



JUDGMENT CALL

Paying up

First Data spun out Western Union and replaced its CEO but now faces an enormous integration challenge

by Eric Grover

Faced with investor frustration, anemic growth and headline-grabbing client losses in its legacy U.S. card-issuer processing business, **First Data Corp.** replaced CEO Charlie Fote with his predecessor Ric Duques and decided to spin out its high-growth money transfer business, **Western Union Holdings Inc.** First Data stock rose 4.6% on Fote's resignation and 5.4% on the Western Union spinoff announcement. Value was unearthed insofar as the market expects that separated one or both entities will deliver more robust earnings growth.

Duques concluded that Western Union's synergies with the rest of First Data were "not compelling." Perhaps. Western Union operated fairly autonomously since Duques merged it with First Data in 1995. It has strong consumer payment brands and a powerful distribution network, which should have translated into leverage. If synergies weren't there, maybe different leadership was needed.

An independent Western Union looks to continue its torrid growth, though it will see increased competition from electronic money transfer alternatives and, consequently, suffer eroding margins.

First Data's remaining portfolio of payment processing assets generated \$6.6 billion in revenue last year and is still richer than any competitor's. But where is its coherence? Duques must demonstrate why the card-issuer, merchant and payment network processing businesses are more competitive because they share the same shareholder.

For starters, First Data could handle more payments end to end, deliver intelligence around utility card and merchant processing, and furnish a genuinely global platform.

Its businesses touch every step in the payment cycle. In many markets, First Data has assembled, or is close to having, a critical mass of card-issuer and merchant acquirer relationships which would enable it to authorize, clear and settle "on-us"

payment transactions, i.e. within its network. It could achieve synergies by completing the entire payment transaction loop.

First Data's limited foray into on-us processing and Visa U.S.A. Inc.'s banning the use of third-party processors for interbank processing provoked reciprocal lawsuits. Judge Jeffrey White determined Visa's ban "affects the ability of member banks to compete with one another" in Visa and other credit cards. His March 2 partial summary judgment against Visa U.S.A. should encourage First Data to more vigorously pursue this head-to-head competition with **MasterCard Inc.**, **Visa International** and national bank processing cooperatives overseas.

In the U.S., increased issuer concentration changed the nature of the market ... to First Data's disadvantage. Enormous buyers such as **Bank of America Corp.**, **Capital One Financial Corp.**, **J.P. Morgan Chase & Co.** and **Citigroup Inc.** can exact tougher

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terms, and in-house competition is more formidable. In a market where the top five issuers now have 80% of all MasterCard and Visa credit cards, First Data has taken a battering at the hands of rival **Total Systems Services Inc.**, which is now the largest U.S. bankcard issuer processor.

Meanwhile, First Data and its partners control more than 50% of merchant acquiring. They could entertain a relationship treating their combined transactions as on-us, sharing foregone Visa- and MasterCard-fee savings.

Differentiation in standalone businesses generating the bulk of revenue is increasingly problematic. For example, payment posting, maintaining cardholder open-to-buys and statementing have become commodities. First Data can deliver more value and command richer margins by also providing ac-

tionable intelligence across all channels touching its clients' prospects and customers.

Due to acquisitions, the mammoth processor has too many platforms under the hood. Its cumbersome legacy U.S. card processing system has, arguably, been at a decisive competitive disadvantage.

To address its platform woes, First Data looked to external solutions. Where performance requirements and circumstance permit, it is migrating to VisionPlus, acquired with PaySys International Inc. in 2001, and Omnipay, built upon RS2 software and an Irish dynamic currency conversion processor acquired in 2002, as card issuing and merchant processing standards, respectively.

The PaySys acquisition was a masterstroke, moving First Data toward being able to create its own global third-party and in-house processing ecosystem. However, it has been sluggish pushing the agenda.

First Data's heft and ability to deliver almost globally is a huge advantage. Global FIs such as Citi, **GE Consumer Finance** and **HSBC plc** would benefit

from one worldwide card processor and delivery platform. In that regard, First Data is relatively well positioned. Neither European competitors **Atos Worldline** and **Sinsys NV** nor American rivals **Fidelity National Information Services Inc.**, **Global Payments Inc.**, **NOVA Information Systems Inc.** and **Total Systems Services** match up well in terms of geographic reach and product breadth.

First Data has a strong but nevertheless tier-two U.S. payment network, Star, which is at risk of being commoditized. It should add credit, thus better matching up against **Discover Financial Services Inc.**, MasterCard and Visa. It should also expand internationally. First Data ought to piggyback global FI relationships to spread Star overseas and to acquire well-established proprietary networks such as

BNP Paribas SA's Carte Aurore credit network.

The lion's share of First Data's revenue is generated in the U.S., where its heritage businesses' growth prospects are modest. But many developing markets offer enormous growth headroom. In 2004, card payment transactions in India grew 37%, in China 66%, in the Ukraine 31% and in Brazil 25%. A payment processing land grab is under way. The mastodontic processor must continue to expand the depth and breadth of its international footprint through acquisitions and organic growth, particularly in strategic high-growth, often chaotic, emerging markets.

Digesting a host of acquisitions, First Data is a smorgasbord of cultures. That said, a conservative, bureaucratic data-processing culture dominates. The contrast with a smaller, more nimble, customer-and-sales-focused competitor such as **Euronet Worldwide Inc.** is stark. Culture matters enormously. Clients and competitors think of First Data as slow-footed. Duques must engage the organization relentlessly to create a more enterprising, forward-leaning culture.

Cultural and financial reward systems shape and drive organizations. Earlier this year, Duques and Fote profited handsomely, cashing in options from value created, in part, by Fote's resignation and the Western Union spinout announcement. Relative to owning shares, options encourage management to pursue higher-beta growth. If the board asked management to instead covenant to buy and hold stock, that would more closely align management's and shareholders' interests.

First Data is better positioned to provide and dominate end-to-end payment processing worldwide than any competitor on the horizon. Time and the new management team's mettle will tell whether or not the company can fulfill its promise. ■

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