

The Rise of Vertical SaaS: How Embedded Fintech is Reshaping Industries, Empowering SMBs and Redefining Small Business Economics

The opinions expressed in this blog are solely the authors' and do not reflect the views of PayPal.

In today's rapidly advancing technological landscape, software-as-a-service (SaaS) has become a crucial driver reshaping industries globally. Within the broader SaaS realm, it's important to appreciate the differences between vertical and horizontal SaaS, as each has distinct implications and offers unique opportunities.

We'll delve deeper into the distinct advantages that vertical SaaS can offer. We'll then explore the transformative influence of vertical SaaS in catalysing the rise of small and medium-sized businesses (SMBs), and how the integration of embedded fintech is further changing the economics of vertical SaaS and – by extension – SMBs. Lastly, we discuss and share key considerations on what makes an interesting vertical SaaS investment, while also highlighting as an illustrative example one of PayPal Ventures' latest investments.

What is vertical (and horizontal) SaaS?

Vertical software-as-a-service (SaaS) focuses on developing software solutions tailored to the needs of specific industries or niches, such as healthcare, finance, construction, shipping, automotive dealers, retail, hospitality, etc. These solutions address industry-specific challenges, such as client appointment scheduling, reservations management, employee (shift) management, and many more. Examples of vertical SaaS include:



Industry: Restaurants
Founded: 2011



Industry: Field Services
Founded: 2013



Industry: Life sciences
Founded: 2012

Industry: Automotive Dealers
Founded: 2016



Industry: Interior Design
Founded: 2009

Industry: Logistics
Founded: 2015



Industry: Healthcare
Founded: 2014



Industry: Hospitals
Founded: 2016

Industry: Restaurants
Founded: 2014



Industry: Logistics
Founded: 2013

Industry: Logistics (Analytics)
Founded: 2014

Industry: Industrial (Analytics)
Founded: 2014



Industry: Hospitality
Founded: 2005



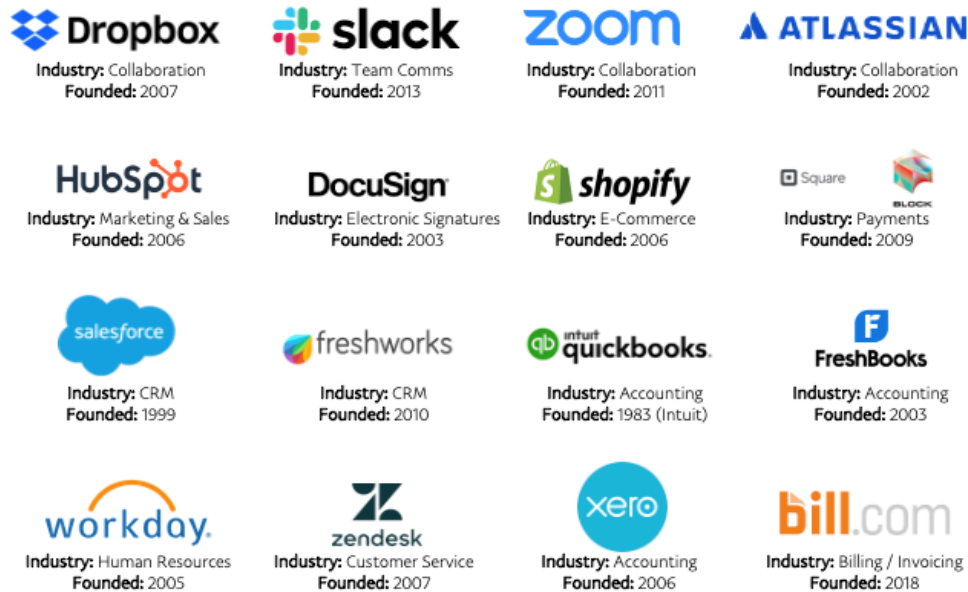
Industry: Social Services
Founded: 2013



Industry: Real Estate
Founded: 2012

Industry: Spas & Salons
Founded: 2010

In contrast, horizontal SaaS offers general-purpose software that can be applied across industries without meaningful customization. These solutions target a wider audience of businesses that span a broad array of industries. As these solutions are characterized by more generalized features, they generally do not address industry-specific challenges, so they may lack the depth of specialization that typically distinguishes vertical SaaS solutions. Examples of horizontal SaaS platforms include:



How vertical SaaS has fuelled the rise of Small and Medium-Sized Businesses

The steep, upfront costs historically associated with building SaaS products from the ground-up meant that in prior decades, Small and Medium-Sized Businesses (SMBs) were largely left to fend for themselves with manual workarounds or resort to generic, horizontal SaaS solutions that offered limited utility to SMBs, let alone those with sector-specific needs. As scalable acquisition and monetization models remained scarce, there simply was no clear path for such SMB-focused SaaS platforms to achieve viable unit economics.

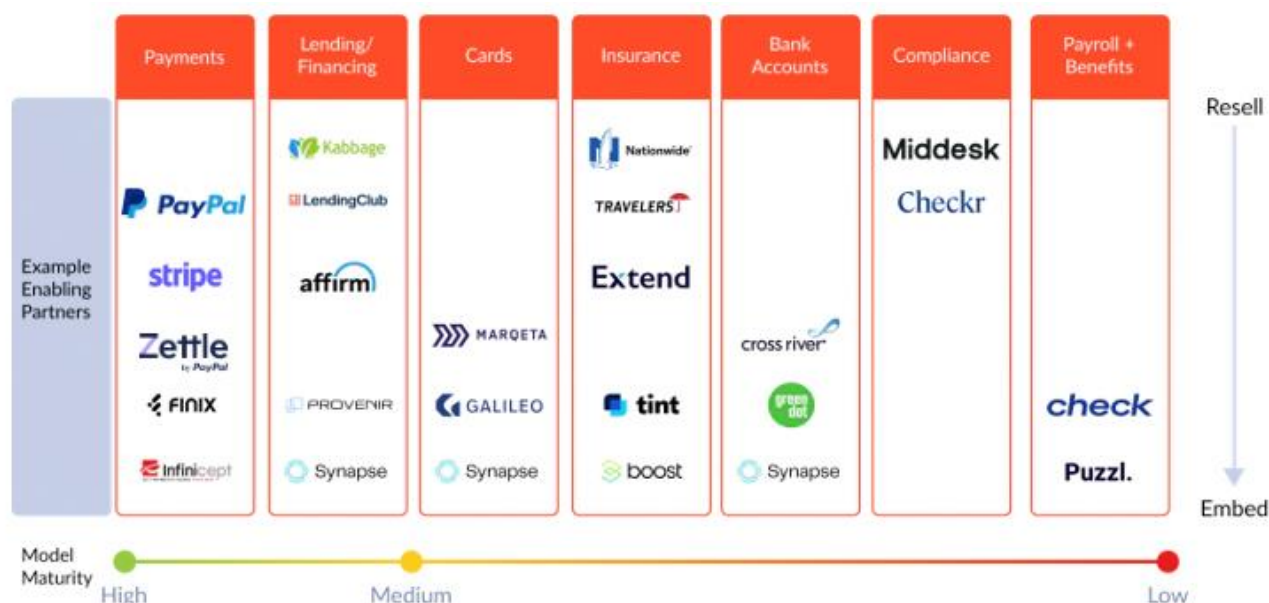
Over the past 15 years this dynamic has shifted dramatically. The emergence of APIs has enabled software firms to capitalize on existing solutions to augment their technology and product stack, eliminating the need for costly, ground-up development in their quest to serve SMBs.

How embedded fintech has changed the economics of vertical SaaS and – by extension – SMBs

While the initial wave of API-based solutions allowed SMB-focused platforms to tap into third-party solutions to enable specific functionalities like offering online payment acceptance, the economics associated with that functionality largely accrued to the third-party API provider. In recent years, we've increasingly seen API-based fintech solutions that allow platforms to not only offer certain functionality (e.g., online card acceptance), but also enable them to capture a portion of these economics (e.g., payment fees).

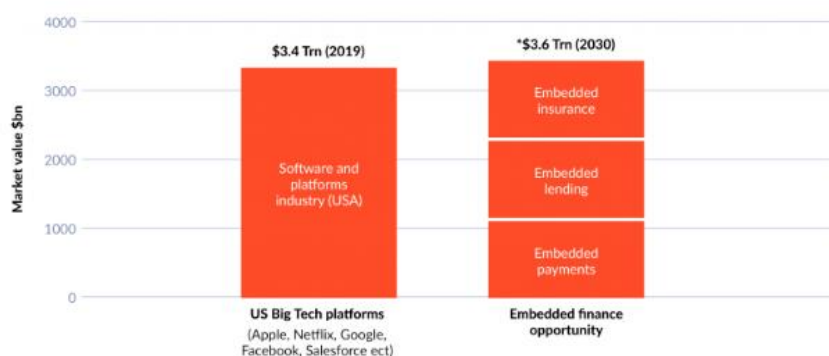
These embedded finance solutions have created opportunities for SMB-focused platforms to capitalize on an ever-increasing scope of new functionalities above and beyond their core, subscription-based models. SMB-focused platforms can now monetize new products like payment, lending, or insurance flows – all without building the underlying technology in-house. With embedded finance broadening the scope of potential ancillary services, combined with the ability to develop new products inexpensively, SMB-focused platforms are now able to create new revenue sources in ways that were inconceivable in the past. In fact, some vertical SaaS platforms are now generating more revenue from their embedded finance offerings than their core subscription products.

Below is an overview of use cases and examples of enabling partners that illustrate the breadth and profound impact that integrated fintech solutions can drive for vertical SaaS platforms (and beyond)



Graphic modified to include PayPal and Zettle - source & reference of original graphic: *The fusion of SaaS and Fintech through embedded finance* (available at [SaaS Alliance](#)) and *How Fintech Scales Vertical SaaS: Use Cases and Examples* (available at [JatApp](#))

In terms of the actual market opportunity that embedded finance represents, estimates from the SaaS Alliance put it at \$3.6T by 2030 (in line with the market caps of US Big Tech platforms). Toast and Shopify, where financial services drive 76% and over 80% of total revenues, respectively, are emblematic of the broader embedded finance opportunity. Irrespective of where the exact numbers shake out, the opportunity is and remains massive.



Source: *The fusion of SaaS and Fintech through embedded finance* (available at [SaaS Alliance](#)) and *How Fintech Scales Vertical SaaS: Use Cases and Examples* (available at [JatApp](#))

What makes an interesting vertical SaaS investment

Our team at PayPal Ventures has been closely tracking this next generation of platforms and we're particularly excited by vertical SaaS platforms that address the underserved needs of historically largely offline sectors and SMBs, while also leveraging embedded finance to drive and accelerate monetization.

The industries that we believe are particularly ripe for vertical SaaS solutions exhibit some of the following characteristics:

- **Sector-specific needs and unique use-cases:** Industries with sector-specific enterprise resource planning (ERP) software systems or underlying complexity that a sector-agnostic tool cannot mirror. Think of industries like restaurants, construction, beauty and wellness, trucking, automotive dealers, real estate, shipping, etc.
- **Sizable market segments:** Whether that's the number of market participants and/or the number of transactions or the dollar-volume processed (preferably a combination of these factors). Think of restaurants for example and the estimated 23M¹ foodservice establishments globally, of which 700K are situated in the U.S.
- **Industries with comparable needs across geographies:** Comparable needs across geographies increase a platform's ability and probability to monetize its product beyond single markets. Think of the needs of automotive dealers, the hotel and service industry, restaurants, etc. – despite some local nuances the core set of needs tends to be similar across geographies.
- **Low digital maturity:** This manifests itself in inefficient and manually managed back offices operating generally on thin margins (e.g., restaurants, automotive dealers, construction, etc.)
- **Comparably thin margins:** Segments operating on comparably lower margins tend to be most incentivized to driving efficiencies via software-first solutions that substitute for manual labour / work-arounds. Those segments tend to also be most keen on identifying adjacent revenue / monetization opportunities, for example, by leveraging embedded finance solutions as the impact of those solutions tends to flow directly to a company's bottom-line

Bearing the above in mind, PayPal Ventures recently invested in [NX Technologies](#) ("NXT"), a Cologne, Germany-based company that operates the payment management platform [bezahl.de](#), and specializes in digital payment processes for the automotive industry.

NXT's solution addresses the massive divide between digitized showrooms versus the largely inefficient and manually managed back offices that can cost automotive dealers up to two-thirds of their margin. They also result in clunky consumer experiences involving paper invoices, manual processing and reconciliation of payments, analog communication, unavailability of payment status, etc. Such experiences stand in stark contrast to what consumers purchase: automotive vehicles that are increasingly loaded with the latest and greatest tech. NXT has been able to establish its highly differentiated positioning in Europe as a leading automotive industry focused platform with deep integrations into 30+ ERPs that are specific to the industry.

Concluding thoughts

It's evident that the SaaS landscape is continually evolving, presenting both challenges and opportunities for businesses. From the nuanced differences between horizontal and vertical SaaS and embedded fintech applications on SMBs, the industry continues to be dynamic. As we look to the future, it's clear that understanding and embracing these changes will be vital for businesses – be it platforms servicing SMBs, or SMBs themselves – that are seeking to thrive by positioning themselves at the forefront of innovation, driving growth, and unlocking new possibilities in the realm of vertical SaaS.

We, at PayPal Ventures, are actively digging deeper into the space and would love to engage with founders building in the space, and/or investors bullish on the global opportunity.

Sources

- [The fusion of SaaS and Fintech through embedded finance](#)
- [How Fintech Scales Vertical SaaS: Use Cases and Examples](#)
- [Forbes Article titled "Toast Vs. Square \(2024 Comparison\)"](#)

¹ [According to Statista](#) ("Number of food service establishments in selected countries worldwide in 2020")

- [State of Vertical SaaS 2021 by Fractal](#)
- [The New Era of Vertical SaaS by Changemaker Ventures](#)