

Complex consolidation won't save payment incumbents from fintechs

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FIS' and Fiserv's acquisitions of Worldpay and First Data for \$43 billion and \$39 billion, including assumed debt, create two fintech and payments giants.

Cheerleaders sing the deals' hosannas, declaring they will transform the bank and payments processing landscape.

But simpler, more focused fintechs and payments enterprises such as Adyen, Square and PayPal in 2018 increased net revenue year over year by 60 percent, 49 percent and 18.4 percent, respectively. Neither FIS nor Fiserv on its current path is going to generate double-digit organic growth.

Management tout cost and revenue synergies. Fiserv's and First Data's CEOs Jeff Yabuki and Frank Bisignano asserted that by year five they'd deliver a whopping \$900 million and \$500 million in annual cost and revenue synergies apiece. CEO Gary Norcross and CFO Woody Woodall committed to \$400 million and \$500 million of cost and revenue synergies, respectively, in year three.

The four processing behemoths have all been acquisitive, and, in the normal course, rationalized redundant delivery systems and operations. However, these two humongous combinations have little business overlap.

While each has a U.S. debit network and issuer processor, consolidating them won't generate near the promised cost synergies. Shaving administrative overhead and costs of carrying First Data's massive debt won't do the trick either.

The mammoth consolidators' growth has been anemic. FIS' 2018 organic revenue growth was 2.8 percent year over year. Fiserv's 2018 revenue increased 2 percent year over year. While First Data's 2018 revenue year over year was up 6 percent, it has been growing slower than retail electronic payments. Worldpay's 2018 revenue increased a more respectable 10 percent. Of the four Worldpay is growing fastest, is the most narrowly focused and enjoys the richest valuation multiples. Worldpay, Fiserv, FIS and First Data trade at 8.7x, 5.8x, 4.2x, and 2.8x revenue apiece.

The combos' distribution systems, in principle, can deliver more products to more banks and merchants in more markets.

Core-bank processing is a sleepy oligopoly. The service is sticky, protecting incumbents, but rendering organic growth tough. Moreover, the number of U.S. banks peaked in 1922 at roughly 23 thousand. But for a brief couple of years in the mid-'30s, it's been declining since.

Bigger banks command better prices and are more inclined to insource. First Data and Worldpay won't change near-term bank-processing market dynamics for Fiserv and FIS.

Credit card issuer processing is also an oligopoly with high entry barriers. Fiserv is picking up the world's leading credit card issuer processor. But Fiserv's ownership won't fundamentally alter First Data's credit card outsourcing prospects in the U.S., much less abroad. Total Systems, FIS, and Worldline remain potent competitors.

Acquiring is a healthy, robustly competitive market that's seen a wave of innovative new entrants worldwide. FIS will have the U.K.'s largest acquirer and America's third largest by volume and second by transactions, and a world-class e-commerce payment processor with toeholds in growth markets like Brazil and India. FIS contends it can accelerate payments there by leveraging its bank relationships.

Fiserv can push referral relationships for the world's largest acquirer First Data with thousands of small-bank clients. But, the bank-referral market has been intensively plowed for decades. And, while still important, banks have been ceding acquiring share and relevance in the U.S. and Europe.

Competition is intensifying. As performance of First Data's acquiring business over the last decade and a half attests, being part of the world's largest portfolio of payment-processing assets doesn't necessarily provide a compelling edge.

Branded retail payment networks with critical mass are to-die-for businesses. Unfortunately, a consolidated, brand-gelded Star-Accel debit network will be a weak number three for Fiserv against Visa and Mastercard. A merged NYCE-Jeannie debit network for FIS will likely be a feeble number five. Nobody at Visa or Mastercard is quaking in their boots.

The gigantic mergers' most compelling synergies would come from control of greater portion of the payments ecosystem — more touchpoints end to end, enabling the industrial-strength processors to deliver greater value to cardholders, banks and merchants, and charge for it. FIS promotes loyalty and rewards programs within its ecosystem. That ecosystem will now have a viable merchant component.

However, it's not easy. First Data's efforts to wrap value around and the lower the cost of processing on-us Mastercard and Visa transactions, and to differentiate Star, came to naught. Chase attempted to deliver closed-loop benefits to its merchants and cardholders with ChaseNet, thus far without obvious success.

The tectonic acquisitions make two enormous, complex processors more complex. There will be diseconomies of increased complexity.

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