OUP Blog, Raj Chari

Let's Fly Away: IAG and Aer Lingus

News has erupted of another potential merger and acquisition (M&A) in the Airline sector – the acquisition of Irish airline Aer Lingus by the International Airlines Group, IAG.

IAG, the product of the merger in the early 2010s between ex-state-owned enterprises British Airways and Spain's Iberia, has become one of the world's global giants, ranked in the latest Forbes 2000 index of 2015 as the third largest airline in the world (see: http://www.forbes.com/global2000/#industry:Airline). IAG's formation took place in the wake of other ex-state-owned European airlines merging in the 2000s in the context of EU liberalization initiatives that changed the rules of the game, facilitating M&A. This was seen in the deals between Air France and KLM (which later took over an important stake in Alitalia, only to sell this later) and Lufthansa' and Swiss.

As the Aer Lingus/IAG deal draws out, how can we better predict the outcome? Surely, airline consolidation – as has taken place in other sectors such as automobiles, electricity, petroleum, and banks across the world – almost suggests an inevitable path where firms 'eat up' other firms and become global giants.

But, the newly released OUP title *Life After Privatization,* which examines and explains the evolution of privatized firms, argues that in order to understand the creation of world champions that merge and acquire, one should look less at what goes on in business and more at the 'politics' firms face in global markets.

Let's consider developments in Aer Lingus between 2006 and 2013. Privatized in 2006, the state nevertheless retained a 25% stake. Since the privatization, Dublin-based Ryanair, led by Michael O'Leary and which now has several other bases throughout the liberalized European economy, made 3 unsuccessful bids for full takeover of Aer Lingus (the last of which was in 2013). The main explanation of Ryanair's failed takeover bids lies in the role of the Irish state, which wanted the acquisition blocked. It also lies in the role of European Commission's regulatory authorities in DG Competition that blocked the proposed deals, despite the various remedies proposed by Ryanair. Politics – at the domestic level and at the supranational level in Europe – ultimately mattered.

Now, let's fast forward to 2015 where IAG is trying to takeover Aer Lingus. With the recent green light indicated by the Irish government on May 26 (see: http://www.irishtimes.com/business/transport-and-tourism/cabinet-agrees-to-sell-state-s-25-stake-in-aer-lingus-1.2226310), this deal appears to be set. Why?

Beyond the price offered, the Irish state is happy that IAG has given a commitment to the slots in Heathrow and offered a guarantee for smaller airports beyond Dublin that Aer Lingus flies out of (Cork and Shannon). At this stage, the deal is still subject to both other shareholder approval (including Ryanair which owns close to 30% of Aer Lingus) and, perhaps more importantly, regulatory approval of the European Commission. But considering that the Commission has never rejected a deal involving BA/Iberia/IAG as examined in the book, it is likely to approve the deal of the 'trusted friend' it has in IAG.

To be fair, talented operators who lead firms – such as Willie Walsh of IAG – are important, if not crucial, in explaining firms' vision for global expansion.

But such leaders who envisage having their firms enter into other parts of Europe or the world by merging and acquiring only have to ask three essential questions that have less to do with business and more to do with politics. Do the rules allow for it? Will states facilitate it? And will regulators ultimately approve it?

If the answer to these is 'yes,' then it is smooth flying going forward. If the answer is 'no' to any of them, expect significant turbulence.

When it comes to IAG's takeover of Aer Lingus, sit back and relax: it's unlikely to be a bumpy flight.