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M&A Hot Takes

Financial Services: Everyone Wants a Piece of the Action

Convergence in this rapidly disrupting sector is prompting financial services executives to look outside the industry, and non-financial services executives to look in

Financial Services: Everyone Wants a Piece of the Action

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Perhaps no indication of disruption in financial services is as stark as the physical manifestation seen in bank branches. These lofty, prestige spaces—located in local communities but also in high-rent central business districts—are struggling to justify a reason to exist. Some hope to attract foot traffic by offering coffee and other non-financial delights.

The COVID-19 crisis has only exacerbated this disruption, with bank branches devoid of customers, who primarily transact over home computers and smart phones.

Indeed, financial services' business-as-usual is becoming outdated at an even faster pace.

To be sure, the need for financial services is expected to grow, just not in the way the business leaders of 20 years ago expected. Whether it be asset management, insurance, or banking and payments, legacy players are preparing for the digital future in large part by forging cross-industry partnerships and tapping the M&A market. Even a focus solely on banking and payments reveals a hunger to gain advantage through innovative dealmaking.

The convergence phenomenon in financial services is very much a two-way street. Non-financial players want to get in on the action as frequently as financial leaders want to invest in non-core products and services.

According to Liz Fennessey, a principal at Deloitte Consulting LLP, the inbound interest in financial services started in the unregulated area of payments, including credit cards. While large consumer brands and retailers have been trying to gain a foothold in credit cards for decades, Fennessey says: "I am holding my breath to see who will be the first ones to make their way into the regulated space, and how they're going to put in place a readiness to be regulated and fulfill all the new compliance requirements when regulators suddenly starting to look at you as a banker."

Many financial services leaders increasingly have eyes that wander beyond their core competencies. In some cases, these cross-industry partnerships and acquisitions are intended to expand the market for core services. There have been examples of payments companies acquiring consumer-facing internet companies with the intent of cross-selling services to online shoppers.

Buy vs. Build

The classic question of whether to gain a new capability or product through an internal build or via an acquisition has never been more in play than in the current financial services market.

The traditional analysis applied to this decision often comes down to time and cost — would it be better to simply acquire a capability and bypass years of potentially fruitless internal effort?

Fennessey points to another important consideration: "What would be the argument against a legacy player trying to build out some sort of digital service in house? What could go wrong? Talent. They could be better off buying talent that's already done it numerous times, and they just have to effectively apply this talent to their environment."

In many cases, acquisitions are happening to support internal operations. For example, given the increasing amount of transactions and customer service that takes place online, some legacy players have acquired state-of-the-art IT and cybersecurity companies rather than trying to build these capabilities internally. Enhanced security can be positioned as a service to customers. "We see examples of banks and payment companies buying fraud-related capabilities that offer fraud monitoring and fraud alerts," says Fennessey. "It's not a core capability, but it's complementary, and it's for the purpose of attracting a different client base and offering a differentiated experience."

Going back to the bank branch example, Fennessey points out that the digital push is being led by the largest, multinational banks and financial institutions. Leading up to the global pandemic, local community players were more confident in the business models of yesteryear. "Traditional community banks are still very much embedded in their communities," notes Fennessey. "If you are a small community bank in upstate New York, or the Midwest, you have a pretty sticky consumer footprint. Your M&A strategy is going to be focused on buying other branches opportunistically. Will they ultimately end up aggressively going digital? Maybe, but probably not even in the next 10 years."

Right Strategy, Right Target

Whether they lead a globe-spanning corporation or a local credit union, financial services executives are preparing for coming change, but to different degrees. A company's M&A strategy will be very much a function of its business strategy.

Fennessey notes that most financial businesses have strategy departments that do consumer, market, and competitive analysis to understand where unmet needs exist and then how to address those needs either via an internal project, a partnership, or an acquisition (see boxed item).

Leading companies will be confident in their business strategy ahead of any deal-by-deal considerations, including the acquisition of technology companies. "As far as a target acquisition goes, you go through an end-to-end target-screening process," says Fennessey. "Even if there's a tech startup that does very cool things in the market, if you don't see a path to effectively integrating it into your company, then it's not the right target for you."

That said, Fennessey expects accelerating cross-industry M&A not simply because decision-makers understand the importance of technology in the abstract, but because they are engaged in fierce competition to win customers who expect digital access. "Somebody can say, 'Hey, I can make a payment product that fulfills consumer needs that nobody else has fulfilled'," she says. "And maybe even those consumers don't know that this is something that needs to be fulfilled, right?"

Dogs in the Office

Convergence is often accompanied by cultural differences, especially when a large, traditional company buys a tech startup. Fennessey stresses that managing this cultural integration is just as important as the technology integration.

The cultural differences could be as seemingly trivial as whether internal communications take place via email or an online communication tool. Or they could be profoundly different, such as the number of hours employees are expected to work. An employee at a startup might break attire norms by wearing shorts to the office, but exceed conventional work expectations by putting in an 18-hour day. Today, given the shared work-from-home experience of the pandemic, a manager overseeing a recently acquired startup company may find it unwise to enforce legacy office-culture guidelines that were shown to have no measurable impact on productivity.

The important point, says Fennessey, is not to let the superficial cultural differences imperil promising synergies. "You bought a particular company because you knew that it had value," she says. "You need to be very cognizant about not eroding that value. Do you really care if people bring their Saint Bernards to the office and wear flip-flops?"

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