FINTECH USE CASE

DISRUPTING A TRADITIONAL FINANCIAL PROCESS IN F500 COMPANIES

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Prelude

The Fintech space has been one of the fastest growing industries since the turn of the millennium, when startups offering a myriad of solutions - all aiming to revolutionize the conservative and heavily regulated financial filed – started to appear.

Tax was one of the fields to be disrupted, and the upcoming solutions were granted the term: *Tax Technology**. New tools were created, all aiming to transform the tax function, by taking advantage of technological developments in fields such as artificial intelligence, robotic process automation, blockchain, machine learning, and augmented and virtual reality. These efforts gave rise to a great array of tools - it seemed that the high-tech industry has decided it was time to design the 'The Tax Function of the Future', to help it become more efficient, increase throughput, and decrease costs.

*EY's definition of *Tax Technology* is:

"Technology defines and underpins the workings of the new digital tax function, making it possible to answer the mandates of the global digital economy. Managing tax big data enables efficient compliance and provides insights that facilitate strategic business decisions."

https://www.ey.com/en_gl/tax/technology-data

The challenge

Among the various tax related topics, one major area of focus was *indirect taxes*, mostly known as Value Added Tax - VAT (and GST, in the US).

While VAT is only incurred by the end customer, tax regulations require every company to pay VAT even if it is not the end customer. The VAT can be deducted from VAT charged by it, for services and goods it sold to its customers.

This complicated system of VAT reports, deductions and returns, has become a burden for many companies, to such a degree, that many companies choose to leave substantial amounts of the incurred VAT unrecovered. This tendency is especially noticeable with VAT incurred in small transactions, where the VAT sum is too low to make the complicated reimbursement process worthwhile. The world of T&E (Travel Expenses), is an example of a field abundant with such transactions. Consider a businesswoman that travels to Switzerland: it is likely she will eat dinner, or take a cab, in both cases, her invoice will include VAT. The incurred VAT may, under certain conditions, be returned to the company she works for, if reported correctly.

But, while billions of euros and dollars are left on the table by companies every year, another, equally important challenge, arose, compliance. Transactions that are not recorded to the full, and invoices that are not kept intact, pave way for inaccuracies in reporting to the authorities, which may result in an increased risk of audit, and prodigious fines.

GTM: Enterprise, or SME?

It seemed clear to everyone: entrepreneurs, investors and business advisors, that the opportunity for a solution that will solve the challenge - i.e. one which will make it financially feasible to recover any VAT amount, automatically, and in a trustworthy manner - was great.

The industry rushed to figure out the best way of doing that, harnessing the power of OCR, ML, and Big Data. Results were quick to come, and a new era in VAT recovery was about to begin, with several technology ventures competing among them to gain market share, establish their brand as market leader, and become THE standard for VAT recovery - strong enough to gain the trust of the tax authorities worldwide, which would be the ultimate END GAME.

Like with any disruptive idea, the commercial challenge was enormous, and like with any startup, many questions arose, GTM being one of the most fateful among them:

Which markets should be addressed, the Enterprise, or SME?

Pros and cons were obvious. The SME market would require a low touch / high numbers approach, and hence, a high degree of automation; not only on the lead-gen and sales side, but also on the technology side, as the VAT recovery service would have to be self-service. Moreover, the low amounts of recoverable VAT per company, would make it less likely to involve Customer Success (CS) in handling the SMEs, hence, the process would have to be made as low-touch as possible, maybe even fully self-serviced.

In contrast, the Enterprise market would require long sales processes, engaging multiple stakeholders, and growing slowly between the customer’s entities (some MNE’s have tens of legal entities). It would also require a lot of CS support, not only to manage of the growth process within each MNE, but also to enable integrations with related IT systems and ensure compliance with internal regulations.

No doubt, a vendor addressing the SME market would be a whole different organization than one addressing the Enterprise market.

It seemed that the industry had decided to build GTM strategies around the Enterprise market. It is difficult to say whither the decision was based on the notion that the enterprise market presented a greater opportunity, or because companies wanted to avoid the technological challenges presented by the SME market - after all, building a functioning CS department is more common than getting the required OCR, ML and Big Data technology to run smoothly enough, to enable a fully self-service E2E process.

Channels

The VAT recovery market is a mixed one, where some companies hire their own teams to perform the necessary tasks, and others use a 3rd party - most likely an accounting firm that offers VAT recovery services - essentially outsourcing the functions The lack of clear market intelligence around the question of which is the most common choice, most vendors initially decided to make use of a combined strategy: utilizing both direct sales and indirect sales, where the VAT recovery agencies were an obvious candidate for channel partners.

Common practice in the Enterprise sales determines that utilizing direct sales in the early stages of a startup is preferred: direct sales will result in strong vendor/customer relationships, which in turn may lay ground up-sell, and increase the chance of customers being willing to serve as references, both for other potential customers, and for investors. Also, the direct sales approach facilitates more precise understanding of the Voice of Customers and, in turn, improved product development, a crucial aspect for emerging technologies.

Yet, the tax field is conservative and heavily regulated, and – until the rise of Fintech – most tax functions were not used to being approach by salespeople, let alone use unsanctioned tools. This made it more attractive to use the channels, which had already established relationships with the relevant key people. This led most vendors to choose a dual approach, working both direct sales and trying to establish an eco-system of partners as indirect channels.

While direct sales saw the occasional success that early stage sales process most often do, the indirect channels – comprised primarily of VAT recovery agents – were not much of a success. Ironically, one major reason for the seemingly failure of channels approach was the technology itself: the VAT recovery agents base their services on human skills and manual labor, which stands in contradiction to the new approach, which seeks to tag the manual VAT recovery process as inefficient, and deems human skills insufficient and prone to mistakes. Basically, in adopting the new technology, the VAT recovery agents would "dig their own graves". As a result, direct sales were crowned, by natural-choice mechanism, as the leading approach.

Driving revenue

Upon signing a contract with a customer, work had to be done. Putting it simple, invoices had to be scanned with an OCR and turned into a digital format, where intelligent software would determine the validity of the invoice, and possible VAT charged, according to the applicable rules and regulations. Scanning large numbers of invoices would make it possible to apply Big Data methods to present analytics, key figures and trends to the tax employees and company management, as well as the authorities.

It all made so much sense that a simple – yet also very important factor - was overlooked: scanning millions of invoices is an operation on its own, and for the sake of efficiency, it has to be done in a dedicated, specialized, process. A viable solution for scanning of the invoices had to be found.

First technology, then Operation, and last, Strategic Partnerships

In search for a suitable solution for scanning the invoices, just about all vendors experimented with a mobile app. While creating the apps was not a complicated task, it seemed it would not help solve the whole problem, as many of the invoices were already stacked in paper format, in large deposits, and that its implementation – i.e. getting all relevant customers, and their employees, to use the app was a very big task.

Moving forward, mobile scanning apps could be a part of the solution, not all of it.

The vendors turned their efforts to creating large, centralized, scanning centers. These manual operations were a quick, and relatively easy, fix for the challenge at hand. Yet, as invoice numbers grew, so did the scanning centers, which created an absurd situation, where the scanning centers employed many more employees, than the vendors did for all other functions, even when counted together. In any case, the scanning centers were deemed as a temporary solution only, despite the many resources invested in them.

A better solution, in the form of strategic partnerships, appeared: the VAT recovery vendors would partner with providers of IT tools, some of which offer systems that include (actually, often required) scanning of invoices.

Such vendors are abundant in the T&E field (often referred to as Travel & Expense Management Software, or TES), and include brand names such Concur (an SAP company), Expensify, Basware, and many more.

Basically, the partnership would work like this: users of the TES would be offered to manage and recover T&E related VAT from all their transaction, automatically, by activating the VAT “add-on” in their TES. If activated, all the scanned invoices would be copied from the TES to the VAT recovery system, which will work its magic. Simple.

Even though T&E only covers a small part of the VAT incurred globally, and that not all companies make use of TES, the pain-relief for the VAT vendors was so great, that most of them couldn’t resist turning the TES vendors into strategic partners. Some took it a step forward, basing their whole GTM on it.

Today, most VAT vendors have already established an eco-system of partnerships with TS vendors. These relationships are typically non-exclusive, and the TES vendors offer several automatic VAT recovery options for their users to choose from.

What we still do not know

Two major questions arise from this choice of strategic partnership and GTM:

First and foremost, does the T&E related VAT make a big enough market potential to support the growth of the VAT vendors?

Secondly, is it possible for the VAT vendors to establish a competitive advantage, without having exclusivity over the partnerships with the TES vendors?

Lastly, what will it take for VAT technology vendors to successfully address the SME market?

The answers for the above questions will evolve before us in the upcoming years, would be interesting to follow.