by Peter Taylor, Tim Gallagher, and Joel Van Ardale, 15 July 2024

Embedded Payouts Are Booming

Introduction

Much of the market's embedded payments focus is on pay-in use cases feeding into payment acceptance and acquiring. Embedded payouts are less-developed than pay-ins, but a massive growth opportunity for both platforms and fintechs. In this article, we walk through key growth tailwinds, specific use case opportunities, and potential partners for supporting embedded payouts. We focus primarily on the U.S. market but acknowledge that many of these same upsides exist elsewhere in the world.

High-Value Payout Use Case Opportunities

Let's start with a basic definition of embedded payouts. First, we acknowledge there are relationships between payers and payees (aka disbursement recipients), noting that our focus within this article is mostly on business-to-consumer payouts. We acknowledge the scale of both business-to-business payouts and person-to-person remittances, both vital domains within the broader payouts opportunity. B2B accounts payable (A/P) automation and expense management are particularly attractive domains for both platforms and fintechs, generating a massive revenue pool in the U.S. powered by commercial card economics.

Next, we note that not all payout use cases have high-value potential. B2C payout use cases that provide a strong fintech monetization opportunity are higher in value because they meet one of the following criteria:

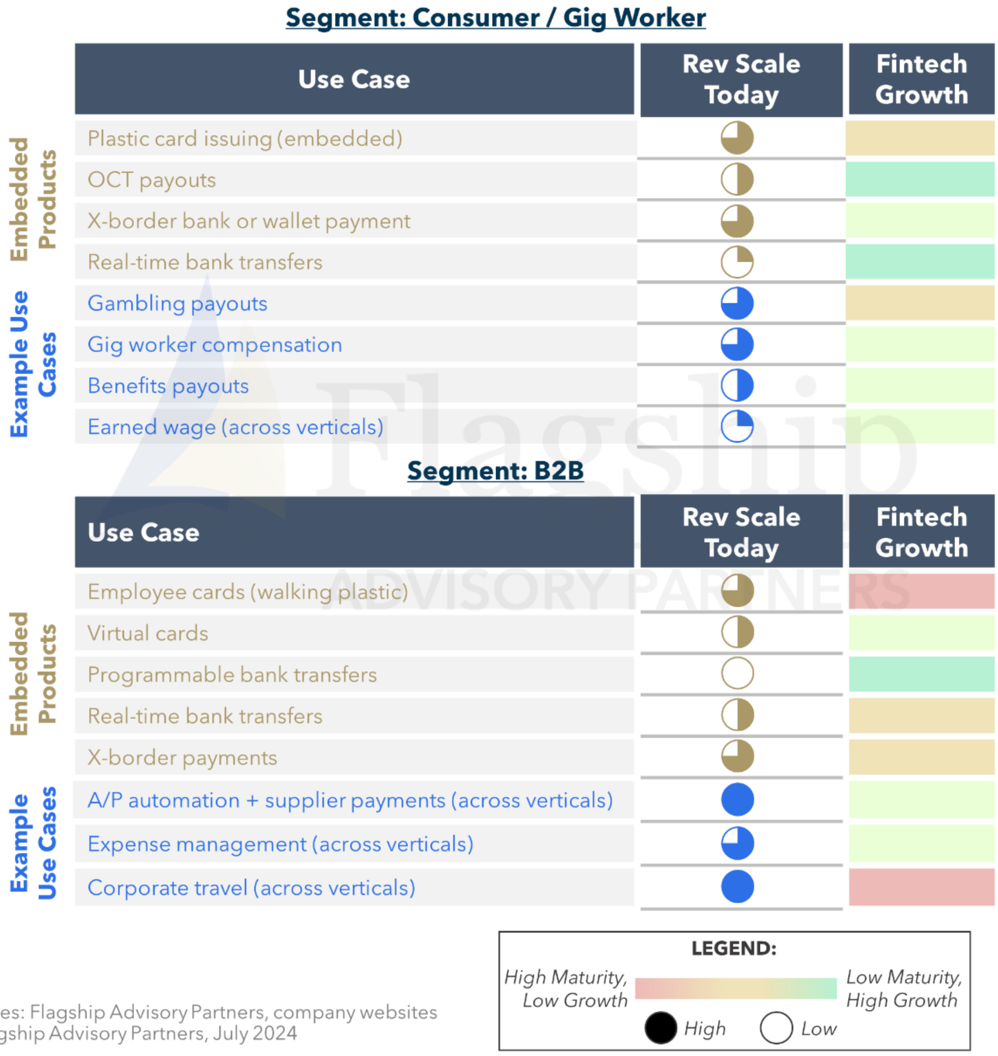
1) Urgent timing
2) Cross-border
3) Recipient is under-banked
4) Integration of the payment into a broader automated workflow
5) The payment needs to be tightly controlled

In other words, most traditional payouts from businesses are simple, batch bank transfers. Batch ACH is low-cost and works fine when none of the above criteria hold. But when one of the above criteria is met, then traditional batch bank payments fail to fully meet the needed value-adds, and this is where the lucrative opportunity for fintechs is created.

We also focus herein on embedded payouts, meaning payout use cases that are part of a broader relationship with the parties, oftentimes via a technology platform, such as ERP software, a marketplace, or a gig-economy platform. In Figure 1, we depict several high-value payout use cases, noting that this list is not comprehensive.

We also delineate between the enabling disbursement product (e.g., plastic card, virtual card, real-time bank transfers, etc.) and the nature of the disbursement relationship (e.g., employee, gig worker, business supplier, etc.).

Figure 1: Embedded Payouts Use Case Maturity



Sources: Flagship Advisory Partners, company websites
© Flagship Advisory Partners, July 2024

Note that in the interest of keeping Figure 1 simple, we do not fully portray the use case variance across verticals. For example, verticals such as government, insurance, healthcare, charities, etc. all have unique requirements. As payout fintech matures, the vertical angle oftentimes becomes the natural battleground as vertical specialists (i.e., vertical ERPs) compete with horizontal point solution providers.

Embedded Payouts Growth Tailwinds

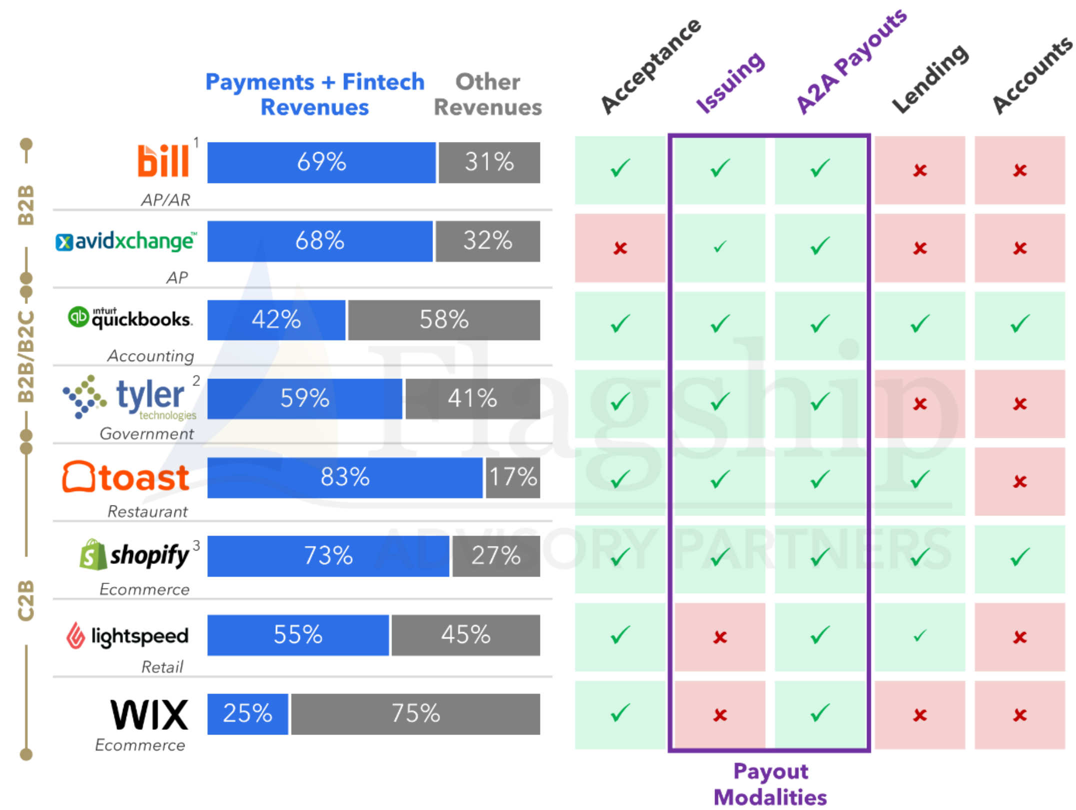
Now let's talk about why embedded payouts are booming. There are four primary drivers of growth acceleration in embedded payouts:

1. SaaS-embedded acceptance has been an exceptional success, but often maturing, and platforms and PSPs are looking for the next embedded finance opportunity.
2. Payouts are highly monetizable, particularly card-based payouts.
3. Penetration of software and other forms of platforms with the potential to embed payments continues to increase as well as the utility (use cases) powered by these platforms.
4. The supply of embedded payout services and operating models is growing and maturing.

<u>Growth Driver #1: Need for Embedded Finance Revenue Growth Beyond Acceptance</u>

As shown in Figure 2, leading platforms have moved beyond acceptance and have proven the value of other embedded finance product categories. In many cases, these companies are generating over 50% of revenue from embedded finance. With demonstrated success, many platforms are now looking to enter adjacent fintech product categories and/or build upon current payment capabilities to enable new use cases.

Figure 2: Platform Payments Revenue & Product Breakdown
(select providers; 2022 revenues)



1) Bill.com includes Divvy and Invoice2go revenues. 2) Subscription and transaction revenues including acquisitions.
3) Revenues reported under merchant solutions mainly driven by payments and fintech.
Sources: Flagship Advisory Partners, company websites
© Flagship Advisory Partners, July 2024

Growth Driver #2: Payouts Can Be Lucrative

Simply put, embedded payouts have the potential to be very lucrative for platforms, especially card-based payouts and use cases that demand additional, monetizable value-added services (e.g., x-border payouts, earned wage access, etc.). Scaled platforms enabling spend via virtual cards can earn 150 bps (before any potential client incentives/rebates) or more from commercial card interchange sharing from their issuing partner, margins which are even higher than typical pay-in acquiring net take rates. Visa and Mastercard continue to innovate their rails to capture the payouts opportunity including the rapid globalization of their OCT programs (Visa Direct, Mastercard Send) and ongoing evolution supporting virtual and commercial card issuing.

Growth Driver #3: Platforms Growing Rapidly, Expanding Fintech Use Cases

We continue to see steady adoption of platforms across industry verticals. As merchants become increasingly acclimated to using vertical software as their primary business management operating system, the platforms' right-to-win with embedded finance grows.

Further, the utility of these platforms, the ability to support many use cases, is also stimulating demand (for example, being able to support normal payroll, earned wage, and x-border gig payouts, etc.).

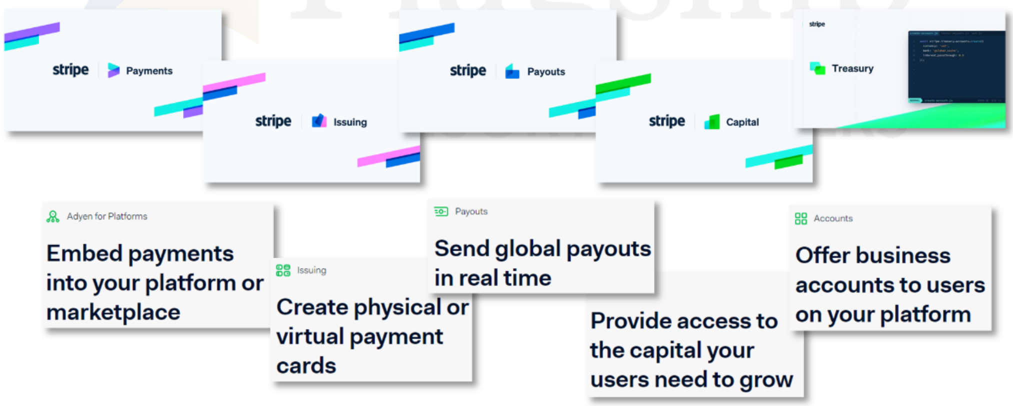
Growth Driver #4: Expanding Payout Partner Supply

Leading PSPs recognize the opportunity in embedded payouts, and platform-focused providers are rapidly building comprehensive suites of embedded finance tools for platforms (as shown in Figure 3). While it won't always be the case that vertical platforms should source payouts from their current payment acceptance partner, there are obvious benefits to building embedded finance on a single, primary partnership.

Figure 3: Embedded Finance Offerings of Leading PSPs
(select providers; non-exhaustive))

	Acceptance	Issuing	A2A Payouts	Lending	Accounts
stripe	✓	✓	✓	✓	✓
adyen	✓	✓	✓	✓	✓
nuvei	✓	✓	✓	✗	✓

Examples from Stripe & Adyen:

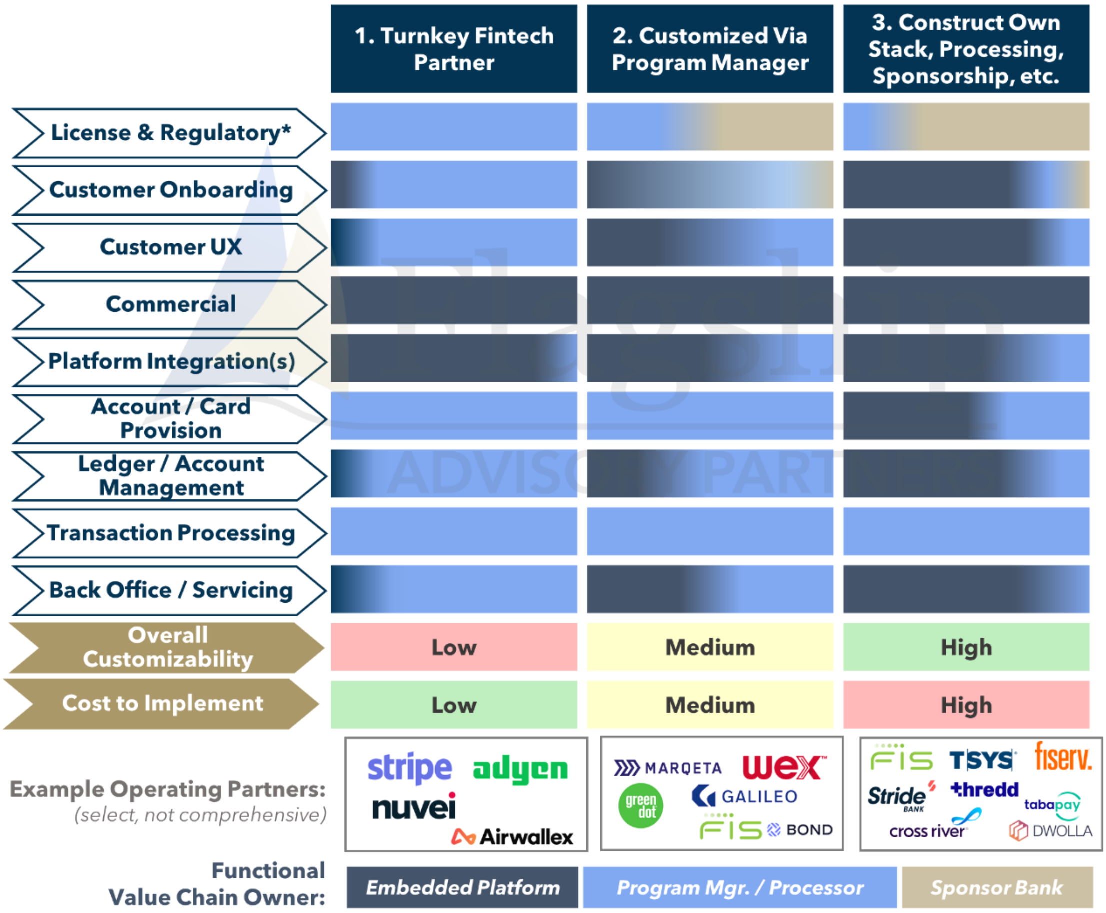


Sources: Flagship Advisory Partners, company websites
© Flagship Advisory Partners, July 2024

Operating Model Considerations

To capture the payout opportunity, platforms must find the right operating model, powered by the right payouts partner(s). We illustrate the embedded payouts operating model option set in Figure 4 below (noting that this is a simplification relative to the reality of many options and permutations).

Figure 4: Embedded Payouts Operating Model Spectrum



Source: Flagship Advisory Partners
© Flagship Advisory Partners, July 2024

As illustrated in Figure 4, the operating models range from simple but not customizable to complex but highly customizable. The simplest option is to use a turnkey partner like Stripe who may already be integrated for enabling pay-ins. If you require more customization and control over the user experience, then there are program managers that can meet these needs (as shown in column #2). Lastly, platforms who can deliver large scale have the option to build a customized stack, working directly with a processor and a sponsor bank. In our experience, most software platforms lack the scale to effectively build their own issuing/payout stack.

We also acknowledge that this operating model illustration is not universal across verticals and use cases. For example, cross-border payouts or vertical-specific payouts introduce a different set of partners.

Conclusions

Many embedded payouts use cases are still relatively nascent or at least small relative to their potential (SMB B2B, payroll, insurance, healthcare) while others are already scaling rapidly (travel, corporate B2B, gig worker, gambling). We see rapid growth across many vertical use cases in the coming years. Payouts embedded into technology-driven use cases are a powerful value-add for the payers and payees, and a great way for platforms to make money (particularly when cards or FX are involved). We are also encouraged by the rich supply of fintech providers focused on powering embedded payout use cases across.

Please do not hesitate to contact Peter Taylor at Peter@FlagshipAP.com or Tim Gallagher at Tim@FlagshipAP.com with comments or questions.