The Ultimate Embedded Payments Guide for

SaaS Providers

Introduction

Embedded payments and embedded finance are financial tools built directly into non-financial systems. Although you may not have realized it at the time, you've probably used an embedded system in the last year — maybe even in the last week.

For instance, when you order food from DoorDash and pay through the app, you're using an embedded payment system. The same can be said for rideshare apps like Uber, streaming services that offer in-app purchases and even travel and hospitality providers that let you book tickets or pay for reservations through a software application.

For SaaS companies and developers, embedded payments offer a way to manage all aspects of the payments process directly from their platform. Embedded payments are especially helpful for software providers who develop solutions for niche markets. For example, dental practices use specialized patient management systems to run day-to-day operational workflows like scheduling appointments, sending reminders and managing patient records. An embedded payments solution would allow them to accept payments from within the same system.

Merchants around the world are choosing software-driven payments over traditional credit and debit card processing for their convenience and ease of use. Thankfully, the proliferation of fintech and digital payments makes integrating payment processing into software solutions simple. It's a great way for SaaS providers to keep business users happy and generate more revenue.

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The Problem With Traditional Payments

Traditionally, payments were separate from a merchant's other operational workflows. Merchants would use a customer relationship management (CRM) system or an industry-specific platform to manage inventory, schedule appointments, store documents, communicate and more. Their payment processing would come from somewhere else.

This arrangement is cumbersome for both merchants and software providers. For the merchant, the process is unnecessarily complex and expensive — especially since they have to manage a second vendor, account, set of systems and support process.

For software providers, relying on third-party payment processing leaves money on the table and diminishes the value of their solution (since they aren't offering a feature that merchants need anyway).

The Embedded Payments Solution

The solution to both problems is to blend software and payments. With **embedded payments**, not only can the merchant accept money, store customer information and manage billing directly through their business management platform, but they can also get their payment processing *directly* from the SaaS platform.

The merchant's workflows are simplified, providing additional value, while software providers earn transaction fees that previously went to a third-party payment provider. It's a win-win for both parties.

An Overview of the Embedded Payments Market Opportunity

Research shows that merchants are already migrating towards software-driven payments. **Half of merchants** get their payment processing from a software platform instead of a traditional payments company, according to McKinsey. In addition, The Strawhecker Group found that **84% of card-accepting merchants in the U.S. already use a software platform** in some way, with SaaS companies hitting 90% penetration in core industries like non-profit and health and beauty.

As more industries adopt niche software platforms to manage daily workflows (and more businesses integrate payments into those systems), the penetration of embedded payments will skyrocket.

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The opportunity is so significant that the integrated payments channel is expected to grow at **double the overall market rate** in the years ahead. For SaaS platforms, that means two things:

1. Merchants will increasingly expect embedded payment options
2. SaaS platforms must act now to reap the benefits of embedded payments (and avoid being left behind)

The Top Industries for SaaS Adoption

Integrated software payments are becoming a universal opportunity as niche platforms popularize. Today, some industries are particularly dependent on software providers. Among small and medium-sized businesses doing less than $5M in annual volume, we've found that the top verticals are:

- Car washes
- Movie theaters
- Membership clubs (sports, recreation and athletics), country clubs and private golf courses
- Drinking places (alcoholic beverages), bars, taverns, cocktail lounges, nightclubs and discotheques
- Dance halls, studios and schools
- Health and beauty spas
- Eating places and restaurants
- Sewing, needlework and fabric stores
- Dry cleaners
- Computer maintenance, repair and related services (including database development)

These verticals offer the perfect opportunity for SaaS platforms looking to stand out through embedded payments.

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The Competitive Advantages of Offering Embedded Payments

Embedded payments are crucial for SaaS platforms looking to compete in rapidly tightening niches. Platforms with built-in payments provide several benefits to their developers, including increased financial resources, a stickier user base and a clear differentiator over rival systems.

Turn a Cost-Center Into a Revenue Generator

The most significant competitive advantage embedded payments offer is the ability to **turn a cost center into a revenue generator**. That extra boost enables everything from a more robust safety net to the ability to invest in growth.

Offer an Improved Merchant Experience To Boost Loyalty and Stickiness

Embedded payments turn the platforms merchants already use into one-stop, end-to-end solutions. **Convenience drives customer behavior**. Merchants don't want to juggle multiple solutions and vendor relationships. Instead, centralizing various features into a core platform is a great way to stand out and provide more value.

Differentiate Software Platforms From Less Capable Competitors

Competition in the software space is growing exponentially. Today, there are 100,000 SaaS platforms building software targeted at different channels and niches. Some experts expect that number to grow to **a million or more within the next few years**.

As competition increases, SaaS platforms must differentiate themselves from competitors by maximizing the usefulness of their software to end users. Offering embedded payments is a great way to provide more value, stand out and develop a loyal customer base as competition grows.

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Now that you have an understanding of where the market is, how do you actually monetize embedded payments?

Generating Revenue With Embedded Payments

Every card transaction carries a small fee, paid by the merchant, that is added to the purchase price. Residuals are the commissions a payment provider earns on each transaction fee.

The average residual is a fraction of a single percent of the transaction value. Although it seems minor, with thousands of transactions performed by hundreds of merchants, residuals add up quickly.

That snowball effect makes the payments space so lucrative and positions embedded payments as a crucial revenue generator for SaaS platforms.

Example:

A payment provider buys wholesale bulk payment processing from an acquirer for 2.5% + $0.05 per transaction. The provider marks that up and charges its merchants 2.7% + $0.10 per transaction. The provider's residual is the extra 0.2% + $0.05 earned on each transaction.

A $100 transaction earns the provider just $0.20 plus the flat $0.05. If that merchant does $2 million in sales per year, they will generate over $4,000 in residuals. Multiply that across dozens or hundreds of merchants, and the case for monetizing payments is clear.

Selling Payment Processing

SaaS platforms that don't offer embedded payments are giving money away; merchants will use a third party for payment processing, and the software provider will lose all the revenue associated with transaction fees. Selling payment processing directly to merchants through a software solution can change that.

A software provider can choose one of four sales models depending on their goals and willingness to navigate complexity and risks. They include the referral model, the provider model, the hybrid model and the partner-enabled model.

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The Referrel Model

The referral model is the simplest, but it offers the most limited earning potential. In this model, the SaaS platform offers payments to users with the help of a third-party partner like an independent sales organization (ISO) or payment facilitator. The partner sets the merchant up with payment services in the background but allows the software platform to be the face of the merchant/processor relationship.

This model offers the lowest barriers to entry and the lowest risk. However, the third-party provider keeps most of the residuals, paying the software provider a small commission from each transaction.

Research from the Strawhecker Group shows that the referral model is the most widely used; it is a low-friction way for small software providers to get started in payments. However, SaaS platforms can quickly outgrow their partner's infrastructure and revenue models. At that point, they'll need to provide payments themselves.

The Provider Model

The provider model eliminates the middleman, with the SaaS platform becoming the primary payment provider. In this model, the software provider has a direct relationship with an acquiring partner — like a bank or a large payment processor. These SaaS platforms buy transaction processing from the acquirer at a wholesale rate and mark it up. That markup represents the software provider's residual, which it keeps instead of sharing with an additional partner. With payment processing in place, the software provider can onboard merchants to their own payment services.

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While the provider model is more lucrative, it is also more complex and requires more upfront work. For instance, for this model to work, SaaS platforms must either find and be sponsored by an acquirer or act as the acquirer themselves by becoming a payment facilitator or ISO:

- **Payment Facilitator:** Becoming a **payment facilitator (PayFac)** is the most popular option for SaaS platforms looking to monetize payments under the provider model. A PayFac opens a master merchant account with its acquiring partner and uses it to process all transactions for its merchants — known in this model as sub-merchants.

Since the SaaS platform processes transactions through its own account, it controls pricing and which merchants to accept. That's important when offering a fast, frictionless sign-up experience like PayPal and Square do. Subsequently, this means they also take on *all* the risk — more than some SaaS platforms are comfortable with. PayFacs can also only work with one payment processor, limiting the options they can provide to merchants.

- **Retail Independent Sales Organization:** Like PayFacs, **ISOs are companies that resell payment services** on behalf of a merchant acquiring partner. However, unlike PayFacs, retail ISOs — the type most SaaS platforms want to become — are purely intermediaries. They recruit merchants and provide support, but the acquirer conducts all the processing and risk management. It's like the referral model, but instead of a merchant being passed from the software provider to a third-party ISO to the acquirer, the software platform becomes the ISO.

  Registering as an ISO requires SaaS platforms to get approval from the big card companies like Visa and Mastercard. Retail ISOs also have little control over which merchants their partners accept, which can result in frustrating denials for merchants the SaaS provider would otherwise work with.

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Despite those drawbacks, the retail ISO model works well for platforms looking to earn larger residuals without taking on the risk management aspects of the PayFac model.

- **Wholesale Independent Sales Organization:** Wholesale ISOs work like retail ISOs but take partial or full responsibility for underwriting the merchants they recruit. That exposes them to extra risk but also enables them to earn higher residuals and have more control. A wholesale ISO has (arguably) the best qualities between a retail ISO and a PayFac.

  Unfortunately, going wholesale requires significant resources and a larger portfolio of merchants than the average software vendor. Because of this, only a fraction of software vendors become wholesale ISOs, making it the least common way to monetize payments. However, for SaaS platforms that have the size and resources necessary, it's a highly lucrative option.

The Hybrid Model

The hybrid model is a mix of the referral and provider models. This model allows a SaaS provider to become a retail ISO or PayFac while maintaining its referral partnerships. This enables software vendors to be selective with how they serve each merchant. It also offers additional processing options for merchants with a high-risk profile.

For instance, a software company might accept low-risk merchants as a PayFac but pass more difficult merchants to a partner specializing in high-risk cases. That choice allows SaaS platforms to offer most applicants a fast, streamlined sign-up process while minimizing the number of users they deny due to risk.

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The Partner-Enabled Model

The fourth and newest model software providers can choose is the partner-enabled model. In this case, the software provider partners with a payments platform designed specifically to enable embedded software solutions — like NMI. The platform partner provides all the infrastructure necessary to offer payments directly to end users and also takes on the risk involved in processing. That leaves the software provider to focus on recruiting merchants and doing what it does best — building great software — while reaping the revenue benefits of payments.

In essence, the software provider gets a white-labeled payments business that runs on its partner's platform behind the scenes. They enjoy the best of all worlds — simplicity, low risk and the ability to tailor a solution to their needs, all without the need to become an ISO or PayFac. They also get the peace of mind that comes with having a stable, experienced payments company in their corner.

Selling Value-Added Merchant Services

Beyond payment processing, software providers can offer other payment-related services to generate residuals. The value-added reseller (VAR) model allows SaaS platforms to provide merchants with consulting, hardware, value-added services and more.

In many cases, value-added services (or extensions) can be bundled with payments through the same onboarding processes. This offers SaaS platforms a fast, easy way to upsell merchants while providing a more comprehensive payment experience.

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Some common value-added services SaaS platforms can sell include:

- Advanced fraud protection
- Tokenization and data security
- Off-site customer data storage
- Mobile text-to-pay
- Level III transaction processing
- Automatic card updating
- Advanced payer authentication
- Accounting software integrations
- EMV-compliant hardware
- Electronic invoicing

Considerations for Getting Started: Questions to Ask Before Evaluating Potential Payment Partners

The most important step when taking the leap into embedded payments is finding a partner who can make the transition to embedded payments frictionless. While SaaS platforms of any size can benefit from monetizing transactions, offering payment processing in your app or solution only makes sense if you can unlock revenue opportunities without weighing down your core business.

Your partner's goal should be to make your payments experience **[as frictionless as possible]**. They should handle the nitty-gritty details of processing while providing a thorough education so you can integrate payments into your software and thrive as a pillar of support for your merchants.

However, some aspects of payment processing (and general operations) are helpful to know upfront, even before you start shopping for a payments partner. Having a clear answer to as many of these questions as possible will help you in several ways, including:

- Making a better shortlist of potential partners
- Saving you time during research and initial discussions
- Developing a clear vision so your potential partner understands your needs (and ensures they're offering you the right services)

When searching for the right partner, be sure to ask them a variety of questions to gauge their expertise and understanding of your industry.

Learn more about your embedded payments partner by asking about:

- **Experience:** Ask your partner how much experience they have in the embedded payments space. It's also important to ask them how familiar they are with your industry and any relevant regulatory requirements
- **Support:** A great partner will offer ongoing education and support, even after the initial integration
- **Functionality:** Your partner should offer a variety of payment options, including online, point-of-sale, contactless, text-to-pay and more

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- **Developer Support:** Your partner should make it easy for you to integrate payment solutions into your software solution. Ask them about their no-code, low-code SDKs and APIs and integration support to ensure adding payments to your tech stack won't be a headache
- **Revenue Sharing:** Many payment providers don't offer worthwhile revenue sharing. Finding a partner who does will enable you to offer payments to your customers at a profit, rather than a cost

In addition to the questions you should be asking potential partners, we've compiled seven questions to ask yourself as you prepare to dive into payments.

Don't worry if you don't know the answer to all of them — your payments partner will be able to help you fill in any gaps. But the more questions you can answer upfront, the better the foundation you'll have when selecting a partner and developing your payment services.

Question 1: What Vertical Am I Serving, and What is My MCC?

For processing purposes, major card companies place every merchant into a vertical using a merchant category code (MCC). As a software vendor, your MCC applies to your software sales. For instance, if bakeries are your primary customers, you only need an MCC for that vertical. However, once you begin offering embedded payments, things will get trickier as you will also need to consider the verticals your merchants serve.

Your MCC will greatly impact your payments monetization, determining everything from pricing and compliance requirements to the risk level you represent to partners.

Your MCC will greatly impact your payments monetization, determining everything from pricing and compliance requirements to the risk level you represent to partners. Unfortunately, MCCs aren't always well-defined. That means identifying the MCC of your future merchants may be easy in some cases and difficult in others.

For instance, MCCs occasionally change depending on card brands. There are also some gray areas across different categories, so the sooner and more concretely you can identify the MCC(s) you'll serve, the better.

A potential payments partner will need to know this information early. Not all payments companies work with all MCCs, so while a prospective partner can help you determine the category you'll be serving, you may find that it's outside of their acceptable risk profile. So, knowing the MCCs you need to serve ahead of time can save you time and effort.

Here is a complete list of **Visa and Mastercard's merchant category codes**.

Question 2: How Do I Want to Price My Payment Services?

There are different ways you can price your payment services that will impact your earnings and the complexity of your operations. While your potential payment provider will discuss your options with you in detail, it's good to understand what different pricing models entail.

The two primary options you'll have to choose between are interchange-plus pricing and flat-rate pricing. Choosing is a question of deciding whether simplicity or price is more important to you and your customers.

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Interchange-Plus Pricing

An interchange fee is charged to the payment processor whenever a card transaction is processed. The card networks set these interchange fees, which are due directly to the customer's issuing bank. Interchange-plus pricing takes this base fee and adds a set markup — interchange plus the markup.

However, it's important to remember that interchange fees aren't uniform for all transactions. They change based on multiple factors. For instance, a card-not-present transaction, like an online payment, is riskier than a card-present transaction and carries a different interchange rate as a result. There are also different interchange rates for credit and debit cards, even under the same brand. Finally, merchants in different industries generate different interchange rates.

All of these factors make interchange-plus a complex pricing model.

The upside is that when an interchange fee is low, the merchant pays less, resulting in lower average fees than flat-rate pricing. As a result, if you're going after big merchants doing high sales volumes, interchange-plus is almost a must.

There is no need for you to pour over interchange tables to learn them in detail, but it is a good idea to have a general idea of whether your merchants' verticals carry higher or lower fees.

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Flat Rate Pricing

In the flat rate system, you charge your merchants a set rate for every transaction, regardless of the industry or how a payment is made. For example, a common flat rate fee would be 2.9% + $0.10 on every transaction.

The obvious benefit of this model is that it's simple and easy to understand for both you and your merchants.

However, it can be more costly for your merchants since they won't benefit from lower-interchange transactions, like card-present (in-person) debit payments.

Question 3: Do My Customers Need Level 2 or Level 3 Transaction Processing?

Whenever a credit or debit transaction goes through, data about the buyer, seller, and product or service is generated. For the simplest transactions — the kind we all perform daily — as little as four data points are collected. These include:

- Purchase date
- Seller name
- Merchant category code
- Total purchase amount

This is known as **Level 1 processing**; it's the kind the vast majority of merchants use.

Whenever a credit or debit transaction goes through, data about the buyer, seller, and product or service is generated.

However, some merchants need more data. For large corporate or government purchases, merchants often have to collect up to a dozen additional data points to meet the customer's transparency and financial control requirements. A merchant that can't is excluded as a potential vendor.

The more advanced types of processing that make additional data collection possible — **Level 2 and Level 3 processing** — aren't offered by all payment providers. It's worth considering whether or not your merchants will serve large corporate or government clients. If so, you'll need to factor in the need for Level 2 or 3 processing when evaluating potential payment partners.

Question 4: How do My Merchants Need to Process Payments?

Depending on your software and customer base, your merchants may need to take digital payments, card-present payments or both. Digital "card-not-present" payments are transactions where the buyer doesn't tap, insert, or swipe a physical card. For instance, ordering a meal through an app is an example of a card-not-present transaction. Purchasing a shirt online with a stored credit card is another example.

For most SaaS platforms, the ability to process card-not-present payments through the software is a standard feature. That's enough for many merchants. However, some may also need to take debit and credit card payments in person.

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For example, a dental office needs to be able to process payments directly through its office management software while also catering to patients who want to pay at the counter after their treatment. To serve merchants needing card-present payments, you'll need to offer hardware solutions like payment pads or even full POS (point-of-sale) systems. That means any potential payments partner you work with will need a suite of hardware (and, ideally, mobile solutions) available at prices that will appeal to your merchants.

Question 5: Do I Want to White Label My Payment Services?

[White labeling your payments experience](#) has two major benefits: it enhances your branding and makes the signup experience feel more secure for merchants.

A traditional solution works like this:

- Your merchants opt into payment processing through your software
- They then enter a portal or are redirected to another website

The secondary website would feature your payments partner's branding rather than your own. Not only does that undercut your authority as a payment provider, but it also adds friction to your merchants' signup and onboarding experience. Just like with an online checkout, unexpectedly going from one set of branding to another can be jarring for a merchant, especially if they're unfamiliar with your payments partner.

White labeling solves the problem entirely, ensuring your merchants only interact with your software platform's branding every step of the way, increasing their impression of your brand and cementing trust.

To serve merchants needing card-present payments, you'll need to offer hardware solutions like payment pads or even full POS (point-of-sale) systems.

Not all providers offer white labeling, so it's a good idea to inquire with potential partners to determine exactly how your brand will be featured throughout the merchant's payments journey.

Question 6: Is There a Future Option to Become a Payment Facilitator?

You can offer payments directly to your merchants in several ways, one of which, as we mentioned previously, is as a **payment facilitator or PayFac**. Becoming a PayFac is an advanced step that most SaaS platforms will only take once they've reached a certain level of scale and experience. It offers several benefits, including higher earnings potential and more control over which merchants you work with and how. However, it also comes with additional risk, technical and compliance factors, maintenance requirements and costs.

When your SaaS business has grown significantly, and you have hundreds (or thousands) of merchants under your umbrella, it may be time to consider becoming a PayFac.

To minimize future friction and business interruptions, inquire with any potential payment partners to ensure they offer PayFac enablement.

The right partner will help make the transition seamless, should it become the right choice for your business. This will also ensure you don't have to find another provider when you're ready to scale.

To minimize future friction and business interruptions, inquire with any potential payment partners to ensure they offer PayFac enablement.

Question 7: What Kind of Integration Resources Do I Need?

Today, you can easily integrate payments into your software using low-code, no-code APIs and SDKs. Self-serve integration is common for SaaS platforms launching services with a new partner. However, every software company is unique, and there is no one-size-fits-all solution. Because of this, it's important to consider what kind of resources, assistance or guidance your team will need to get your new payment solutions up and running.

Depending on your in-house experience, you may need more support from your payments partner. In this case, finding a partner with best-in-class integration and support teams is a must. It's also important to communicate any specific timing requirements you may have so your partner can ensure your services are live exactly when you need them to be.

The support experience should always be a top priority when evaluating payment partners, regardless of your company's needs or experience. Offering payments processing provides substantial value to your users — unless they can't get issues solved promptly and effectively. Finding a payments partner that provides the highest quality support ensures you, in turn, can offer great support to your merchants.

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Let NMI Be a Trusted Advisor on Your Payments Journey

NMI offers a full suite of services designed specifically to meet the needs of SaaS payment providers. Whether you're just entering the embedded payments space for the first time or you're a seasoned veteran looking to take things to the next level, NMI has the services, systems and support necessary to meet your payment goals.

As an NMI partner, you will have access to a leading payment gateway, all the payment processing solutions you need to serve your users, a complete suite of value-added services (extensions) to resell, an industry-best support team and a trusted advisor with over two decades of experience leading payments innovation.

To find out more about how you can get started with the most frictionless embedded payments solution available, **reach out to a member of our team**.

Contact us
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