The Vertical SaaS Fintech Playbook

Introduction

The key to building a $100M+ ARR vertical SaaS business is identifying opportunities to expand the product beyond its primary function as workflow software. These “second acts” unlock new value in the form of increased revenue from existing customers as well as revenue from entirely new customer segments.

One of the most powerful levers for expanding vertical SaaS TAM is embedded fintech, which allows software providers to expand their presence in the industry value chain by offering their customers payment processing, lending, and many other financial services.

Embedded fintech was enabled by the unbundling of traditional financial services such as lending and payment processing into APIs that allow any SaaS provider to offer services once reserved for banks or other financial institutions. It grows TAM along multiple dimensions, including:

1. Revenue Expansion

Core workflow SaaS is typically only a portion of a customer’s software spend. Embedded fintech products allow vertical SaaS companies to capture revenue from payments, payroll, and other business functions that would otherwise go to third-party financial service providers while simplifying the customer’s software ecosystem.

2. Increased LTV

Embedded fintech increases the lifetime value of customers by enabling vertical SaaS providers to tap into new revenue streams (e.g., a percentage of all payments made to their customers) and improving the stickiness of the core workflow product to reduce churn.

3. New Markets

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The strategies for implementing financial products in workflow software have changed significantly over the past decade. The first wave of vertical SaaS companies that used fintech to expand their TAM primarily resold services from third-party financial institutions. Increasingly, however, vertical SaaS companies are moving toward embedded financial services, which have the advantage of higher revenue and an improved customer experience.

The spa and health center SaaS provider Mindbody offers a great example of this transition from outsourced to embedded fintech. As detailed in its S-1 filing from 2015, Mindbody offers its customers a variety of fintech solutions including payments and payroll, and for the three years leading up to its IPO, payments alone accounted for more than one-third of Mindbody's revenue. More recently, Mindbody expanded its fintech offerings to include lending products. Initially, they referred their customers to LendingClub for business loans and earned a commission on each referral. Today, however, Mindbody offers short term cash loans to its customers underwritten by future payments processed on its own platform. As we'll see throughout this guide, the embedded fintech model can be a serious revenue driver for vertical SaaS companies of any size and in some cases may actually outstrip the revenue from their core workflow software.

How to Use Fractal's Guide to Embedded Fintech

This guide is meant to help founders navigate the tradeoffs that come with building various embedded fintech products. It examines four of the most common fintech products—payments, lending, credit cards, and payroll—but this is hardly an exhaustive list. Bank accounts, compliance services, benefits, and insurance are all equally viable pathways to expanding TAM with fintech and much of the advice offered here is applicable to these alternatives.

It also explores three primary pathways for implementing each type of fintech product: outsourcing the service to a third-party, contracting with a specialized provider to build a white label product, and building the product entirely in-house. The choice a vertical SaaS founder makes will ultimately depend on their company's revenue, customer profile, industry dynamics, and the type of financial product they are offering.

Payments

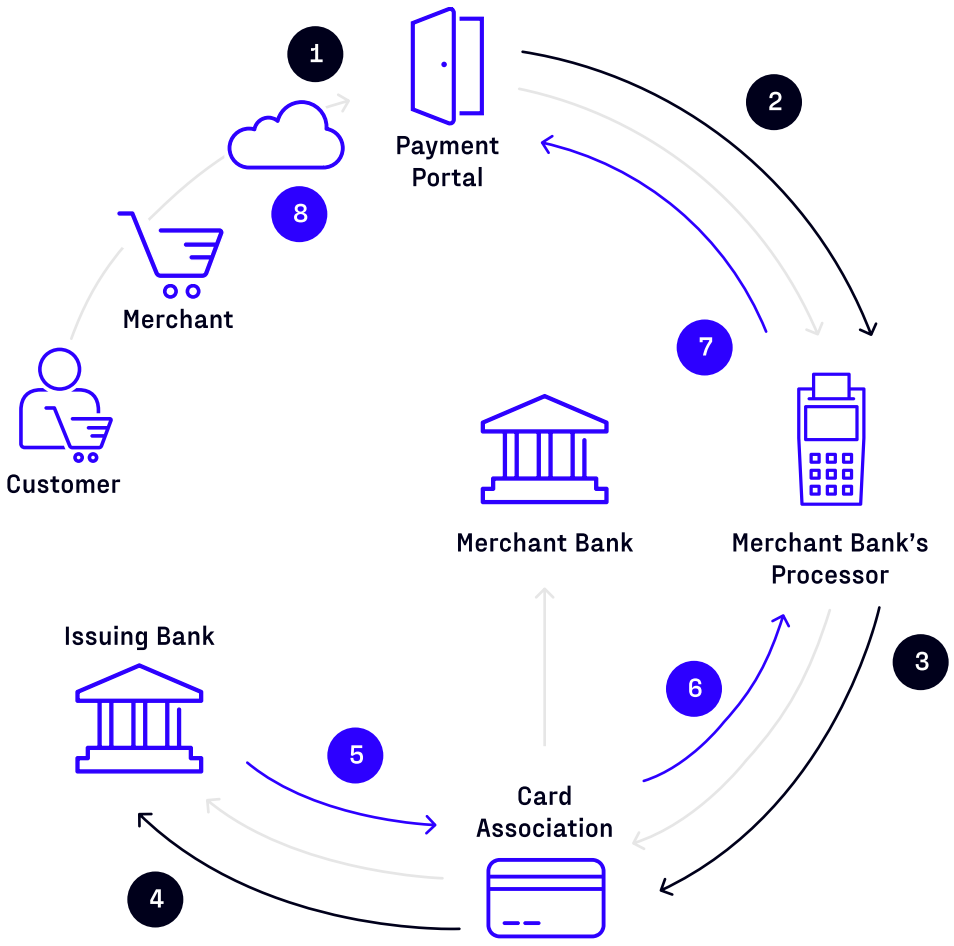
Payments Overview	
Ideal Industry Characteristics	Highly fragmented; no customer commands more than 10% market share
Customer Profile	Merchants with significant card-based transaction volume where the average transaction is less than $1000
Customer Examples	Grocers, jewelers, auto repair shops, pest control, e-commerce

Payments are the typical entrypoint for embedded fintech on a vertical SaaS platform. This is due to the relative maturity of API-driven payment facilitation services and the strategic position that payments occupy in a customer's business. Embedded payments provide vertical SaaS companies with important customer data that can be leveraged to launch new financial products such as loans or credit cards that are underwritten with payments data.

Payment System Basics

The goal of a payment system is simple: move money from the customer's account to the merchant's account. But when you pop open the hood, you'll find a complicated network of intermediaries that interact with the payment before it lands in the merchant's account. A typical payment process looks something like the diagram below. When a customer purchases a product from a merchant with a credit/debit card, the merchant submits this request to a payment processor that passes the request on to a credit card network like Visa or Mastercard, which in turn passes the request on to their network of merchant banks. The merchant banks then interface with the bank that issued the customer's credit card to authorize the payment and if the payment is approved, the issuing bank debits the customer's account and transfers the funds to the merchant's account.

A high level overview of the payment process and players in the payments ecosystem



Advantages of a Payment Facilitator

The problem with the conventional payments system is that it is remarkably cumbersome for a merchant to interact with. In the past, a merchant would have to apply for a unique merchant ID, which would kick off a weeks-long underwriting process where a bank examines the risks of the merchant's card transactions. If the merchant application is approved, it would receive a business checking account with the bank and could begin processing payments. Yet with all the intermediaries involved, the actual process of moving money from the customer's account to the merchant's account is relatively slow.

The rise of payment facilitators ("payfacs") fundamentally changed this dynamic. Rather than each individual merchant applying for an account with a payment processor, a payment facilitator opens a single master account with a payment processor and its bank. The payment facilitator then allows merchants to open sub-accounts under the umbrella of its master account. The primary advantage of the payfac model is that it is significantly faster in terms of merchant onboarding and moving payments between the customer and the merchant. Unlike the conventional payment processor model, payment facilitators underwrite every transaction rather than a single upfront underwriting process. This reduces risk of fraud and allows for same-day merchant onboarding. And since the payment facilitator has a single master account with its bank, it can batch process payments from all its merchant sub-accounts, which results in a significantly faster payment settlement process.

Well known examples of tech-enabled payfacs include Stripe, PayPal, and Square, which allow software companies to easily embed payment functionality into their software using APIs. Increasingly, however, some vertical SaaS companies such as Toast are opting to register as payment facilitators themselves, which cuts out the middleman and allows them to capture more revenue from payments. The tradeoff is that registering as a payments facilitator and building a payments platform requires significant amounts of time and capital. A middle of the road solution is for vertical SaaS companies to contract with a company such as Finix, Payrix, or Tilled, which can provide white label payfac solutions for a software platform. Each of these options will be considered in greater detail on the next page.

	Managed	White Label	In-house
Build Time	<3 months	6-12 months	>2 years
Risk	Low	Medium	High
Revenue/Tx	<50 bps	<50 bps	50-100 bps

Managed Payfac

The simplest pathway to integrating payments on a vertical SaaS platform is to contract with a managed payfac provider. These third-party providers are companies like Stripe that handle both the technical implementation and the risks associated with payment processing such as fraudulent credit card transactions or undelivered goods and services. Letting a third party entirely manage the payments solution can dramatically lower time to implementation as well as the risk carried by a vertical SaaS company, but it makes it far more challenging to monetize revenue from payments. In general, contracting with a third party payfac requires negotiating lower processing fees based on the number of transactions flowing through your platform and savvy operators will be able to push these fees lower at scale.

White Label Payfac

A white label payfac has many of the benefits of contracting with a third party provider with the added benefit of a more cohesive experience for a vertical SaaS platform's customers. This is useful for driving conversions at checkout or creating customized reward programs that drive further sales. Contracting with a company like Finix, Payrix, or Modern Treasury for a white label solution essentially means a vertical SaaS company is allowing these providers to handle building the tech infrastructure they need to become a payfac such as compliance, underwriting, and tokenization APIs. The higher revenues generated from a white label payfac solution typically reflects the risk carried by the vertical SaaS company: the fees they collect on payments are typically around 10 basis points per transaction. (Note: This fee is in addition to the interchange/assessment fees paid to the issuing bank and card network.)

In-House Payfac

Building an in-house payments system can be an attractive investment for vertical SaaS companies that have the capital, engineering talent, and scale to pull it off. In addition to enabling a more cohesive user experience, it dramatically increases the revenue from payment processing. The tradeoff of this approach is that it will take significantly more time and capital to accomplish. It will also require a dedicated payments team that includes banking and risk management elements to handle the significantly elevated risk of fraud. In general, building the infrastructure to become a payfac in-house is really only viable for companies that have at least $50M in transaction volume annually. Even then, it may still make more sense to contract with a white label payfac service. The vertical SaaS platforms that opt for this route can expect roughly 75 to 100 basis points per transaction, but a substantial upfront investment in building engineering and compliance teams.

For the vast majority of vertical SaaS businesses, opting for a managed or white label payfac solution will make the most sense. While it is always possible to build an in-house solution later if the company has the requisite engineering resources, capital, and risk management infrastructure in place, this will typically incur significant switching costs. With the rise of cost effective white label solutions, there are vanishingly few reasons for vertical SaaS platforms to become their own payfacs.

Perspective on Embedded Fintech: An Interview with Finix

Finix is a payment infrastructure platform that gives businesses an alternate way to own, manage, and monetize their entire payments experience without the headaches or expenses associated with building an in-house system from scratch. We spoke with Finix leadership about the benefits of white label payfacs, comparisons of different fintech products, and the engineering requirements for implementing a white label payments product.

Why are white-label payments solutions preferable to alternatives?

Finix: White-labeled payment solutions allow SaaS companies to underwrite and manage merchants directly. Owning the relationship improves the merchant product experience, decreases merchant confusion, and preserves your brand in the minds of your customers. With managed solutions (e.g., Stripe Connect Standard), you give up control over the merchant experience since they have to go through the underwriting process outside of your platform.

Can you describe the engineering process required to implement an API-enabled white-label payments solution?

There are generally four main steps in the integration process for platform payments:

1. **Gateway integration:** This allows you to securely capture and transmit payment card information from a mobile app, website, or point-of-sale device.

2. **Merchant onboarding:** This allows you to safely accept sensitive information (e.g. name, address, tax ID number) needed to underwrite and onboard a merchant. Again, this can be captured from a mobile app or website.

3. Merchant management: This allows you to establish rules for each merchant (or a group of merchants), such as the fees they will pay to you as a platform for each transaction.

4. Creating a sale: This allows you to actually pull money from a buyer's card and designate those funds to a merchant (while taking your cut).

How does a payments solution compare to alternative fintech products for SaaS companies?

Starting with payments is often the logical choice as it provides insights to program sponsors into a business's finances, including cash flow from credit card sales—all of which are prerequisites to other financial services such as lending. We expect that most companies will, over time, consider adding more than one embedded fintech product, but the sequence will depend largely on your vertical and your customers' needs. For example, businesses that require a lot of working capital may decide to add lending to their payments offering, whereas if your customers need the ability to manage stored wallets or facilitate faster access to earned wages, issuing a card might make more sense.

What kind of compliance burden is there for companies that build an embedded payments product?

Being in the money movement space means navigating compliance requirements as part of ensuring good behavior and best practices by all stakeholders. The reason many companies choose to work with Finix is that we abstract away most of the compliance burden from our customers, allowing them to focus on their core business and what they do best.

Lending

Lending Overview	
Ideal Industry Characteristics	High capital costs, challenging working capital cycles, and/or significant seasonal revenue fluctuations
Customer Profile	Customers with significant payment delays or lack of credit
Customer Examples	Construction, trucking, restaurants, barbershops, retail, ski resorts, agriculture

Vertical SaaS companies that have implemented a payment product on their platform are particularly well positioned to expand their fintech offerings into lending products. Starting with a payment product is not strictly necessary and in many industries may not make sense. But it does offer vertical SaaS companies an important advantage over horizontal lending providers by giving them access to their customer's cash flow data. This not only helps them underwrite loans, it also gives them a frictionless pathway to automate loan payments by collecting a fraction of each transaction.

The dynamics of a vertical SaaS company's industry will determine the type of lending products that make the most sense for their customers. Some industries, such as construction, may need significant loans to finance large projects. Other industries that are highly seasonal or have long periods between delivery of a product and payment may need short term loans to bridge the gap. In the latter case, vertical SaaS companies can offer invoice factoring, which allows them to pay SMBs immediately after they issue an invoice for a flat fee.

Lending products also allow vertical SaaS companies to reach their customers' customers. The field services platform ServiceTitan, for example, has arranged partnerships with lending platforms such as GreenSky, Service Finance, and Financeit that allow home services companies to provide financing to end consumers. This creates value for ServiceTitan's customers by helping them close

more sales, and ServiceTitan is able to expand its loan revenue by taking a commission on each financing transaction.

Like payments products, vertical SaaS companies have three main pathways for implementing a lending product. They can either refer customers to a platform lender, partner with a platform lender, or build their own embedded lending solution.

	Managed	White Label	In-house
Build Time	<3 months	<3 months	>1 year
Risk	Low	Low	Low-Medium
Revenue/Tx	One time fee	Small portion of loan interest	Large portion of loan interest

Platform Lender Referrals and Partnerships

The simplest way for a vertical SaaS company to offer loans to their customers is to strike a referral deal with a platform lender. These are companies like Kabbage, Lending Club, or Lendflow that have existing partnerships with banks and specialize in issuing loans. This is the risk-free option for vertical SaaS companies. It creates passive income through referral fees without burdening the company with the risk of customer defaults. It may also benefit the vertical SaaS company's customers if they receive interest rate reductions as part of the referral agreement. The downside, of course, is that referral fees are quite small and do not scale with the size, frequency, or terms of the loan. Furthermore, it requires customers to interact with a third party rather than the vertical SaaS platform, which can create friction and lower participation rates in the lending product.

Vertical SaaS companies that want to tap into revenue based on the interest rate of the loan should consider foregoing a referral program and partnering directly with a platform lender. This is a low-risk strategy where the platform lender still carries the risk of default and provides the vertical SaaS company with a portion of the interest rate in exchange for marketing the loan service on the vertical SaaS company's platform. While the percentage of the loan interest is still likely to be modest, it has

the comparative advantage of scaling with the size or frequency of the loans. The major downside of this approach is that the vertical SaaS company assumes brand risk from partnering with the platform lender. If their customers have a negative experience with the lender, it will reflect poorly on the vertical SaaS company and may cause their customers to look for alternative solutions.

Embedded Lending

Embedded lending products have a similar structure to partnerships with platform lenders, but the vertical SaaS company takes a significantly larger cut of the interest paid on the loan. This strategy pairs particularly well with payments solutions for two reasons. First, it allows vertical SaaS companies to underwrite the loan based on the data from payment processing services. Second, it can automate the repayment of the loan by applying a small portion of each transaction to the outstanding loan balance, which significantly reduces the risk of loan default. Arguably the biggest challenge with this strategy is that lending is a highly regulated space, which means that vertical SaaS platforms must partner with a bank that will ultimately underwrite the loan. The process of negotiating with banks can be incredibly time consuming and will require the vertical SaaS company to maintain a dedicated regulatory team and software engineers to service its lending product. Typically, the bank partner will shoulder all the risk of a loan default, but it is possible for vertical SaaS companies to take on part of this risk in exchange for a larger cut of the interest. Recently, however, embedded lending providers such as TapWater have simplified this process by creating a marketplace that connects banks and software platforms. In this arrangement, the marketplace provider handles risk, compliance, and connecting SaaS platforms with banks in exchange for a portion of the lending revenues.

Once a vertical SaaS company has determined that a lending product is right for their business, it needs to calculate how each pathway to a lending product may impact its revenue:

Referral model: Calculate the number of businesses likely to request a loan in their industry and then negotiate a flat referral fee with a lending platform that reflects this demand.

Partnerships or embedded products: Calculate the total industry debt and negotiate a percentage of the interest rates based on the value of the outstanding loans. Expect to receive substantially lower portions of the interest rate in partnerships compared to an embedded solution.

Perspective on Embedded Fintech: An Interview with Tilled

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PayFac-as-a-Service

Tilled is a PayFac-as-a-Service platform that allows B2B SaaS companies to monetize payments that pass through their platforms without any of the headaches, regulatory compliance, or liabilities of becoming a fully registered facilitator. We spoke with Tilled leadership about when a vertical SaaS company is ready to implement a fintech product, and the tradeoffs of managed payfacs versus becoming a payfac.

A lot of vertical SaaS companies start out with managed payment providers because they are easy to set up, but this comes with a significant cost to their revenue. When should SaaS companies start to consider alternatives such as a payfac-as-a-service or becoming a payfac themselves?

Tilled: There are several signs that a vertical SaaS company has outgrown their initial partnership with managed payfac providers like Stripe or Braintree. The first is when they start realizing how expensive they are, and realize that instead of a large line item cost, payments should be a revenue stream for their business. Maybe at that point, they try to negotiate better rates with their provider. For many vertical SaaS companies, that's just not going to happen — sign number two it's time to move on. As their business grows and their payments volume increases, this becomes even more and more of a problem, as more and more money is being left on the table. Especially as vertical SaaS companies look towards an exit strategy or a new funding round, a properly monetized integrated payments strategy becomes a must have for VCs or potential buyers. But really, the final and most important sign you're ready to move on from managed payfac providers is that you just can't stop talking about an alternative. Most companies recognize they need to move on from Stripe long before they actually do. So whether it's your CEO, CTO, CFO, or VP of Sales, you probably have

someone on your team who's continually evaluating competitors. You talk about it at every board meeting. You ask your colleagues about it at events. That's when you know you're ready for a change.

Are payments a natural starting point for other fintech products (e.g., lending, cards) and if so, what are common next fintech products that SaaS companies launch after payments?

There's a saying right now, "every company is a fintech company," and when you consider payments you can start to see why. Many vertical SaaS companies recognize the value of offering payments through their platform right away, which is why managed payfac providers like Stripe and Braintree exist. If you're offering your customers a full-service solution for their businesses, and their businesses accept payments, your software solution better be able to process payments. After payment processing, we've found that many companies are interested in other related products such as integrated lending, Buy Now Pay Later options, and omnichannel and alternative payment methods. Each of these options make it easier for merchants to do business, and with the initial payments products already available, these tools are even easier to implement.

What are common challenges you see SaaS companies encounter as they work toward an embedded payments product and after they launch a payments product?

For many SaaS companies, the initial problems they encounter are development and implementation. That's why so many start off with Stripe, Square, or Braintree. They are quick and easy to implement. Depending on the size and growth of the company however, pretty quickly afterwards the costs of working with managed payfac providers becomes a problem. Until recently, this presented software companies with a real challenge. Do they work with a legacy processor to monetize their payments, but take a huge step back in their customer experience in the process? Or do they begin the long and difficult process of becoming their own payfac? Those were the only two options available to founders, until PayFac-as-a-Service. Now, founders can launch a monetized integrated payments product from day one, and while we don't recommend that for every startup, it's something every founder should be considering. By the point that your software company is processing $100 million a year in payments, that's $500,000 you're leaving on the table in terms of revenue. Don't do that to your bottom line. PayFac-as-a-Service is the best solution on the market today for software companies of any scale looking to integrate payments into their product offering.

Cards

Cards Overview	
Ideal Industry Characteristics	Complex expense management and heavy reliance on subcontractors
Customer Profile	Businesses with frequent short-term cash needs, employees with variable income, and/or reliance on loyalty programs to drive spend
Customer Examples	Restaurants, transportation, property maintenance

If a vertical SaaS platform decides to offer their customers access to a credit and/or debit card, this typically involves partnering with a card issuer and collecting a percentage of the interchange fees. Although their customers could use a horizontal solution, it is often easier to use a card issued by the same platform that provides their system of record because it simplifies account reconciliation in an integrated software ecosystem.

Another distinct benefit of card issuance is that a vertical SaaS company's customers can use debit cards as an alternative to direct deposit to pay their employees. This allows their employees to access their wages faster, which increases their job satisfaction. This was a strategy leveraged by the restaurant software platform Toast, which issued a Toast Pay Card for restaurants that gave their employees instant access to wages while reducing the administrative overhead for the restaurant operator. Furthermore, a card offering can be tailored to reward customers for certain purchases—such as spending with a particular company—which can open up new revenue streams through partnerships with participating businesses.

Vertical SaaS companies that choose to issue a card have the same options as the companies that choose to offer a lending product. They can strike a referral agreement with a card issuer such as Brex, Airbase, or Ramp, partner with a card issuer, or pursue embedded card issuing.

	Referrals	Partnership Referrals with Platform Issuer	Embedded Card Issuing
Build Time	<1 month	<1 months	<3 months
Risk	Low	Low	Medium
Revenue/Tx	Flat fee per referral	<50 bps	50-150 bps

Card Referrals and Partnerships

The credit card industry deals with a massive amount of fraud, typically in the form of card-not-present fraud where the scammer uses the victim's credit card and personal information to make purchases online. Vertical SaaS companies can avoid this risk by arranging a deal with a card issuer for a flat referral fee. In these arrangements the vertical SaaS company shoulders none of the fraud risk. The downside is that the revenue from card transactions is not flowing through the vertical SaaS platform, which means that the company misses out on the lucrative interchange fees in exchange for minimal one-time referral revenue.

For vertical SaaS companies that want to tap into fees from credit card transactions, they can strike a deal with card issuers to share some of the basis points on each transaction based on the referral volume. In this arrangement, the card issuer still handles the majority of the program. The attractiveness of this strategy largely depends on the vertical SaaS company being able to negotiate a favorable fee share agreement with the issuer.

Embedded Card Issuing

To capture the largest amount of fees from card transactions, vertical SaaS companies should consider an embedded card issuing model. In this structure, the vertical SaaS vendor partners directly with the issuing bank and shares the profits. The risk is typically split between the issuer and the vertical SaaS company such that the issuer manages chargebacks while the vertical SaaS platform is responsible for fraud. Aside from earning more revenue per transaction, this structure has the added benefit of making the vertical SaaS platform substantially stickier because customers are able to instantly access funds on the platform. Like an embedded loan product, however, it can take

a long time to negotiate an agreement with a card issuer. Vertical SaaS companies can potentially expedite this process by working with virtual card issuers like Bond or Marqueta, which simplifies the process through an API integration.

Perspective on Embedded Fintech: An Interview with Modern Treasury

MODERN TREASURY

Modern Treasury automates the full cycle of money movement—from payment initiation, through approvals, to reconciliation—for vertical SaaS businesses that want to implement payments through a web application or API. We spoke with Modern Treasury leadership about where to start with fintech, regulatory burdens for startups, and the engineering resources required to launch a fintech product.

How should founders think about the traditional banking system as a partner along with a solution like Modern Treasury to power their approach to embedded payments?

Modern Treasury: Traditional bank rails like ACH, Wire, and RTP are the most reliable and cost effective ways to move money in the US and globally today, especially for use cases with large average transaction sizes or complex fund flows (incoming payments, reconciliation and disbursements). Using Modern Treasury to integrate directly with a bank lets you move money faster because payments flow directly from your bank account to your customers and vendors, gives you more visibility into fund flows and gives you greater control over the payments experience. The alternative to working directly with a bank is working with a third-party processor, where funds flow between your bank account and your customers and vendors via a third-party intermediary. There are pros and cons to both approaches. It usually takes longer to go live if you're working directly with a bank since they need to underwrite your use case and make sure you have a compliance program in place. But it's typically the best long run solution because it can be cheaper and faster at scale. It's a lot faster to go live with a third party processor, but they tend to be expensive and restrictive at scale. Ultimately, your decision should be based on whether you see value in sitting in the flow of funds.

What kind of engineering resources does a vertical SaaS company need to integrate with a platform like Modern Treasury?

Integrating with Modern Treasury should be a familiar process to any engineering team. We provide a standard REST API, free developer sandbox and public API documentation to get started. Going live with our Payments and Virtual Accounts product requires an integration with a partner bank, while our Ledgers and Compliance products do not. The infrastructure needed to build embedded payments ultimately depends on the use case, such as marketplaces, digital wallets, or escrow.

Does it make sense to start with one kind of fintech product versus another?

The easiest answer to this is to look at what your customers want. If your SaaS app has workflows or a system of record that's creating a lot of value for your customers, it's often pretty clear what embedded fintech product makes sense. For example, if you have an invoicing workflow, adding bill pay functionality makes a lot of sense. But assuming you've done that, another key consideration is fund flow complexity and accounting logic. For example, a lending use case not only needs to automate loan disbursements and repayment collection, but also needs to split reconciling repayments between interest and principal so that users can track the state of their loan reliably. It also needs to track loan balances as they change with each repayment.

What kind of compliance burden is there for companies that build an embedded payments product?

In general, any company moving money through their product will have some compliance requirements. They can range from basic KYC/KYB on the users transacting through their product, to having a full compliance program in place with KYC/KYB, AML compliance and sanctions screens, transaction monitoring and suspicious activity reporting. Aside from the BSA/AML compliance requirements outlined above, companies also need to understand if their use case can be considered money transmission. Both approaches, using a third-party processor or working directly with a bank require implementing compliance requirements and checking if your use case qualifies as a money transmitter.

Payroll

Payroll Overview	
Ideal Industry Characteristics	Complex compensation management and large numbers of employees
Customer Profile	Businesses that employ a mix of compensation types (salary, hourly, flat-rate contracts, performance-based) and/or have unique compensation structures (e.g., tipping)
Customer Examples	Restaurants, consultancies

One of the newest fintech products for vertical SaaS companies to consider are payroll services, which is often a major cost center for their customers. By consolidating this function into the business' main workflow software, vertical SaaS platforms can significantly expand their revenue while saving their customers a significant amount of money.

The payroll product implementation pathways are similar to those for payment processing. Vertical SaaS vendors may opt for a referral agreement with existing payroll service providers, a white label solution, or an in-house build.

	Referrals	White Label	In-House
Build Time	<3 months	6-12 months	>2 years
Risk	Low	Low	High
Revenue/Tx	Small flat fee	Large percentage of payroll spend	100% of payroll spend

Referral

A referral program is the simplest pathway to implementing a payroll solution. The challenge is that this strategy is difficult to monetize given that referrals are typically less than $50 per customer and only occur once per customer. At the same time, it exposes the vertical SaaS company to various risks, such as debit risk when employees are paid by the payroll provider but the employer doesn't have the funds, and shadow employee risk when payments are made to non-existent employees. Vertical SaaS companies are also opening themselves to reputational risk by referring their customers to a payroll service provider that may offer subpar service that reflects negatively on the vertical SaaS company.

White Label Solution

Unlike referral solutions, a white label solution allows vertical SaaS companies to capture a portion of the profit from payroll revenue. Under this arrangement, a vertical SaaS company can partner with a provider like Check to develop a white label payroll solution for their platform. In addition to enabling vertical SaaS companies to collect a significant portion of the payroll revenue, it also reduces churn for the core workflow software due to the highly sticky nature of payroll software. The risk is minimal because the white label provider handles any fraud risk, but the tradeoff is that the payroll revenue is split with the third party provider.

In-house

Vertical SaaS companies that build an in-house payroll solution reap all the benefits of a white label solution without splitting the revenue with a third party. This solution will reduce churn and increase

revenue, but it comes with substantial costs in terms of time and capital. Building a payroll solution can cost tens of millions of dollars and take years to complete. Once it is done, it will also require a full time team dedicated to engineering support and compliance because the vertical SaaS company is now responsible for all the fraud risk.

Much like payment processing solutions can be used as a jumping off point for a lending product, payroll products pair well with card issuance. Vertical SaaS companies that provide debit cards to employees of their customers, for example, make it easier for those businesses to pay their employees or track expenses, in the case of credit cards. If that vertical SaaS company also provides a payroll solution, its customers can easily reconcile purchases and manage employee payments while reducing the administrative overhead from purchase orders, invoices, and so on. The vertical SaaS company can capture a percentage of the spend on those cards in addition to the payroll software spend while saving their customers both time and money.

fractal

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