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NASDAQ/OMX Combination Puts Spotlight on Volume, Technology

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The NASDAQ/OMX deal marks a new chapter in exchange consolidation. However, traditional metrics such as market capitalization and value traded are not the most important criteria to assess this deal's impact.

NEWS ANALYSIS

Event

On 25 May 2007, the NASDAQ Stock Market and OMX, the Nordic exchange and technology group, announced they will combine operations in a cash and stock deal worth approximately $3.7 billion. The deal also promises cost savings, estimated at $100 million (two-thirds from the consolidation of IT operations). The combined entity, named the NASDAQ OMX Group, will have a market capitalization of $7.1 billion with NASDAQ shareholders owning 72% and OMX shareholders the remainder. The deal is subject to shareholder and regulatory approval, and possible rival bids, such as from the Dubai International Finance Center.

Analysis

This deal highlights the trend in investment services that Gartner describes as the bimodal market, where only "megafirms" with many connections or small firms with great agility will thrive. As this polarization increases, midsize firms and exchanges will disappear.

The NASDAQ/OMX combination follows many of the business case criteria advanced in previous exchange consolidation deals — regional expansion, asset type diversity, technology capture, liquidity and scale. The deal will benefit both entities. With OMX, NASDAQ gains:

- Improved standing in equity derivatives (something lacked by the London Stock Exchange, its earlier merger target)
- The capabilities of OMX's Genium platform for multiasset trading
- Commercial technology operations (OMX sells and maintains IT systems for 60 exchange clients across 50 countries.)

OMX will benefit from the financial backing of a large U.S. partner and avoid the fate of being left behind as European exchanges get bought.

As competition between traditional exchanges and new rivals — such as alternative trading systems (ATSs) and multilateral trading facilities (MTFs) — heats up, trading commissions are falling as the business model shifts to a flat fee per trade. Therefore, the daily traded volume becomes more important financially and technically. Messaging, trade and market data volumes are increasing exponentially and are subject to spikes, boosted by the use of automated trading algorithms. Many big exchanges have struggled to cope with recent spikes in volumes, and this trend will accelerate.

Successful (that is, profitable) exchanges will also need to maximize their access to customers. OMX is a pioneer in providing clients with a single point of access for the Nordic and Baltic exchanges it operates. As listing becomes more automated, the New York Stock Exchange/Euronext dominance of aggregate market capitalization (nearly $30 trillion) is likely less important and less secure. Moreover, in addition to establishing its own London presence, the NASDAQ OMX Group will also be able to take aim at traditional rivals such as the London Stock Exchange and Deutsche Boerse by possibly offering the Genium technology to new entrants.

RECOMMENDATIONS

Users of NASDAQ and OMX:

- Examine how the cost synergies for IT will be achieved. For example, check that the consolidation of platforms or data centers doesn't affect operational risk or other aspects of service-level agreements.
- Monitor the combined entities' financial situation. A large debt load (approximately $1.5 billion) might constrain NASDAQ OMX Group's ability to deliver further innovation if broad economic troubles arise.
- Continuously evaluate the cost advantages and other benefits offered by the combined firm compared to other regulated markets, ATSs and MTFs.

Other exchanges that use OMX technology:

- Check the proposed IT road map for the new entity for delays or changes to the rollout and support of OMX products and the platforms and architectures associated with them.

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RECOMMENDED READING

- "Exchange of the Future: Competitive Landscape" — Exchanges are increasingly defined by their IT performance and capabilities, as well as traditional measures such as liquidity. **By Peter Redshaw**
- "Expect Integration Issues to Challenge NYSE/Euronext Merger" — Gartner fails to see a clear rationale for an aggressive focus on cross-geography mergers. **By Peter Redshaw, David Furlonger and David Schehr**

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