

Can Bank of Ireland handle an AIB mega merger?

Introduction

The recent debate on whether a Bank of Ireland merger with AIB would be preferable to a foreign takeover assumes that Bank of Ireland could actually deliver real value from a domestic mega merger. The real issues go far deeper than potential job losses in the short-term. The medium to long-term potential to deliver customer, employee and shareholder value will ultimately determine it's success or failure. This article sets out the significant challenges facing Bank of Ireland if an AIB mega merger were to happen and dispels some of the myths surrounding such a deal.

The critical question

The possibility of Ireland's two largest banks merging was unthinkable until the AIB "rogue trader" scandal changed the course of direction not only for AIB but also for Bank of Ireland. Ironically their respective futures seem to be inextricably linked. Bank of Ireland Chief Executive Michael Soden's logic is understandable when he says that Ireland's two biggest financial players could prevent the country's banking sector falling to predators. Soden's fear is that if AIB or Bank of Ireland were taken-over by a non-Irish entity the other was more likely to fall. This would greatly accelerate the creeping trend, which is taking decision-making in Irish financial services offshore. The critical question is however can Bank of Ireland handle an AIB mega merger and would it be in the customers' best interest?

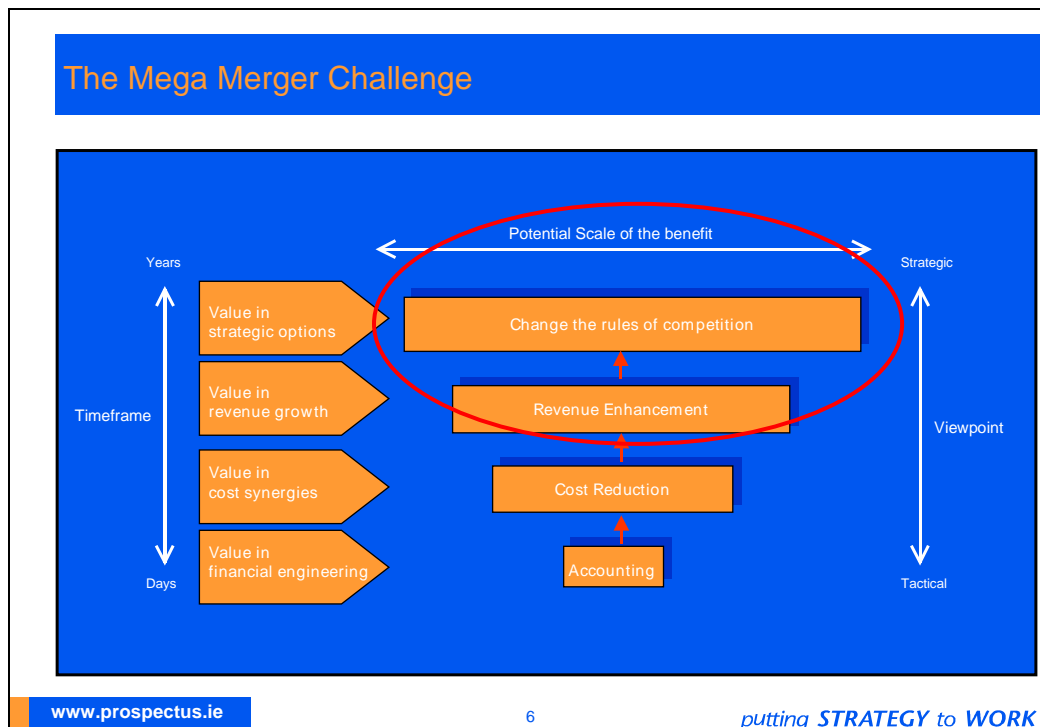
In the customers' interest?

The battle that will rage in the media and with the regulator will centre on whether such a combination will be in the interest of the customer. On the one hand the hugely dominant position will be seen as anti-competitive while on the flip side Michael Soden argues "The game we are in today is all about capital and capital management...The larger your capital base becomes the stronger the position you have in the marketplace in terms of independence and I believe the independence can be a good thing for the country, for customers and for shareholders." The difficulty will be in the fact that in this scenario Bank of Ireland will need to manage the tension between a defensive move to ensure safeguard their own independence while capitalising on the opportunity to shape the market and change the dynamics of the Irish Financial Services market. Whether or not this deal happens, it begs the question whether a merger of this scale in Ireland will deliver or destroy value for the country, customers and shareholders.

Breaking the rules!

A mega merger of this scale and market dominance in Ireland would undoubtedly break some of the rules from a regulatory perspective. The real challenge is however to change the rules of competition to create real value for customers, employees and shareholders. To create real value the deal would have to go much further than traditional combinations which typically attempt to deliver benefits without greatly disturbing the customer experience (see diagram – the mega merger challenge). Market expectation and regulatory matters would necessitate this deal to be ground breaking in terms of innovation, service, choice and competitiveness delivered to the

customer. Simply delivering the obvious synergies will fall short for customers, the regulator and the financial markets. Such a strategy would ultimately destroy value and fail to achieve Michael Soden's objective of securing the future of Bank of Ireland as an independent entity. Achieving a strong capital base is one thing but the real challenge is how this base is used to create value and sustainable competitive advantage.



Bank of Ireland/AIB Mega Merger Myths

To understand how to deal with the challenges and complexities of a Bank of Ireland/AIB merger it is necessary to lift the merger veil and dispel some of the myths around mega mergers.

- Myth 1 - A Bank of Ireland/AIB deal would be anti-competitive**
 The bland assumption that such a deal would be anti-competitive is too simplistic. The case would have to be proven either way. There would be a huge onus on Bank of Ireland to prove the case to the regulator and other stakeholders. The acid test would be the extent to which the deal is in the best interests of the customer as viewed principally by the regulator and the shareholders of both banks. To prove such a case radical, robust and innovative proposals would need to be developed with detailed scenarios that highlight the customer impact.
- Myth 2 - Mega mergers are the same as other mergers – the difference is scale.**
 A merger of this scale provides a unique opportunity to create a step change in terms of how financial institutions in Ireland serve the corporate and individual customer. The real opportunity is to be radical in terms of innovation and provide a new model or template for the industry in Ireland. Due to the complexity of the challenge the degree of difficulty in delivering value is much greater. The blueprint strategy needs to be more radical and challenge the ways in which customer needs are currently met. The interest of the customer would not be best served by maintaining the status quo. This will not satisfy the

regulator, as it is the equivalent of simply creating a cartel situation by another name.

- **Myth 3 – In a mega merger it is better to retain autonomy and not integrate.**
The sheer scale of the integration challenge will lead some to conclude that value can be maintained by not integrating. A Bank of Ireland/AIB scenario will have to prove that significant value can be created – it's not enough for customers of shareholders to simply try to run two autonomous operations. Precisely because the integration challenge is complex, significant integration will be required but it is not simply a case of putting the two banks together. A two into one new organisation model is required rather than merely a one plus one model. The challenge here is to create a new and unique entity that surpasses existing customer and shareholder expectations.
- **Myth 4 - A strong capital base will secure Bank of Irelands' future independence.**
Michael Soden's assertion that "you become a much more formidable force...when you have a larger capital base to work from" is correct but is not in itself enough to secure future independence and success. The strength of the capital base is important but is no substitute for a clear strategy that leverages that base to deliver value. In other words the advantage of a strong capital base only becomes a competitive advantage if used to achieve a radical value creation agenda for customers and shareholders.
- **Myth 5 - It doesn't matter how the merger happens - as long as it happens!**
Getting the dynamics right in such a mega merger is critical. Many large deals destroy value because they fall into the trap of being consultative-hostile. That is, the acquirer tries to be overly accommodating and inclusive while the acquired assumes a hostile position. This prolongs the status quo and leads to uncertainty, a lack of decisiveness and an inability to capitalise on the deal. The time, resources and energy expended to manage this situation typically leads to a lack of focus on the customer and initiatives getting "bogged-down" in internal politics. The decisive factor here is how the approach is made and how employees, shareholders and customers, from both sides, are managed through the process. The dynamics of Bank of Ireland/AIB deal would need carefully scrutiny. To deliver value Bank of Ireland would need to be clear on the "atmospherics" they wish to create and avoid a consultative-hostile situation.

Conclusion

The driving rationale for a Bank of Ireland/AIB deal must be clear to customers, shareholders, employees and the regulator. The danger is to get caught between a defensive move which focuses on maintaining Bank of Ireland's independence through its accumulated capital base and the enormous opportunity to change the face of Irish banking and greatly enhance the customer proposition. The two are not mutually exclusive but can be divisive if the complexities, which surround the arguments, are not understood. The critical question is the how to leverage the capital base to deliver real customer and shareholder value from the deal and create sustainable competitive advantage for the combined entity. To do this the focus must be on radical and innovative ways of serving the customer. The challenges are, without question, complex and lie hidden in the myths surrounding mega mergers. The first step is therefore to understand the complexities behind the mega merger myths, be clear on the driving rationale for a Bank of Ireland/AIB deal and detail how and why it is in the best interests of the customer. Without this clarity of thought a Bank of Ireland/AIB deal will become yet another statistic which reinforces the mega merger myths.

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