Opinion: Consolidation of the online gambling industry

Few can have missed the recent run of M&A activity in the UK online gambling sector, with deals such as that involving Paddy Power and Betfair. Plenty have commented on the reasons for this wave of consolidation activity. In this article, gambling consultant Steve Donoughue, who runs business and political strategy consultancy www.GamblingConsultant.co.uk Limited and is the Secretariat of the Parliamentary All Party Betting & Gaming Group, gives his opinion on what gambling industry consolidation means for operators, regulators and consumers.

If you've been living under a stone for the last few months you will probably be unaware of some big mergers happening in the world of gambling: Ladbrokes and Coral, Betfair and Paddy Power and the acquisition of Bwin Party, itself the result of a merger, by GVC Holdings, owners of Sportingbet. This follows on from last year's acquisition of Full Tilt and PokerStars by Amaya and the Intertain Group buying Gamesys this year and the Vera & John Group last year. If you've got money - and money is quite cheap these days - it supposedly pays to M&A.

Any basic economics qualification will teach you that when you are in a market of generic products, and let's face it, one roulette wheel is much the same as another, price is too often the only thing that can give you comparative advantage, and to counter this you need scale. As costs have increased in the industry and margins have been squeezed, buying marketshare can be seen as the only way to ensure consistent profits. Anyone with a basic legal or accountancy qualification knows that a good run of mergers and acquisitions can put a whole brood of children through private school and so should not only be welcomed but thoroughly encouraged.

As a management consultant specialising in business and political strategy in the gambling industry for the last twenty years, I am no fan of industry consolidation. It happened in the land-based industry decades ago and is now, after years of conference talks about it being bound to happen, finally kicking off big time in the online industry. My problem is that it usually doesn't work and it's bad for regulators and bad for customers.

The figure bandied about is that 80% of mergers and acquisitions don't work. I suspect that the real definition is that 80% don't achieve the financial goals that the M&A was expected to achieve and that's because these goals are calculated on a spreadsheet and not on the office floor. The number one reason getting two companies to mould as one doesn't work is because of a mismatching of culture. Usually a key part of this is due to the focus of senior management being on 'making out like bandits' and not keeping their eyes on the ball, thus leaving it all up to middle management to take the strain and fight the battles as to who stays or goes and that is rarely done based on the value add they provide. I obviously have taken legal advice so as not to provide any live examples of this but what I can provide is one merger where cultural fit seems like a definite positive: Betty Power, as Paddy Power and Betfair's marriage has been called.

The senior management at Paddy Power have always struck me as intellectually superior to many of the dinosaurs that have lumbered across the savannah that we call the gambling industry. I think their track record speaks for itself on that, so it was with rare excitement that I heard they were going to get the gang back together. Betfair's CEO Breon Corcoran was once Paddy's COO and will be joining Paddy's CEO, Andy McCue, who joined Paddy Power a year after Breon became a Board Director in 2005. Now this history of working together means nothing if they hate each other; I don't know them, but I suspect they have a good relationship and this means an enormous amount in terms of dictating the new culture. Culture is what determines how well a company operates, how long its key staff stay and how quickly it learns from its mistakes. And it's set from the top. We all know that CEOs generally have a wide array of personality disorders, it's the extent to which this is replicated throughout the organisation that is of importance. Good guys do operate good companies, bad guys don't, just ask the man who flogs his donkey to make it work harder and then is surprised when it dies or runs away.

Another factor of critical importance is the fact that the two companies merging should complement each other rather than just duplicate each other. With Betty Power, Betfair's is a sophisticated product, Paddy Power's is more mass market. This means less people worrying about their future. It also means a more comprehensive product range being brought to market rather than just the same stuff just with more registered customers. If we look at Coral and Ladbrokes, there's a lot of duplication going on there. Additional economies of scale will be useful but who knows the internecine battles that will be erupting in every business unit. Dual branding could maintain historical allegiances and set the stage for conflict.

As for the customer, what do they get when the industry consolidates ever further? They get bored, that's what happens. We're seeing it already in the online industry due to our overly consolidated software supplier sector and dominance by just a handful of companies. As a judge in another trade publication's annual awards recently, I was shocked to see just how similar everybody's products were and more than that, just how lacking they were in innovation. We don't seem to have moved on in the last five years. It would appear that the investments made back then in software development are now being harvested and the operators are happy just to sit on their hands. We are lucky that we have an almost vertical demand curve for our products with some of our customers, but for some we are purely an indulgence. Treat them with complacency and they will go elsewhere for their fun and entertainment. Just have a look at the quality of video games out there and then look at the two-dimensional tedium of many of our products.

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My final gripe about consolidation is what it does to regulators. It gives them an easy life. They have less people to deal with, more chance of achieving industry consensus and big companies usually do much better at compliance. Regulators know that a listed company isn't going to risk it all because they can't be bothered to dot some regulatory 'i' or cross some licensing code 't', whereas a small start-up may just fail to do it because it hasn't got the resources, whether it be time or money. So what can be wrong with that?

Laziness - that's what's wrong. We need a certain level of dissent and distrust between operators and the regulator for the system to work at its best. Look at the land-based casino industry, heavily consolidated and according to the trade association, the National Casino Forum, there's a fabulous working arrangement between the handful of operators and the regulator. Yet look at the latest money laundering scandal, which involves the Rank Group. I'm 100% certain that at head office they didn't know that their AML policies weren't being abided by and it also looks like the Commission didn't know until the police got involved (in some of the cases at least). And this is my point: with consolidation comes the risk of capture. Not the traditional definition where the regulator gets captured by those who it wishes to regulate, but group capture, where everyone is so happily singing from the same song sheet that no one notices what is going on in the shadows.

We need a vibrant industry of many sizes and shapes not just a few amorphous blobs. Operators and suppliers need the conflict of competition to keep them lean and keen. Customers need choices and innovation to ensure they keep coming back. Regulators need to be kept on their toes so the industry's reputation doesn't get blemished. The only trouble is we are fighting the full force of economic theory and advisers needing school fees to prevent consolidation and that may prove an unstoppable force.

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Note: Steve writes in a purely personal capacity.