments and financial services, and enhance their service models to better serve customers and drive new revenue. Learn more at <https://www.carat.fiserv.com/en-us/solutions/platforms/>.

The PayFac Economy and the Embedded Payments Revolution may be updated periodically. While reasonable efforts are made to keep the content accurate and up to date, PYMNTS MAKES NO REPRESENTATIONS OR WARRANTIES OF ANY KIND, EXPRESS OR IMPLIED, REGARDING THE CORRECTNESS, ACCURACY, COMPLETENESS, ADEQUACY, OR RELIABILITY OF OR THE USE OF OR RESULTS THAT MAY BE GENERATED FROM THE USE OF THE INFORMATION OR THAT THE CONTENT WILL SATISFY YOUR REQUIREMENTS OR EXPECTATIONS. THE CONTENT IS PROVIDED "AS IS" AND ON AN "AS AVAILABLE" BASIS. YOU EXPRESSLY AGREE THAT YOUR USE OF THE CONTENT IS AT YOUR SOLE RISK. PYMNTS SHALL HAVE NO LIABILITY FOR ANY INTERRUPTIONS IN THE CONTENT THAT IS PROVIDED AND DISCLAIMS ALL WARRANTIES WITH REGARD TO THE CONTENT, INCLUDING THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, AND NON-INFRINGEMENT AND TITLE. SOME JURISDICTIONS DO NOT ALLOW THE EXCLUSION OF CERTAIN WARRANTIES, AND, IN SUCH CASES, THE STATED EXCLUSIONS DO NOT APPLY. PYMNTS RESERVES THE RIGHT AND SHOULD NOT BE LIABLE SHOULD IT EXERCISE ITS RIGHT TO MODIFY, INTERRUPT, OR DISCONTINUE THE AVAILABILITY OF THE CONTENT OR ANY COMPONENT OF IT WITH OR WITHOUT NOTICE.

PYMNTS SHALL NOT BE LIABLE FOR ANY DAMAGES WHATSOEVER, AND, IN PARTICULAR, SHALL NOT BE LIABLE FOR ANY SPECIAL, INDIRECT, CONSEQUENTIAL, OR INCIDENTAL DAMAGES, OR DAMAGES FOR LOST PROFITS, LOSS OF REVENUE, OR LOSS OF USE, ARISING OUT OF OR RELATED TO THE CONTENT, WHETHER SUCH DAMAGES ARISE IN CONTRACT, NEGLIGENCE, TORT, UNDER STATUTE, IN EQUITY, AT LAW, OR OTHERWISE, EVEN IF PYMNTS HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

SOME JURISDICTIONS DO NOT ALLOW FOR THE LIMITATION OR EXCLUSION OF LIABILITY FOR INCIDENTAL OR CONSEQUENTIAL DAMAGES, AND IN SUCH CASES SOME OF THE ABOVE LIMITATIONS DO NOT APPLY. THE ABOVE DISCLAIMERS AND LIMITATIONS ARE PROVIDED BY PYMNTS AND ITS PARENTS, AFFILIATED AND RELATED COMPANIES, CONTRACTORS, AND SPONSORS, AND EACH OF ITS RESPECTIVE DIRECTORS, OFFICERS, MEMBERS, EMPLOYEES, AGENTS, CONTENT COMPONENT PROVIDERS, LICENSORS, AND ADVISERS.

Components of the content original to and the compilation produced by PYMNTS Intelligence is the property of PYMNTS and cannot be reproduced without its prior written permission.

We are interested in your feedback on this report. If you have questions, comments or would like to subscribe, please email us at feedback@pymnts.com.