WHITEPAPER

BUILD VS. BUY:

Becoming a Payment Facilitator Versus PayFac-as-a-Service

Exact Payments delivers turn-key payment facilitation solutions enabling SaaS businesses to rapidly onboard their clients for processing, instantly activate a variety of payment methods and accelerate revenue through payments. By offering an easy integration process, a one-stop-shop for embedded payments and maximized margins, Exact enables SaaS providers to deliver a better customer experience backed by top-tier support and deep payments expertise. Learn more at www.exactpay.com.

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EXECUTIVE SUMMARY

Payment facilitation has brought the lucrative strategy of embedded payments to masses of software companies. This innovative merchant services model enables ISVs and other software providers to integrate payments within their platform so that clients can start processing payments.

By adopting the payment facilitator (PayFac) model, ISVs can own — and deliver — a seamless payment experience while earning a reliable revenue stream from processing fees. In fact, research from venture capital firm Andreessen Horowitz found that SaaS businesses who integrate payments can increase per-customer revenue by 2 to 5 times.[1]

This software-led payments model brings many benefits to SaaS merchant clients, as well. By registering as "sub-merchants" under the PayFac's processing account, merchants are able to bypass the traditionally lengthy and tedious account onboarding process.

The great news is that businesses today have the flexibility to choose whether to build or buy their payment facilitation technology. While both models facilitate business growth and provide sleek embedded payment experiences, they differ in terms of their overhead costs and ultimate revenue potential.

Businesses today have the flexibility to choose whether to build or buy their payment facilitation technology.

Building a full payment facilitation infrastructure is complex and costly, requiring a full tech stack and in-house payments expertise. Yet when considering the incredible ROI potential of the PayFac model, these upfront costs can make sense for larger SaaS providers that are ready to take on the challenge.

In contrast, buying a PayFac-as-a-Service (PFaaS) SaaS solution is more straightforward and less expensive. It's great for businesses that want to hit the ground running, without compromising revenue-earning potential.

There's a lot to consider when deciding whether to go the build or buy route. The best option for your business is highly dependent on your key business drivers, budget, and merchant portfolio size. In this white paper, we will closely explore these various factors and guide you through the decision-making process. You'll learn about what it takes to become a PayFac versus using a PFaaS solution, the difference in overhead costs and initiatives for each model, and the main pros and cons of building versus buying.

[1] https://a16z.com/2020/08/04/fintech-scales-vertical-saas-2/

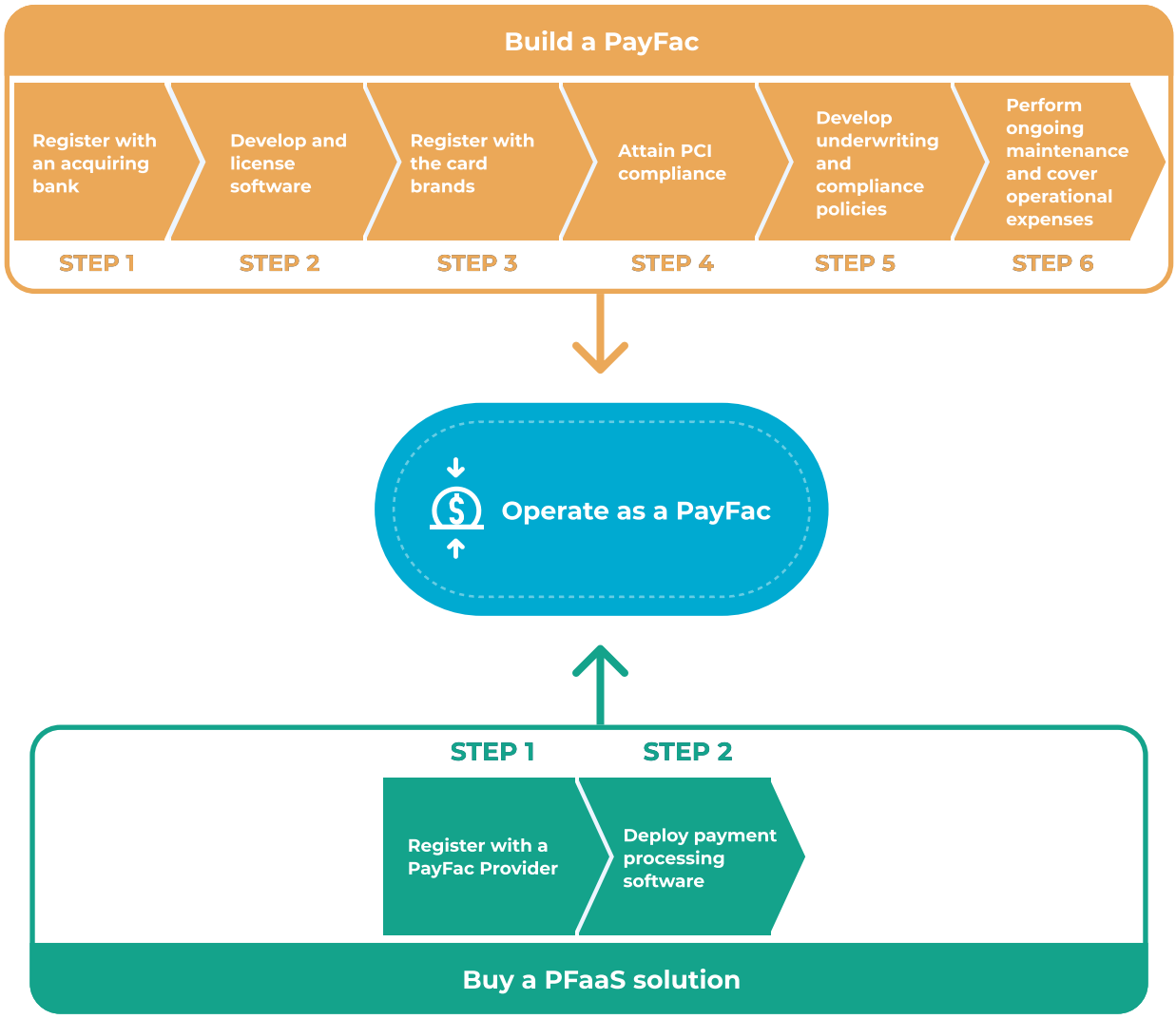
BUILD VS. BUY

Becoming a full-fledged PayFac is a tedious process. The aspiring PayFac needs to develop relationships with processing banks, build software, ensure compliance and manage risk oversight, and oversee account onboarding and customer services.

On the other hand, buying a PFaaS solution (also known as a managed PayFac) is generally a lot quicker and easier. These plug-and-play technologies feature all the tools and software needed to integrate payments and onboard merchant processing accounts. Additionally, the PFaaS provider manages back-office operational processes like risk and compliance, underwriting, and account onboarding.

For most SaaS businesses, the PFaaS model will be the best option to minimize costs while still earning an additional revenue stream. Though for larger SaaS businesses with higher risk tolerances and longer ROI timelines, becoming a full payment facilitator can sometimes make more sense.

Before we explore this further, let's take a closer look at the full process of becoming a PayFac — for both models.



OPTION 1: BUILDING A FULL PAYFAC

Becoming a full-fledged PayFac is a long process that involves several steps:



1. Registering with an acquiring bank

The SaaS provider must first obtain sponsorship from an acquiring bank. The acquiring bank performs a thorough examination of the business's legal and financial situation. SaaS businesses should also be prepared for the bank to conduct a detailed assessment of the PayFac's risk and compliance policies and procedures. If met with approval, the business is registered as a payment facilitator and receives a MID, or master ID.



2. Developing and licensing software

Payment technology is the foundation of payment facilitation. A crucial step in the process of becoming a PayFac is building a tech stack that can handle the complexities of payment processing and support both front-end and back-end functions. Typically, this tech stack includes a payment gateway, any additional customer-facing payment solutions (e.g. apps and payment forms), and a merchant platform. There are many essential features that need to be incorporated into the tech stack, such as support for a wide range of payment methods, merchant dashboards, dispute management, fund disbursement, security features, and Know-Your-Customer (KYC) checks.



3. Registering with the card brands

Each of the four card networks — Visa, Mastercard, Discover, and American Express — has its own rules and regulations regarding merchant payment acceptance. The PayFac must register with each card brand, pay the annual fee, and agree to all terms and conditions.



4. Attaining PCI compliance

The Payment Card Industry's Data Security Standards (PCI DSS) is a set of protocols that businesses must comply with in order to protect sensitive cardholder data. As the SaaS provider builds out its payment infrastructure and workflows, it will need to take steps to ensure PCI compliance. This process generally involves extensive system configurations, on-site audits, and continued software monitoring and upgrades.



5. Developing underwriting and compliance policies

As a payment facilitator, you'll need to implement policies and procedures that verify merchant accounts and mitigate risk. Your underwriting process will have to incorporate KYC guidelines, which are a set of industry standards for verifying identities and assessing risk.

You'll also need to comply with anti-money laundering laws and incorporate risk monitoring tools for detecting fraud and chargebacks. Because regulatory compliance is a complex field, you'll want to staff a dedicated compliance expert to oversee all these efforts.



6. Managing fraud and chargeback prevention

PayFacs are fully responsible for preventing fraud and for managing any chargebacks that occur. To prevent fraud and chargebacks, the PayFac must implement gateway fraud filters and settings and perform ongoing chargeback monitoring. When chargebacks happen, the PayFac must be able to notify the merchant and card network, and debit and credit funds to or from the customer and merchant, as needed.

▸ OPTION 2: BUYING A PFAAS SOLUTION

PFaaS solutions encompass nearly all of the technological, compliance, risk, and registration needs of becoming a PayFac. Thus, by working with a PFaaS provider you'll be able to bypass almost all of the above steps.

The path to PayFac with PFaaS involves:



1. Registering with a PFaaS provider

Once you've decided on your PFaaS provider of choice, you'll need to directly register with them. You won't have to register with an acquiring bank or the card brands, as the PFaaS provider maintains these relationships.



2. Deploying payment processing software

Your PFaaS provider will give you all the software and APIs you need to get started. Your internal teams can then make customizations as needed and begin integrating the technology into your existing platform.

Once these steps are completed, you'll be able to quickly onboard merchants.

CHOOSING THE RIGHT PATH TO PAYFAC: KEY FACTORS TO CONSIDER

The question of build versus buy is a common one among companies looking to implement new software and revenue streams. For businesses considering whether to build or buy their payment facilitation infrastructure, it's important to conduct a thorough review of available resources and long-term budget expectations, specific business goals, and your current business model. Landing on the right option can only happen after you've performed an in-depth cost versus benefit analysis.

Both the full PayFac model and the PFaaS model provide software companies with the benefits of reliable recurring income and innovative payment features. However, they vary in terms of overhead and ongoing operational costs, revenue-earning potential, and time to market. Here are some key factors to consider when exploring the best option for your business:

Key Factor	PFaaS	Full PayFac
Development Requirements	**Minimal.** You'll be able to tap into the PFaaS provider's pre-built APIs or embeddable UI components. Note that the quality and quantity of out-of-box software offerings will vary depending on the PFaaS provider.	**Extensive.** An in-house development team is needed to build all front-end and back-end platforms. This includes back-office operational software for underwriting and risk monitoring, a merchant platform, and end-user payment processing features.
Control Over the End-User Experience	**Extensive.** With access to a robust API, you can work with the PFaaS provider to easily make customizations to features and interfaces.	**Extensive.** Since you're building the full payment tech stack, you'll have end-to-end control over the look and feel.
Time to Market	**Minimal.** After signing up with the PFaaS provider, it's only a matter of weeks until you can start onboarding your clients as sub-merchant accounts.	**Extensive.** It can take many months or even years to build the full payment facilitation groundwork, attain compliance and register with key parties, and staff and train in-house teams.
Fraud and Data Security Compliance	**Minimal.** PFaaS solutions are already equipped with robust security features and are compliant with PCI DSS and other standards. It's important to keep in mind, however, that some providers ask you to shoulder additional risks while others eliminate your exposure. Thus, you should be aware of best practices for mitigating risk and find out what level of risk your PFaaS provider covers.	**Extensive.** You'll carry full responsibility for attaining and maintaining compliance with the card brand's rules, PCI DSS, and other financial regulations. You'll also need to regularly report to your sponsoring bank and the card networks to attest to your compliance. Note that non-compliance results in hefty fines and can even pose a threat to your operations.
Risk Management and Onboarding Policies	**Minimal.** Your PFaaS provider is responsible for developing and overseeing a secure underwriting process for your clients' accounts. They'll also be responsible for performing ongoing monitoring of fraud and chargebacks.	**Extensive.** You will need to formulate a risk management policy and underwriting guidelines that reduce risk and comply with anti-money laundering (AML) laws and the Office of Foreign Assets Control's (OFAC) regulations, in addition to cross-referencing the Mastercard MATCH list. As a part of this process, you must implement KYC criteria, set up automated account verifications, and develop review processes that vet for risk in new merchant accounts and transactions.
In-House Team Staffing and Training Requirements	**Minimal.** Many, if not all, back-office and software development functions will be outsourced to the PFaaS provider, including customer support for your merchant clients. Your development team will need to interface with the PFaaS provider for integration purposes.	**Extensive.** Becoming a full PayFac requires full in-house teams of software developers, risk and compliance experts, account underwriters, and customer service representatives who are well-versed in payment processing.
Sub-Merchant Funding and Fee Collection	**Minimal.** Payouts and fee collection are fully managed by the PFaaS provider.	**Extensive.** Transaction funds are routed through the payment facilitator, so you'll need to develop or contract with third-parties to ensure that sub-merchants are accurately funded on a set schedule.

Key Factor	PFaaS	Full PayFac
Revenue-Earning Potential	**Moderate** You'll earn a share of the money from the fees that are charged on every transaction. You'll also start seeing an ROI pretty quickly since time-to-market is fast and overhead costs are low.	**Extensive** As a full-fledged payment facilitator, you'll be able to pocket all revenue earned from transaction markup fees. But, depending on factors such as your gross processing volume, build time, costs, and how long it takes to go live, it will take you longer to see real profits.
Ongoing Operational Costs and Responsibilities	**Minimal** As your software improves over time or enhancements to the provider's API are made, your development team will need to maintain the integration accordingly.	**Extensive** Even after your PayFac infrastructure has launched, you'll be responsible for carrying out many ongoing tasks and paying the associated costs. This includes running periodic PCI compliance audits, managing chargeback processes, sending data reports to your sponsoring bank, and much more.

AT A GLANCE: PAYFAC PROS AND CONS

Here's a quick look at the main benefits and drawbacks of each PayFac model, based on the above table.

PayFac Pros:

- ✓ Can be highly profitable, as you keep all revenue
- ✓ Provides flexibility over the end-user experience
- ✓ Developing a bespoke solution can give your organization a competitive edge

PayFac Cons:

- ✗ Costly and time-consuming to develop
- ✗ Greater risk burden
- ✗ Requires extensive in-house teams and training
- ✗ Takes more time to see ROI

PFaaS Pros:

- ✓ Fast time-to-market and ROI
- ✓ Reduced costs
- ✓ Lower/no risk burden
- ✓ Back-office functions are outsourced to the PFaaS provider
- ✓ Access to extensive support resources

PFaaS Cons:

- ✗ Marginally less control over the end-user experience
- ✗ Shared revenue split with payment provider

COST AND REVENUE ESTIMATES FOR BUILD VS. BUY

Now that you have a better understanding of the labor associated with each path to PayFac, let's take a closer look at the monetary costs and ultimate revenue-earning potential. With a realistic cost and ROI estimate for each option, you'll be able to perform a more accurate cost versus benefit analysis.

Cost Breakdown Estimate: Year 1 of PayFac

The costs estimated here are the minimum investment required to build a PayFac infrastructure.

Expense	Minimum Estimated Annual Cost for Payment Facilitators
Software development	$450k (for three people each paid $150k)
Infrastructure costs (servers, licensing, and storage)	$1 - 1.5 Million
Registration with the card brands	$10k (for Visa and Mastercard)
PCI compliance	$50k
Back-office payment operations*	$500k[2]
Optional network tokenization registration	$50k
Total Minimum Cost to Operate as a Payment Facilitator	**$2,070,000-$2,570,000 Million**

*Includes data security, underwriting, compliance, fraud management, technical support, and account funding

[2] Internal data from Exact Payments

When Does it Pay Off to Become a PayFac?

When considering whether to pursue the full PayFac or PFaaS model, it's important that you plug in your portfolio data to get a realistic profit estimate. Here are two examples that will guide you through the calculation processes.

PayFac Revenue Potential: Sample Breakdown

Let's say that your business processes $50 million in gross processing volume (GPV) per year. According to an analysis done by Bain & Company, payment facilitators can earn anywhere from 60-100 basis points (bps) or 0.6%-1.0% in net revenue.[3] Net revenue is the total revenue minus the standard interchange fees charged by the card brands.

	Lower Range Calculation	Upper Range Calculation
GPV x Estimated Net Revenue Percentage	$50,000,000 GPV per year X.006	$50,000,000 GPV per year X.01
Net Revenue Year 1	$300,000	$500,000
Ongoing Operational Expenses	$2.1M-$2.5M	$2.1M-$2.5M
Result	**Operating costs exceed annual revenues.**	

As a full-fledged payment facilitator, you could expect to earn an estimated $300,000-$500,000 annually. This entire amount would be yours; however, you would need to also consider the operating costs of over $2M calculated in Figure 1. Clearly in this example, taking on the risks and responsibilities of a full PayFac would not pay off. In fact, your GPV per year would need to be at least $200M at 100 bps or as much as $335M at 60 bps to break even.

[3] https://www.bain.com/insights/riding-the-new-wave-of-integrated-payments/

PFaaS Revenue Potential: Sample Breakdown

Let's take a look at what happens with a PFaaS provider. Again referencing the Bain & Company analysis, alternative payment facilitation solutions can earn anywhere from 20-60 basis points or .2%-.6% on net revenue.

PFaaS gives you the ability to generate additional recurring revenue without the headache of setting up a full payments architecture or the upfront costs.

	Lower Range Calculation	Upper Range Calculation
GPV x Estimated Net Revenue Percentage	$50,000,000 GPV per year X.002	$50,000,000 GPV per year X.006
Net Revenue Year 1	$100,000	$300,000
Ongoing Operational Expenses	N/A	N/A
Result	**You earn an additional $100K-$300K annually.**	

> **Key Takeaway**
> Becoming a PayFac clearly has the potential to be much more lucrative, but that doesn't mean it's always worth it. If you're not hitting a certain threshold in processing volume every month, then your revenue won't exceed your upfront and ongoing operating costs.

BOTTOM LINE: WHAT'S RIGHT FOR YOUR BUSINESS?

Questions to Ask Yourself

By now you know that there are many different factors that must be weighed carefully when deciding whether to build or buy payment facilitation technology. And, the best way to weigh all these factors effectively is to ask yourself some pointed questions about your business – specifically, in terms of its resources, goals, and desired outcomes. Here are some questions to get you started:

1 *What is your current state of resources and technical readiness?*

Building a PayFac requires tremendous overhead costs and in-house tech and payment expertise. Do you have the budget and talent to build a PayFac infrastructure from the ground up? Many businesses that choose to become PayFacs do so with backing from private equity firms — is this something you currently have or anticipate receiving?

2 *What are your ROI preferences?*

Is time to ROI an important factor for you? If you'd rather start seeing profits sooner, then the PFaaS model makes more sense. However, if you're willing to wait it out in order to boost your long-term revenue earning potential, then becoming a PayFac is a reasonable option.

3 *What is your portfolio size and processing volume?*

As the above calculations demonstrated, profitability is highly dependent on your current (or estimated) gross processing volume. If you don't have a large processing volume, then becoming a full payment facilitator is likely not a realistic or profitable option.

> Because of the higher overhead and ongoing costs of operating as a PayFac, it will only pay off if you have a large network of sub-merchants who generate high gross processing volumes.

4 *What are your competitors doing?*

Examine your competitors' embedded payment features. Are you noticing cookie-cutter or inefficient features? If so, and if you have the budget, becoming a PayFac — and building custom features — could be a great way to disrupt your segment and add new value. Or, are your competitors all finding success with PFaaS solutions and you're just falling behind? If time is of the essence and you'll benefit more from a rapid time to market, then partnering with a PFaaS provider makes more sense.

5 *What are your goals for the end-user experience?*

PFaaS providers offer the necessary tools to build an embedded payment experience without coding from scratch. Through robust APIs and embeddable UI components, PFaaS can significantly improve customer experiences.

BECOME A PAYFAC WITH exact payments

If buying a PFaaS solution makes the most sense for your business, then you'll want to work with a provider that offers the most robust feature set, competitive revenue-sharing, and hands-on support.



Exact's PFaaS solution provides you with all the technology, knowledge, and assistance you need to start operating as a payment facilitator. Our comprehensive suite of payment technology includes low-code integration options that will get you up and running fast — with features that your customers will love.

And, you can rest assured that if you decide to become a full PayFac down the road, we'll be here to guide you during the transition process. Our technology is highly flexible, and our in-house experts will assist you as you begin building a PayFac infrastructure. To learn more about our solutions, visit www.exactpay.com.

Give us a call. We're available:

Monday - Friday

7:30 AM PDT - 5:30 PM PDT

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