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Smart Merger Strategies: Balancing Fintech Growth & Competition

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Problem of practice

Fintech companies worldwide operate within ecosystems comprised not only of buyers of fintech products but also other companies with complementary offerings and digital platforms that connect these various players. These ecosystems and platforms create both an opportunity for scaling fintech and a barrier that inhibits new startups seeking to enter the space. Within platform-driven fintech, mergers and acquisitions (M&A) are a popular means to scale rapidly. However, M&A can have negative consequences – not only for the companies involved but also for the overall platform. For instance, rapid M&A could result in market concentration by a few players, which could stifle competition, innovation, and overall growth. Hence, for the CXOs of fintech companies as well as policymakers, we develop a set of best practices by combining insights from two research articles. The first research article by Yongzhi Wang, Lori Qingyuan Yue, Nandini Rajagopalan, and Brian Wu points out that certain types of mergers among complementary companies can strengthen the competitive position of fintech firms.[1] The second research by Shiva Agarwal, Cameron D. Miller, and Martin Ganco suggests ways to balance growth among fintech companies with the risk of market dominance by a few.[2] We combine these insights and apply them to the context of the Indian fintech industry – the world's third largest by funding.[3]

[1,2] The two articles - 'The entry-deterring effects of synergies in complementor acquisitions: Evidence from Apple's digital platform market, the iOS app store' by Yongzhi Wang, Lori Qingyuan Yue, Nandini Rajagopalan, and Brian Wu featured in Volume 45, Issue 13 of *Strategic Management Journal*, and 'Growing platforms within platforms: How platforms manage the adoption of complementor products in the presence of network effects?' by Shiva Agarwal, Cameron D. Miller, and Martin Ganco, featured in Volume 44, Issue 8 of *Strategic Management Journal*, show that when complementary fintech companies merge, they gain strength but clear rules and choices for users help make sure no single company controls everything

Barrier management strategy

The business world today is increasingly dominated by platforms. Platform-based startups have disrupted many B2C industries such as retail, hospitality, and food delivery. Another such industry that platforms have disrupted is the financial services industry. Case in point: the Unified Payments Interface (UPI), which was sponsored by the National Payments Corporation of India (NPCI), enabled digital payment from any bank account to any other. This system encouraged multiple payment providers to participate and scale, which resulted in scale for UPI itself – it recorded over 131 billion payments worth over $2 trillion by the financial year 2024.[4] As the dominant digital payments platform in India, UPI has transformed the Indian fintech industry. Can fintech players on this platform and others create or manipulate strategic barriers and bolster their position in the market? The two research articles we highlighted earlier provide an answer in the form of two techniques – M&A and relationship management with partner companies. In 2024, M&A was a crucial technique, with 26 mergers and acquisitions recorded in the fintech industry in India.[5]

M&A technique

As the platform business model matures, we see a growth in mergers and acquisitions by platform-based firms of other, complementary firms. For instance, BharatPe, a major player on UPI, acquired a controlling stake in Trillion Loans, a non-banking finance company, in 2023.[6] Similarly, LendingKart, a popular digital lending company, acquired another personal lending company – Upwards – in February 2023.[7] In both cases, the acquirers wanted to inorganically strengthen their distribution network and cater to a new segment – Micro, Small and medium enterprises and micro entrepreneurs. This trend is not unique to fintech. Zomato's acquisition of Blinkit illustrates how a food delivery platform expanded into the quick commerce segment by leveraging its logistics capabilities.[8]

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These acquisitions are becoming increasingly common and impacting platform competition in unusual ways. Specifically, the research by Wang and team highlights four types of synergies or rationales that underlie these acquisitions. First, the most commonly understood synergy is through economies of scale or economies of scope. In other words, the larger the merger and the broader its service mix, the more efficient and profitable the combined firm becomes. The scale acts to deter other fintech companies from entering the market, and may even hasten the exit of smaller companies. In the case of platform-based companies, these economies of scale and scope from an acquisition can arise through users or companies themselves. As an example of economies of scale arising through users, consider the acquisition of KountMoney by Lendingkart in 2016.[9] The acquirer and the target sell similar products to different users. The key point of this acquisition was the rapid scaling of LendingKart's user base, which improved market presence, market share, and sales and marketing efficiency.

The second type of synergy arises when the acquisition is conducted to acquire users who consume a different product, but are likely to consume the acquirer's products or services. For example, Lendingkart, a digital lending platform for micro, small and medium enterprises, acquired personal loan provider Upwards in 2023.[10]

The third synergy relies on the extent of similarities in the technology and functionality used by the acquirer and target. When the acquirer and target offer technologies in similar product categories, it becomes easier to integrate the offerings and remove any redundancies. A uniform standard is created across the platform, making it easier to maintain and scale the offering to a larger number of users. For instance, Razorpay acquired Curlec, a Malaysian payments provider, in 2022.[11] The similarity in functionalities allowed it to merge the two technologies and provide a full-stack payment product in Malaysia by 2023. Thus, Razorpay has been able to leverage its economies of scale.

The fourth and final synergy occurs when the acquirer and target have technologies catering to different product categories. Acquiring such companies helps the acquirer enter different markets. The Indian fintech industry has multiple examples of this synergy. These include the acquisitions of Thirdtap, Opfin, Ezetap, and Poshvine by Razorpay. Similarly, Phonepe acquired Wealthdesk and Quantech Capital Investment Advisors to branch into a different market segment – investment advisory and wealth management.[12]

While the above types of synergy might be profit enhancing, the last three types have an added effect – they increase entry barriers to subsequent entrants. Said differently, acquiring a platform for the sake of its user base might not be as effective as cross-selling and technology enhancing. This argument is powerful when the cost of switching to a different platform is negligible.

Relationship management

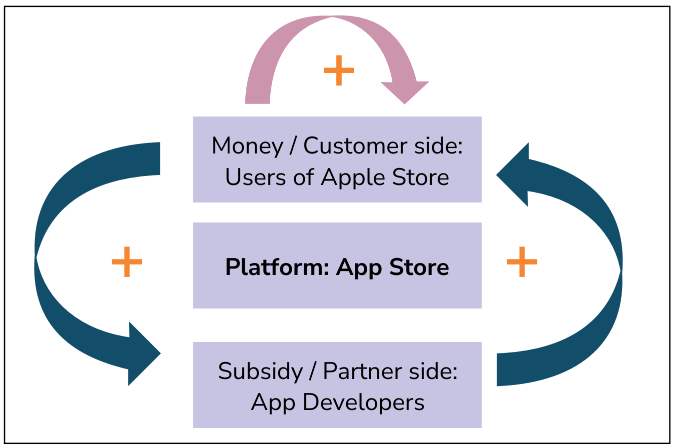
Besides M&A, the relationship between platforms and complementors is an essential competitive technique. Consider the payment platform of GPay (Google Pay): The more merchants that accept GPay, the more consumers will be willing to use the platform, and vice versa. Thus, merchants act as complementors to GPay as the greater their supply, the more the platform effectively generates payments and other businesses that generate revenue for GPay. The term co-opetition can best describe this relationship. Both platforms (e.g. GPay) and the complementors (merchants) need to collaborate to maximise the benefits to them. At the same time, both try to maximise benefits to themselves, often at the other party's cost. For instance, drivers of taxi platforms and delivery executives of food delivery platforms and restaurants frequently complain that platforms are constantly increasing the fees or reducing the amounts payable to them. Simultaneously, platforms are concerned when complementors such as taxi-cab drivers meet up with the consumers and bypass the platform by directly transacting with each other.

Wang and team highlights four types of synergies that underlie the acquisitions:

1. The most commonly understood synergy is through economies of scale or economies of scope.
2. When the acquisition is conducted to acquire users who consume a different product, but are likely to consume the acquirer's products or services.
3. There are similarities in the technology and functionality used by the acquirer and target.
4. When the acquirer and target have technologies catering to different product categories.

Such a case of simultaneous collaboration and friction between the platform and complementor results in a contentious relationship. Both parties try to enhance the dominance of the other to the extent that it benefits them. At the same time, both of them prevent the rise of the other if it hurts their standing. Research by Agarwal and team highlights how platforms sometimes enhance complementors' standing. The study also shows that in other cases, the same platform works to mitigate the impact of the complementor. Before applying the concept to fintech, this essay highlights how it works on Apple's App Store, a digital platform. The research shows Apple platform promotes app developers (through its annual awards) who: a) build high-quality apps, b) enhance network effects (see Figure 1) by attracting more users in that app category, and c) are not category-leading apps.

Figure 1: Platform network effects model



Source: Authors' analysis

The last criterion is the most important if the product category is concentrated. As the platform owner (Apple) is concerned that a monopoly leader can demand favourable terms from the platform, such as lower fees or discounts, and ultimately subvert its rules. To mitigate the risk of such a situation, the app store chooses not to award the leading app. Instead, the platform decides to award it to the next best app. By doing so, the platform directs users to choose the other app and mitigates the leader's dominance.

This logic motivated India's central bank, the Reserve Bank of India (RBI), to announce the New Umbrella Entity (NUE).[13] This entity was supposed to be an interoperable alternative to UPI and its parent. RBI intended to stimulate innovation through competition and prevent the monopoly or dominance of a single organisation. Some industry participants developed their internal offerings to position themselves as an alternative. For instance, private banks such as Axis Bank, ICICI, and payments giant Visa and e-commerce major Amazon, partnered to form a consortium to apply for a NUE license.[14] Similarly, Paytm leveraged its fintech capabilities and partnered with Ola (a major ride-hailing company in India) and IndusInd Bank (another major private sector bank) for the same.[15] The biggest Indian public bank, State Bank of India (SBI), developed a digital banking platform called YONO and heavily advertised it to secure a NUE license. The SBI chairman estimated the potential market value of the NUE market opportunity to be around US$40 billion.[16] Due to various factors, including – but not limited to – data privacy and lack of

clear regulations, RBI ultimately did not launch NUE. However, the point remains that the orchestrator can choose to promote one player over another to achieve its strategic objectives.

Another example of relationship management as a technique for managing platform growth comes to us from NPCI, the parent organisation of UPI. By 2020, NCPI realised that a few payment apps dominated the market.[17] For instance, Google Pay was the market leader due to its heavy cashback offers. Paytm, the market leader following demonetization, had slipped to the third position once its cashback offers stopped. PhonePe was in second position and ultimately became the market leader. NPCI was concerned about anti-competitive practices if one player was allowed to dominate. Over the course of two years, NPCI attempted to influence the dominance of these market players. Eventually, it announced that any player could have a maximum market share of 30%. Payment apps that have more customers would have to shed some of their customers. Again, this example indicates the importance of managing the relationship between the platform owner and the participants to prevent dominance. It was essential for NPCI to ensure low dominance as it wanted to achieve its strategic objective of ensuring no systemic risk.

The road ahead

Given the important role of fintech in India, this essay provides three key insights for companies in this industry to develop a newer source of competitive advantage:

1) If using M&A to scale, consider acquisitions that create technology-side synergies and cross-category opportunities rather than just increasing the user base. Such acquisitions are likely to develop stronger moats and deter new entrants.

2) If competing in a highly fragmented (no dominant player) digital platform, try to scale by creating a network of the type that Paytm and GPay did. In such a scenario, it will help the larger platform to grow the pie for everyone.

3) If competing in a highly concentrated market, as one of the few big players, carefully manage your relationship with the platform owner (e.g., UPI), as you may be perceived to be inhibiting innovation.

Finally, for policymakers, this essay mirrors the recommendations: To grow a nascent fintech ecosystem, it is wise to encourage companies to grow through acquisition and networking. However, as one or two dominant players emerge, the risks of stifling innovation and inhibiting further growth become too high. In such cases, platform operators such as UPI's parent are better off capping relative market share and encouraging smaller players to innovate and scale faster.

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