

Cycles of Innovation

A Study on Global Payment Processing

Payment processing is a massive, global market with many niches and multiple participants. In 2012 alone, the total value of ACH payments was \$144 trillion.¹ The market includes enterprise processors, consumer digital gift cards, terminal management, North America focused, Asia focused, mobile application only, payroll processing, paycheck advance, and bank-to-bank. PayPal is a great example and one of the clear consumer facing successes from this industry.

12 years after its IPO in 2002 and subsequent sale to eBay, PayPal is still a significant player in the payment processing space. Through matching customer and market needs, they pioneered in the areas of anti-fraud, embedded code as a product, and became the preferred payment for eBay auctions. But even with PayPal as a name brand and its upcoming high-profile split from eBay, it is *not the only player and certainly not the current leader or a monopoly*. The landscape has shifted and evolved and the market has matured.

Recently, we've had entirely new consumer facing application entrants like Snapcash, Apple Pay, even Wells Fargo's app following the heels of companies like Venmo. PayPal's upcoming split from eBay is seen as a separation from the slower moving parent company and an adjustment to stay competitive with these younger and more nimble entrants. But is there room for participation and new technology in payment processing? Is there an opportunity for 'the next PayPal' and a new cycle of innovation?

62% of wires in 2012 were sent to domestic payees, and the remaining 38% of wires were sent to foreign payees. Of the wires sent to foreign payees, only 3% were originated by consumer account holders implying the majority are enterprise clients.² The payment processing issues and solutions from the early 2000s that PayPal and competitors faced have shifted away from a single nation's consumer-facing digital payments for goods or services into global and cross-border payment processing.

The Case for Tipalti

The consumer facing payment processing market has matured; there is little capacity for new products and technology. There is a winding down of this cycle of innovation and it now appears to be an environment where current players are fighting for market share and adoption. Observing the lessons from PayPal's success, the solutions they brought and the problems they address, the partners at SGVC have made a thesis-based investment shift. SGVC has decided not to participate further in the consumer facing payment arena and instead focus on the area where there is a lack of streamlined and efficient solutions: enterprise payment processing at a global level.

¹ https://www.frbervices.org/files/communications/pdf/general/2013_fed_res_paymt_study_detailed_rpt.pdf

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Today, the issues facing enterprise customers who operate at a global level are currency exchanges, sophisticated fraud AI, mass payments, invoicing, and security. The needs are significant, complex, non-linear, and the size is enormous and growing. Even PayPal reports over 25% if its transactions are done cross border. You may be able to pay for your latte from your smartphone in a matter of seconds, but what solutions exist for a Los Angeles customer sending mass payments to a São Paulo vendor who needs clear accounting records and immediate currency exchanges?³

*Enter Tipalti*⁴: “Let’s say I want to send a wire in the U.S. It’s simple. A SWIFT code and account number will get the money to the destination,” explains Tipalti’s CEO Chen Amit, “But if you want to send a wire to the U.K., you need something called the short code. In Russia, they want your tax ID. In China, your phone number and ID number... when you cross the border, there are different payment methods. There are dozens of islands of ACH networks around the world.” Further outlining the needs and issues of his clients, Chen states: “[The marketplace] starts with the workflow part of things, knowing who paid, when, what payment method, what succeeded, what failed, what information can be provided, who approved it, etc. The workflow part is just the first challenge.”⁵

The process is at times unnecessarily complex, inefficient, a mystery to growing companies, and very specific and unique to each country. And what does Chen and Tipalti see in this environment of fragmented solutions and customer needs? Opportunity. Tipalti wraps all of these offerings into one solution and can replace the entire transaction with 1 line of embeddable code (nodding to PayPal’s original widget model back in the early 2000’s). In addition to the simplification and streamlining of the process, Tipalti also offers within its software the expanded needs of its enterprise customers: currency exchange, authentication parameters, local regulatory and native compliance considerations, and tax and accounting tools.

On top of their great product, Tipalti has a phenomenal business model. They have spent the past few years building their product with engineers in Israel and expanding their sales and marketing and business development in Silicon Valley and Southern California. This results in an extremely capital efficient company. At a global level no one has more engineers than Israel (135 per 10,000 employees - more than twice the level of the US)⁶ and with less competition, salaries amongst Israeli software engineers average out to a reasonable \$61K per year⁷. Compare this to Silicon Valley, the peninsula and downtown where mid-level software engineers demand a \$110K *average* salary.⁸ Tipalti’s has also been extremely successful in its sales approach because they’ve focused on CFO’s and payment teams rather than developers and the general marketplace.

³ <http://paymentsviews.com/2014/05/15/there-is-no-such-thing-as-an-international-wire/>

⁴ <http://www.tipalti.com/>

⁵ <http://www.pymnts.com/in-depth/2014/mass-payments-and-the-global-marketplace/#.VIDWbGTF9Wt>

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<http://www.investinIsrael.gov.il/NR/rdonlyres/61BD95A0-898B-4F48-A795-5886B1C4F08C/0/israelcompleteweb.pdf>

⁷ http://www.glassdoor.com/Salaries/israel-software-engineer-salary-SRCH_IL.0,6_IN119_KO7,24.htm

⁸ <http://www.cnet.com/news/silicon-valley-talent-wars-engineers-come-get-your-250k-salary/>

Tipalti is a great example of SGVC's investment thesis in capital efficient, growth-stage, enterprise software companies fulfilling a need in a large, underserved market. Tipalti has grown with its clients, many of them startups and many of them building global businesses. At SGVC, we see a paradigm shift in where there is opportunity, room for technological advancement, and ultimately returns for our investors. As my friend and occasional co-investor Joe Lonsdale of Formation 8 explains:

Many investors know that the world around them is changing, but they do not have the tools to translate that awareness into successful investments. A few investors, those most connected with the robust technology ecosystems that foment the changes and those best-versed in the hard and soft qualities that make an outstanding technology company, will understand the factors that expose an industry to disruptive technology. And those investors will create, and benefit from, these immense disparities.⁹

Investors who want to see returns must take these new and unconventional reflections at their landscapes. They must quantify and proactively look at innovation cycles, forward looking industries, market maturity and size, and obviously pick and back the right entrepreneurs. As investors, SGVC pursues opportunities loyal to the concepts outlined herein. What Chen and the team have built with Tipalti is one such globally scalable opportunity.

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⁹ <http://formation8.com/resources/the-coming-transformation/>