How banks can maximize the value of fintech acquisitions

Bank acquisitions of fintechs often fail to create value—but it doesn't have to be that way. Taking the right steps can boost the odds of success.

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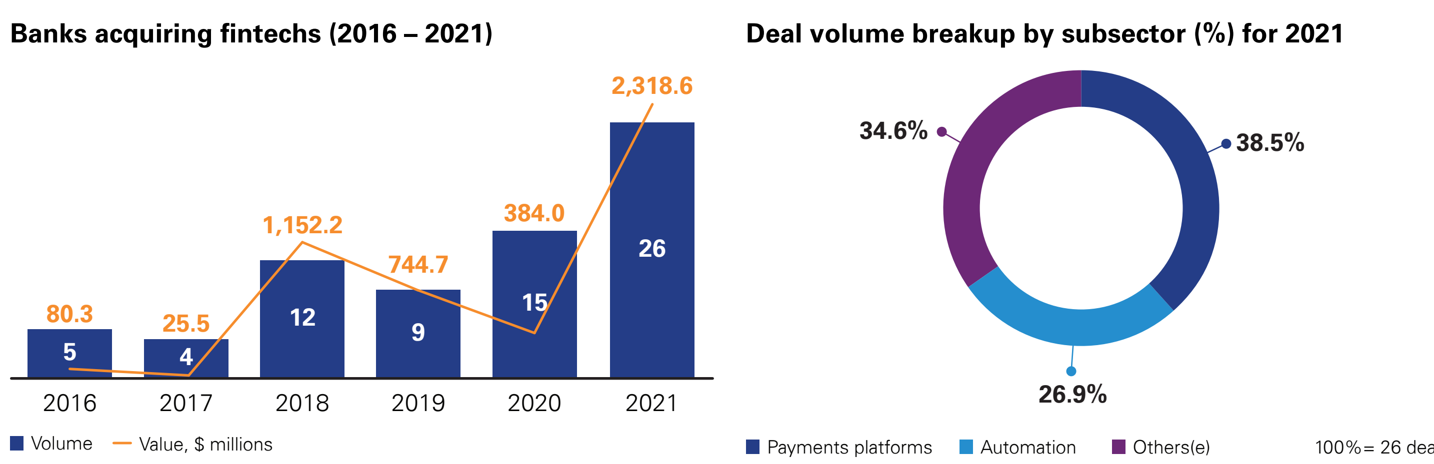
Introduction

Financial technology companies (better known as fintechs) are disrupting the banking industry, notably in payments and other digital services. Recognizing the threat and opportunity of these new players, banks have been acquiring and partnering with fintechs to get access to new technology, reduce costs, speed new products to market, gain top-quality talent, and inject a more entrepreneurial mindset. Bank-fintech deals set a record in 2021, with 26 acquisitions valued at $2.3 billion (Exhibit 1).

Even as banks increase their investments in fintechs, though, banking leaders also must keep in mind that many fintech deals fail to deliver expected benefits. This is no secret: In one recent survey, just 6 percent of senior bank executives said that fintech collaborations had achieved their targeted return on investment. In this paper, we will discuss ways to avoid common pitfalls and help banks maximize returns on their fintech investments.

Exhibit 1. 2021 was a record year for Fintech deals



"Partnerships are a source of frustration for banks and fintechs," Business Insider, April 21, 2020

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Why fintech deals have not met expectations

We see several reasons why so many acquisitions and partnerships haven't met expectations. A classic example in recent years was a credit card issuer's acquisition of an internet-based payments platform. The card company paid a high multiple for the start-up and made it the foundation of a new, tech-driven business unit with a focus on online payments. Just two years later, the acquirer announced that it was shutting down the new unit and later sold the payments business.

This costly failure had many of the characteristics that we see in unsuccessful deals. Here are the most prominent such characteristics:

Failure to scale. A key source of fintechs' appeal to banks is the belief that fintech technology and processes are highly scalable. Such scalability is much easier said than done, however. Bank operations typically are so vast—and fintechs so leanly staffed as to be overstretched in much larger organizations—that scaling up fintechs' smaller and newer systems often is a futile pursuit.

Lack of proper vision. Many banks tend to see their fintech acquisitions as one-off deals instead of as building blocks for product or service platforms (an approach that has worked well for private equity buyers). Instead, banks would be wise to selectively buy fintech companies with the intention of maximizing the fintechs' growth potential, either as standalone units or as category aggregators.

Cultural fit. The cultures and mindsets of banks and fintechs are dramatically different. Banks are much larger and more established, heavily regulated, highly bureaucratic, technologically lagging, and focused on public shareholders. Fintechs, by contrast, are autonomous, lean, entrepreneurial, lightly regulated, and technologically advanced. In addition, they use agile methods, are not burdened by deeply entrenched traditions, and usually have not had to answer to public shareholders. Given these stark differences, it's no wonder that culture is constantly cited as a major source of failure for bank-fintech combinations.

Culture shock for a fintech

A large Midwestern bank recently acquired a West Coast-based fintech that specialized in digital payments. The ink had barely dried on the deal when significant cultural differences became apparent.

- The general pace of business was much slower at the bank, which quickly became a source of frustration among fintech executives.
- The bank's risk and regulatory oversight became obstacles to progress for the fintech, which previously had few regulatory issues to consider.
- The bank's risk and regulatory teams had to review all requests and proposals and often shunned the projects that the fintech wanted to undertake.
- Due to the bank's sheer size, attendance at meetings often was very high and inordinate time was spent on introductions and pleasantries. The fintech simply did not have enough people to attend multi-hour meetings every day

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Acquirer amnesia. Too often, buyers seem to forget the deal thesis—why they acquired a fintech in the first place. Perhaps it was to reduce costs, gain technological expertise, plug a product gap, or bring in new talent. When acquirers focus too intensely on integrating the fintech into the parent organization, they can lose track of these goals.

Unclear compliance requirements. Government regulators haven't implemented extenxive oversight of fintechs, which complicates the compliance challenges banks have with their fintech businesses. At the same time, bank risk, legal, and compliance departments don't understand the fintech business model and product offerings. Often fintechs haven't maintained the documentation that risk and compliance require.

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How to do it right

When acquiring or partnering with fintechs, banks must strive to avoid the pitfalls we've described. The following roadmap can help.

Identify the right candidates

The first step—identifying fintech deal candidates—is more challenging than it might appear. This is not simply a matter of analyzing financial statements and deal comps, this is about finding candidates that align with the bank's strategic ambitions and pass a strict set of qualitative and quantitative criteria.

Banks can start the process by putting together a list of companies and asking these key questions about each one:

- How does this acquisition fit with our business strategy and growth ambitions?
- Does the fintech offer something unique or differentiated that we currently don't have?
- Does the fintech's culture complement ours? Do we want to work with its leadership team on a daily basis?
- Are the fintech's systems and infrastructure sustainable and scalable, particularly if we decide to add our clients to its platform?

Due diligence: Find the right fit

Due diligence should focus on determining whether candidate companies are a good fit for the bank on multiple levels:

- **Strategy.** There must be a good strategic reason for a fintech deal: getting access to key technologies, adding an important product, or building the foundation of a new platform, as SunTrust did. But some banks have bought fintechs for non-strategic reasons, such as trying to keep competitors from acquiring the asset. This typically fails to work out for the bank, the fintech or both.
- **Culture.** As noted, fintech deals carry high risk of cultural conflict. It's therefore crucial that before making a bid, banks thoroughly assess the compatibility of a candidate's culture and recognize if there's a fit. Sometimes the smartest deals are those not done, particularly due to cultural concerns.
- **Operations/technology.** A fintech could be exactly what the bank wants, but its operations and technology infrastructure may be incompatible or fit awkwardly. The bank must assess whether these differences are manageable or too big to overcome—and be prepared to invest heavily if it chooses to move forward.
- **Geography.** Geographical location can be a surprisingly important factor in the success of a combination. On paper, it shouldn't matter where a fintech is based, yet large distances between the fintech and the acquiring bank can give the fintech a sense of isolation and exacerbate other differences between the parties.

Pre-acquisition: Create the right roadmap

The pre-acquisition period—between when the parties agree to a deal and when it closes—is critical to the deal's success. Banks must pay special attention to making sure that fintechs both understand how the integration process should work and feel that the bank will be the right partner.

Clarity and transparency are vital to achieving these objectives. It's paramount that the bank lay out a clear strategy for what it wants to accomplish and a roadmap for how to get there. Both parties need to agree on the planned approach to integration. Further, the acquiring bank should invest the time during due diligence to ensure that the fintech's leaders understand how things will change when the fintech operates as part of a regulated bank. Taking the time for these types of discussions prior to signing can help create buy-in from the fintech and avoid costly mistakes down the road.

The bank should retain the fintech's key leaders and make its personnel feel welcomed, comfortable, and confident that the deal will work as planned. Even if the bank acquires the fintech for its technology or platform—not for its business—it will need to retain key people to run that platform (if only for an interim period). Finally, the parties must hash out and communicate a well-defined reporting structure, which is especially important to the deal's success.

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Post-acquisition: Choose the right integration model

There's no surefire way for banks to integrate their fintech acquisitions. Banks have taken similar approaches and gotten markedly dissimilar results. We see three fundamental integration models, which vary in the level of autonomy granted to the fintech:

1. **Full autonomy:** The bank lets the fintech function independently while providing the necessary level of financial and resource support. This model aims to leverage the fintech's technical expertise and digital knowhow, while allowing it to continue doing what made it such an attractive target for the bank.
2. **Hybrid:** Much like full autonomy, the hybrid model lets the fintech start on a standalone basis. The difference is that the bank steps in at some point and implements full integration.
3. **Immediate:** There is no period of autonomy and the integration process begins immediately.

These three models are straightforward and easy to understand, but their degree of success or failure lies in their execution and—most importantly—the acquirer's commitment to the deal thesis and willingness to be flexible as challenges inevitably arise.

A look at some winning bank-fintech combinations

While many bank-fintech combinations have not worked out, some have. Two notable successes are SunTrust Bank's acquisition of FirstAgain and JPMorgan Chase's purchase of WePay.

Back in 2012, SunTrust (now part of Truist Financial Corp.) bought FirstAgain, an online platform for direct lending to subprime borrowers. This was before online lending or fintech acquisitions were common. SunTrust saw that FirstAgain offered a completely digital and paperless borrowing experience, which the bank correctly identified as a major way to appeal to consumers who were doing more and more of their shopping and other transactions online.

After rebranding FirstAgain as LightStream in 2013, SunTrust targeted LightStream's customer base to drive revenue growth. The bank consistently invested in LightStream to maintain technological competitiveness. SunTrust now operates a leading US online lending platform.

In 2017, JPMorgan Chase acquired WePay, a developer of programming interfaces for payments-as-a-service applications. The deal brought JPMC a key strategic capability: an easy way for app makers and independent software vendors to integrate payments into software commonly used by small businesses.

When integrating WePay, JPMC made the acquisition a semi-autonomous unit and sought ways for the business to keep its startup ethos. This type of "soft" integration has enabled JPMC not only to improve its value proposition for business-payments clients, but also to apply WePay's tools to a much bigger universe of banking products.

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To maximize value, plan carefully—and watch out for common traps

It's clear that much can go wrong when banks acquire or partner with fintechs. Cultures clash, the technology is not easly scaled up, buyers lose track of the deal thesis as they integrate...

In other words, the road to creating and maximizing deal value can be bumpy, even seemingly impassable.

Even so, as we have shown, banks can get the most out of their fintech transactions by adopting a laser-like focus on results and making the tough decisions that are often needed to captuyre value. Fintech buyers must know what the problems can be and conduct their diligence with these problems in mind. Careful planning—and avoiding the common traps—can go a long way toward realizing full value.

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How KPMG can help

The KPMG Financial Services M&A Strategy practice helps provide banks with the skills and expertise to execute transactions in a way that protects core assets and maximizes the value of acquired or divested businesses. We have helped banks through all four phases of the deal cycle: setting the strategic vision, screening targets, due diligence, and integration and execution. We have helped banks and payments companies assess the strategic, operational, cultural and technological fit with acquisition / partnership targets and often helped clients back away from deals that don't meet their strategic objectives.

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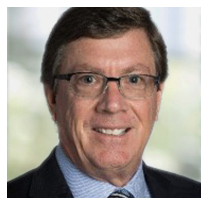
Jack is National Leader of the Financial Services Strategy practice. He has over 25 years of financial services strategy experience, including significant tenures as both an executive and a strategy consulting partner serving leading companies worldwide. Jack has participated in hundreds of strategy and M&A engagements and has led engagements in the U.S., South America, UK, Europe, and Asia-Pacific.



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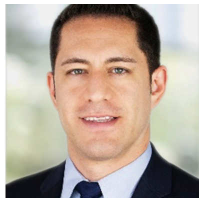
Bob leads the Banking and Fintech Strategy practice. He has more than 25 years of experience in payments, fintech and banking. Bob is responsible for developing relationships with leaders across financial services, fintech and payments, and for leading engagement execution that drives strategic business value. His areas of specialization include strategy development and execution, business transformation, digital and mobile experiences, technology strategy and execution, product and channel strategy, M&A, and risk and compliance.



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Lio has more than 10 years of experience advising midsize and large companies on their strategic and operational initiatives across the M&A lifecycle. His M&A experience has focused on buy- and sell-side advisory along the pre- and post-merger integration phases of a deal including M&A strategy, due diligence, management of transition services agreements, legal day-one planning, synergy assessments, organizational design, target operating model definition and post-merger integration. Lio also has supported corporate growth initiatives through the development of integration/ separation strategies and their end-to-end implementation.

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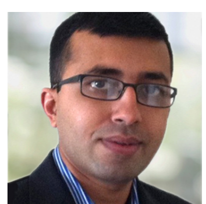

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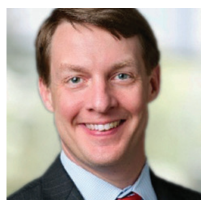
Sahil is a leader of the Financial Services Technology group. He oversees IT M&A engagements across banking, payments and fintech. Sahil has helped banks and payments companies with complex technology integrations as well as carve-outs/ spin-offs of business units. He also has conducted due diligence on banking and payments platforms and helped clients identify fintechs as potential partners or acquisition targets.



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Marc has more than 15 years of financial services industry and advisory experience leading enterprise-wide programs focused on strategic value creation. Marc's areas of focus include mergers, acquisitions, and divestitures; corporate, business-unit and functional strategic planning and execution; capital planning, analysis, and stress-testing; and cross-functional program management of strategic initiatives. His expertise extends across consumer and commercial banking, capital markets, wealth management and insurance.

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