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INVESTMENT BANKING

How Embedded Finance Drives Enterprise Value and Increases Multiples for SaaS Platforms

Broader embedded finance monetization provides key financial advantages, unlocks additional customer value and—as recent data shows—drives valuation premiums.

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Embedded finance (sometimes called embedded fintech) is the integration of financial services—e.g., payment acceptance, payment disbursement, business financing, bank accounts, expense cards, payroll, and insurance—directly into software applications or platforms. It advances the well-established strategy of integrated payments, with vertical SaaS platforms offering personalized and convenient access to additional financial services within the applications where customers are already engaged. While this more comprehensive and integrated user experience has been shown to drive stronger growth, unit economics, and retention for SaaS platforms, the extent to which embedded finance impacts investor interest and valuations has remained an open question.

We can now address that question directly leveraging William Blair's proprietary data and extensive transaction experience advising leading SaaS platforms with embedded finance strategies.[1] That data is detailed in the following article, a collaboration with Stripe, a financial infrastructure company that provides software for accepting payments and embedding financial services. We also explore embedded finance's impact on several key performance indicators that ultimately drive value and provide guidance for SaaS platforms as they consider how to prioritize embedded finance offerings.

How to Implement Embedded Finance—and Its Impact on Key Performance Indicators

SaaS platforms developing their embedded finance strategies have a lot to consider when it comes to determining actionability and prioritization. Embedded finance is especially well suited for end-markets with certain characteristics such as strong electronic payment adoption and high invoice volume (see exhibit 1) and for those platforms serving small to midsize businesses, which are typically underbanked and lack dedicated IT departments.

1. Data exhibits represent median values across approximately 100 William Blair transactions from 2020 to present involving privately owned software companies in North America with enterprise values ranging from $100 million to $3 billion.

Also important is the SaaS platforms' proximity to their customers' end-consumers and vendors as well as key money movements, both inbound (e.g., consumer payments or accounts receivable) and outbound (e.g., accounts payable, expense management, and payroll). The best opportunities are typically where SaaS platforms are powering workflows critical to their customers' financial operations or, alternatively, their ability to engage the end-consumer. These "control points" allow for a relatively smooth transition to multiproduct solutions enhancing platform value for customers by addressing their pain points with customized capabilities and an improved end-to-end user experience.

Exhibit 1: Representative End-Market Characteristics That Suit Embedded Finance

Business Characteristics	Suitable End-Markets
Electronic payment adoption	Restaurants
High payment frequency	Retail
Lower average transaction size	Hospitality
High invoice volume	Non-profits
Fragmented vendor landscapes	Real estate
Tight working capital constraints	Local governments
Prevalence of SMB customers	Education
Underserved financial access	Professional services
High consumer engagement	Field services

The ability for embedded finance to enhance growth and other key performance indicators is clear. SaaS platforms employing embedded finance strategies benefit from expanded total addressable market opportunities, increased average revenue per customer and customer lifetime value, improved attach rates with interrelated capabilities, and greater adoption of premium plans, among other benefits that ultimately drive enterprise value. Customer retention also can improve through greater "stickiness" as embedded finance offers additional customer touchpoints and increased switching costs for end-users, while harnessing more data for customer personalization. These factors provide clear benefits for gross and net revenue retention (GRR/NRR), resulting in a material uplift when comparing the median figures for SaaS platforms with and without an embedded finance strategy (see exhibit 2). The uplift in GRR is even more noticeable when factoring in customer-level product adoption within a given SaaS platform (i.e., comparing the customer cohort adopting available embedded finance solutions to the customer cohort that only uses the core software offering), as exhibit 3 shows.

Exhibit 2: Analyzing Embedded Finance's Impact on GRR and NRR Across Platforms

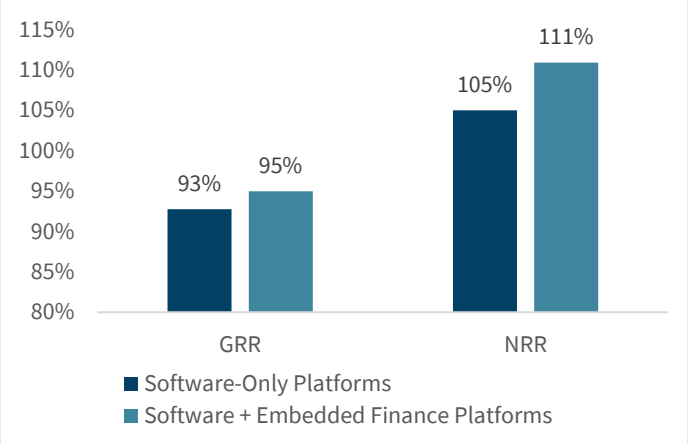
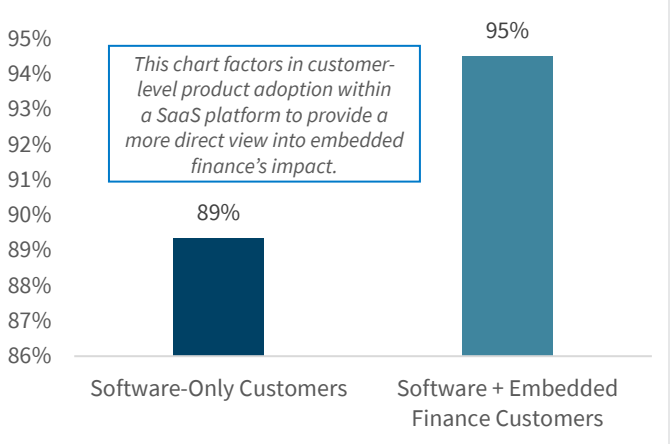
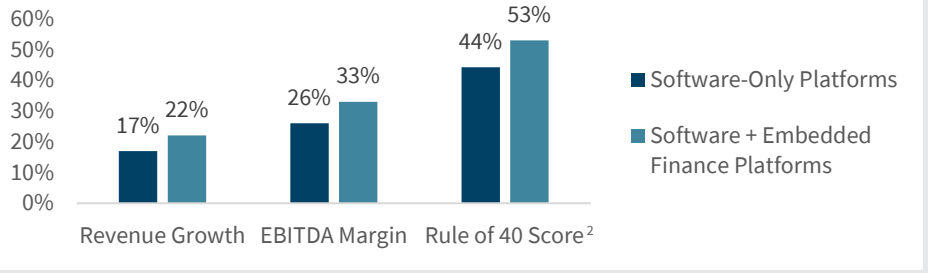


Exhibit 3: Analyzing Embedded Finance's Impact on GRR at the Customer Level



Moreover, once SaaS customers are on platform, revenue from embedded finance solutions pulls through to the bottom line with minimal incremental costs and high margins. Indeed, SaaS platforms monetizing embedded finance solutions often not only experience faster growth, but also see an uptick in EBITDA margin and, as a result, Rule of 40 (see exhibit 4).

Exhibit 4: Embedded Finance's Impact on Key Financial Metrics



How Embedded Finance Adoption Improves Valuations

When considering embedded finance's impact on valuations, SaaS platforms and their investors should resist conventional thinking that software revenue is "more valuable" than transactional fintech revenue. While pure-play, subscription-based software businesses likely trade higher than transactional revenue model businesses, the defining characteristic of embedded finance is its integration and delivery through software applications that are already mission-critical to a customer's business. In other words, in the context of embedded finance, software and transactional revenues are inextricably linked, providing additional monetization of an existing customer, and should not be looked at through a "sum-of-the-parts" lens.

Further, consider the characteristics that determine the relative value of revenue: future growth potential, steady-state margins, and stickiness. The performance benefits outlined above clearly demonstrate how embedded finance solutions enhance those key characteristics, increase the value of software, and ultimately drive incremental revenue that is equally as valuable as software revenue.

The merit of these arguments bears out in recent transaction multiples. SaaS platforms with embedded finance offerings are trading at a 23% premium on a revenue-multiple basis and a 19% premium on an EBITDA-multiple basis compared with peers that do not have embedded finance offerings, as exhibit 5 shows. The full impact of embedded finance on valuation multiples depends on end-market, platform quality, scale, and broader financial profile, but the difference is clear when comparing companies with similar financial profiles (i.e., Rule of 40) and end-market focus (i.e., horizontal vs. vertical), as further explored in exhibit 6.

Exhibit 5: Embedded Finance's Effect on Revenue and EBITDA Multiples

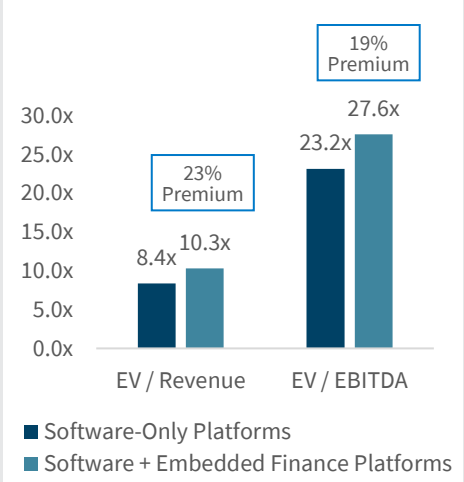
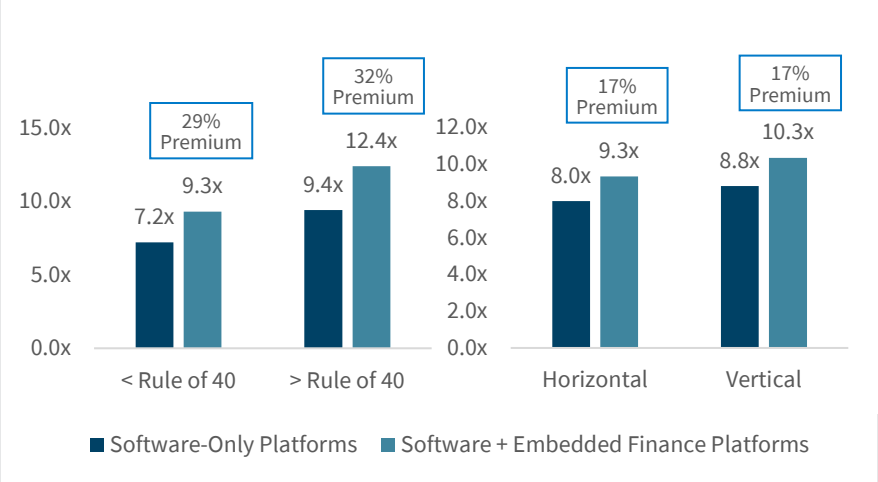


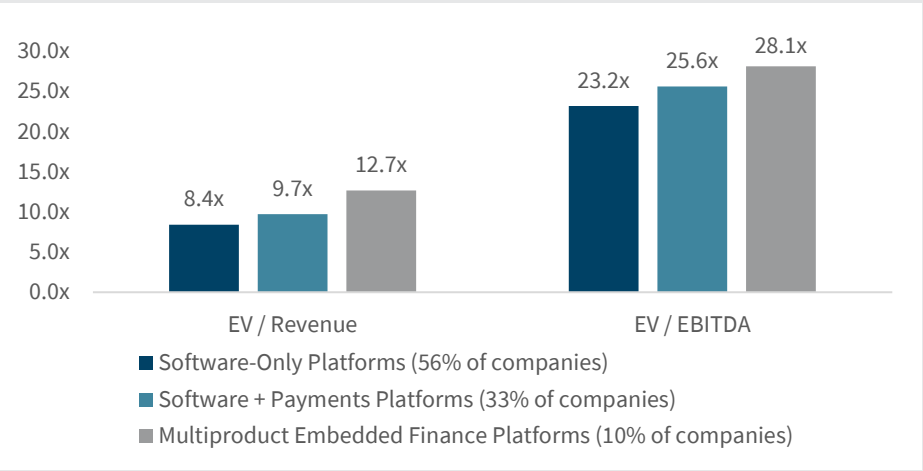
Exhibit 6: Embedded Finance's Impact on Revenue Multiples Remains Consistent Across Financial Profiles and End-Market Focus



2. Revenue growth and EBITDA margins in this chart are medians, not averages, which is why the figures shown do not total the Rule of 40 scores.

In addition, while integrated payments (i.e., the receipt of money) are now largely "table stakes," investors are increasingly seeking SaaS platforms with multiproduct embedded finance strategies. With few software platforms executing on such a strategy at scale, there is significant scarcity value for those platforms that are doing so (see exhibit 7).

Exhibit 7: Analyzing the Scarcity Value of Multiproduct Embedded Finance Strategies



Conclusion

Embedded finance continues to gain traction and is attracting significant investor interest given its ability to fuel greater growth, additional customer touchpoints, and increased stickiness, among other performance benefits. While it is still in "early innings," we can see a clear valuation premium for businesses embracing the strategy. Given the current scarcity value attributed to those platforms monetizing multiple embedded finance solutions, software platforms should be exploring augmenting their software-only approaches to enhance the value of their companies through embedded finance.

To learn more about embedded finance strategies and their effect on valuations, please do not hesitate to contact William Blair or Stripe. To learn more about how Stripe partners with private equity firms and their portfolio companies, please reach out to pe-partnerships@stripe.com.