

Why Fifth Third took a stake in a startup



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Cincinnati Business Courier Fifth Third Bancorp's investment last month in Cincinnati tech startup Zipscene wasn't something outsiders expected to see. Indeed, the Zipscene deal could be viewed as, to steal a word from the bank's current ad campaign, curious.

Banks make loans and take deposits. So what was Fifth Third doing taking an ownership stake in a data analytics company, acting like a venture capital firm?



Sameer Munger is CEO and co-founder of Zipscene

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For those inside the downtown Cincinnati-based bank it was a logical move, one that fit into Fifth Third's strategy under new CEO Greg Carmichael.

Carmichael, who took the helm Nov. 1 from Kevin Kabat, spent most of his career in technology before arriving at Fifth Third in 2003 (see story, next page) as chief information officer. Tech is in his DNA.

"Greg is looking at taking advantage of a digital strategy to transform the bank," said Joe Robinson, Fifth Third's director of technology and operations. "The bank is becoming more and more a technology company."

Carmichael plans to use Fifth Third's digital capabilities to improve every aspect of the bank, from how it uses mobile technology to ways of analyzing customer activity. He sees his tech background as "a huge advantage."

"We need to use technology," Carmichael said, "to re-engineer processes and become more efficient."

The shift in direction comes at a key moment for Fifth Third. Like its competitors, the bank has been stifled by low interest rates, which tighten the margins on deposits and loans. Regulations have squeezed margins as well.

The basic business of banking, taking deposits and making loans, "is truly wind in their face," said Terry Kelly, a principal at Cincinnati money management firm Bartlett & Co.

Fifth Third's performance under a new boss could have a huge impact on Cincinnati. It's the city's largest locally based bank, the nation's 16th biggest, with \$142 billion in assets.

Most of its 7,000 local employees – it's the 10th-largest Cincinnati employer – own shares in the bank.

But its stock price has stayed flat for years, prompting Morningstar bank analyst Tim Puls to say Carmichael needs to “reinvigorate” the bank.

Carmichael’s top priorities can be broken down into three areas:

1. Cutting costs

In this low interest rate environment, this is job No. 1. Fifth Third already has said it will cut 105 branches, a move that should save \$65 million a year.

Fifth Third quietly has cut 14 percent of its workforce over the past four years, and more layoffs could be on the way, according to sources who asked not to be named. (The bank wouldn’t comment other than to say it always is looking toward operational efficiency.)

2. Building tech prowess

The Zipscene deal (neither the company nor Fifth Third would provide details on the size of the investment) wasn’t just important in Cincinnati because it involves a local startup. It sent a clear signal to the investment community that Fifth Third is moving beyond the constraints of typical banking.

“That really caught my attention,” Puls said. “It’s an interesting one. If they’re making a step there now, I’m sure there will be more deals coming.”

Tayfun Tuzun, Fifth Third’s chief financial officer, has been making the rounds at analyst and investor conferences, talking about technology not just as a way to make banking easier through mobile but as a way to capture more valuable data on consumer spending habits.

Fifth Third would like to make more of that kind of information available to its business customers, such as retailers, said Tuzun, adding that Carmichael’s experience should help.

“Transitions like this let you re-evaluate your priorities,” Tuzun said. “(Carmichael’s) technology background gives us a different angle. He clearly understands IT and it just happens to be a time when technology has become a whole lot more important.”

3. Boosting revenue

Banks don’t want to write every loan they can, only to have weak underwriting standards come back to bite them a few years later. So they have to find another way to increase revenue.

When interest rates rise, so will Fifth Third’s revenue and profits, said Erik Oja, equity analyst at S&P Capital IQ. But to get an edge on its rivals, the bank must find a way to boost its sales. That could mean going back to the future.

Fifth Third’s payments processing company, originally called Midwest Payment Systems, was for years a crown jewel, delivering strong profits regardless of the interest rate cycle. But in 2009, during the financial crisis, it sold off half of that company. That company changed its name to Vantiv Inc. and went public. Fifth Third still owns a sizable stake, but it’s not an earnings driver.

Puls said Fifth Third is trying to recreate that type of division.

“Definitely,” he said. “They built it once with Vantiv, and they want to do that again.”

How? Fifth Third has developed new payments processing businesses largely through digital means for online payments. Last year it formed the Payments and Commerce Solutions Group to find opportunities in areas such as digital payments. It’s working with current customers to offer digital payment services and put to use the customer data it compiles.

That group, as it happens, is the one that invested in Zipscene and plans to make similar investments. Fifth Third spokesman Larry Magnesen called Zipscene “a good example of the sorts of things that are of interest and would be consistent with this strategy.”

Oja sees a return to making payment processing a big part of Fifth Third as a likely scenario. The bank could make acquisitions to build up that business, too, he said.

“They know what they’re doing,” he said. “So it’s not like they’re getting in on a lark.”

If Carmichael can accomplish all of these goals, he could bring Fifth Third back to its former role as a banking industry leader when its profits set the industry standard. Now, its return on assets of 1 percent and return on equity of 9 percent are about average.

“It’s not horrible by any stretch,” Kelly said. “But it does not indicate they’re wildly profitable.”

Fifth Third has gone from trading above its peers to trading at a discount, said Jeff Bahl, a portfolio manager who tracks banks for Cincinnati money management firm Bahl & Gaynor. The market would like to see that reversed.

Carmichael’s task is tough, but he stepped in at the right time, Bahl said. Kabat led the recovery from the financial crisis, when Fifth Third’s stock fell as low as \$1.01. Now it’s around \$21, but it’s stagnating. The stock doubled in two years through late 2013. It has been basically flat the last two years.

“Carmichael brings a different focus to the bank,” Bahl said. “The skill set to regain confidence is different from the skill set to grow a healthy bank. Is he the guy to do it He clearly has the extreme institutional knowledge. With a mandate to grow the bank, he probably is the right guy to do it.”

Watkins covers banking and finance, insurance and sports business