Anticipated acquisition by Idox plc of Lalpac Limited

ME/4752/10

The OFT's decision on reference under section 33(1) given on 20 April 2011. Full text of decision published 19 May 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Idox plc** (Idox) is active in three main areas: software, recruitment, and information solutions. Within the area of software Idox delivers process management software including licensing to mainly local government customers across a broad range of departments. In the last financial year (to 31 October 2010) Idox reported revenues of £31.2m

2. **Lalpac Limited** (Lalpac) supplies licensing software to local government customers. Lalpac software covers a full range of licensing requirements, including liquor and premises licensing under the Licensing Act 2003, Taxi and Private Hire, General Licensing functions and the Gambling Act 2005. In the last financial year (to 31st March 2010) Lalpac's UK turnover was £1.4 million.

TRANSACTION

3. Idox proposes to acquire the entire issued share capital of Lalpac, whereupon Lalpac will cease to be a distinct enterprise. The completion of the merger is conditional on Idox receiving confirmation that the acquisition will not be referred to the Competition Commission for further investigation in accordance with the Enterprise Act 2002.

4. Idox notified the merger to the OFT on 2 March 2011, following receipt of a satisfactory submission the administrative deadline for a decision is 6 May 2011.

JURISDICTION

5. As a result of this transaction Idox and Lalpac will cease to be distinct. The parties overlap in the supply of licensing software to local government in the UK, with a combined share of supply of legacy contracts of 45 per cent (with an increment of 20 per cent). The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is therefore met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

Background

6. In its decision on Capita/IBS[1] the Competition Commission (CC) concluded that there was an absence of demand- and supply-side substitution between revenues and benefits (R&B) and social housing software applications. As R&B software is included by the parties in an integrated PMS market the conclusions of the CC also point towards narrower markets for individual PMS products. This is considered further below.

Product market

7. The parties are both active in the provision of licensing software and related services to Local Authorities (LAs). Licensing software is a type of process management software which enables LAs to manage their statutory functions in relation to a variety of licensing responsibilities (for example; taxis, public houses, hotels and restaurants, betting shops etc). The main licensing responsibilities for LAs are liquor licences and taxi licences. Process Management Software (PMS) is a catch all term to cover the various software applications available for all the functions of local government including R&B, Assets, Social Care, Land and Property and Regulatory Services. Licensing software is just one type of PMS. It can be

[1] Capita Group plc/IBS OPENsystems plc —Competition Commission Report — 2009

supplied as part of a bundled or integrated PMS service,[2] as supplied by Idox, or as a standalone PMS product as supplied by Lalpac.

8. The parties submit that the anticipated transaction should be assessed by reference to the overall provision of PMS to LAs. However, evidence put to the OFT suggests that the relevant product market should be defined by reference to the supply of licensing software as a standalone PMS product.

9. From a demand side perspective, the OFT's investigation shows that the highly specific nature of licensing software makes it very unlikely for LAs to consider switching to an alternative PMS product following a SSNIP.[3]

10. In support of a wider market definition, the parties mention an increasing trend towards local government customers requiring integrated PMS services from suppliers. They suggest that suppliers of such integrated packages may constrain providers of individual software products. Set against this, there is evidence of LAs continuing to contract separately for licensing software from other PMS suppliers. In addition LAs presented examples where they had previously purchased an integrated PMS service which included a licensing application and then had subsequently changed suppliers for licensing software only.

11. From a supply side perspective, the parties argue that many firms offer a range of PMS services to LAs and any PMS provider has the necessary skills to develop software packages within new segments.

12. The parties have stated that while three providers, Idox, Northgate and Civica, currently supply licensing software as part of an integrated PMS service there are other major PMS software suppliers such as Capita and Orchard who do not currently supply licensing software as part of their PMS service. [ ]. The OFT's market testing suggests that while for current PMS suppliers the barriers to entry to producing licensing software are not insurmountable the low value of licensing software contracts and the low number of contracts competed for per year meant that they were unlikely to enter in response to a five per cent price increase. In addition there are a number of firms who supply only licensing software to LAs who would face high barriers to entry to supplying an integrated PMS product.

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[2] That is a PMS service which includes a variety of PMS products to meet the software needs of some or all of a LA functions.

[3] A small but significant non-transitory increase in price (SSNIP), usually defined as five per cent.

13. The OFT considers that there may be some constraint from demand for integrated PMS services on providers of licensing only software but that this is not sufficient to broaden the market.

14. On the supply-side while there are firms who provide integrated PMS services and separate licensing software there are also numerous firms who only provide integrated PMS services which do not include licensing and others who provide only specialist licensing software.

15. In conclusion, therefore, taking a cautious approach, the OFT has considered the impact of the contemplated transaction on the basis of the narrowest frame of reference, namely the provision of licensing software and related services to local government.

Geographic market

16. The parties submit that the relevant geographic market in which to assess the transaction is national. This is consistent with the conclusions of the CC on the geographic market for the provision of R&B software in its decision on Capita/IBS. The OFT has received no evidence to dispute the representations made by the parties or the conclusions of the CC, and as such considers it appropriate to examine the licensing software market on a national basis.

HORIZONTAL UNILATERAL EFFECTS

17. The parties overlap in the supply of licensing software to LAs.

18. The parties provided market share data for the supply of licensing software to LAs in the UK. The OFT's investigation showed that the market is characterised by fixed term contracts which are negotiated for an initial term of three to five years but that in practice roll over on an annual basis for a longer period after the initial term. The parties claim that an analysis of legacy market shares therefore does not necessarily provide an accurate view of the likely impact of the merger.

Market shares of legacy contracts

19. The parties supplied the OFT with estimated shares of supply of legacy contracts, that is, existing business for licensing software to LAs.

Table 1: Shares of supply of legacy contracts by number of installations of licensing software — both as part of an integrated PMS service and on a standalone basis

	Number of installations	Percentage of installations
Idox	102	25
Lalpac	80	20
Combined	**182**	**45**
Northgate	93	23
Civica	58	14
LicenceFlo/Flovate	25	6
Diamond	14	4
In-house	9	2
Swift-LG	7	2
Other	17	4
Total	405	100

Source: Parties' submission based on SOCITM data as of 10/02/2011[4]

20. The OFT notes that, on this measure, Idox is the largest operator in the market with a 25 per cent market share, with Northgate the second largest at 23 per cent and Lalpac the third largest with 20 per cent share.

21. The OFT uses the 'hypothetical monopolist' test as a tool to check that a product market is not defined too narrowly, and the relevant market may not always be the narrowest market that meets this test.[5] That said, in interpreting information on shares of the relevant market, the OFT may have regard to how widely the market is drawn: a low combined share of the narrowest market satisfying the hypothetical monopolist test will be a better indicator of the absence of potential competition concerns than the same share on a market that is drawn more widely.[6] In this regard, although the market shares in Table 1 are not based on the narrowest market satisfying the hypothetical monopolist test, in calculating them the

[4] SOCITM is the association for ICT and related professionals in the public and third sectors. The SOCITM data records LA licensing users and is based on responses to customer surveys but can in addition be updated by LAs through a live database.
[5] Merger Assessment Guidelines, paragraph 5.2.3.
[6] Merger Assessment Guidelines, paragraph 5.3.2.

OFT has drawn the market narrowly. On this basis, the parties' combined market share of 45 per cent and the increment to it are high enough to give the OFT cause for concern over unilateral effects.

22. As noted at paragraph 17 above, the parties submitted that legacy market shares were not an accurate representation of competition. They explained that where a customer requires new licensing software or replacement of existing software, the customer invites tenders and generally awards a contract of between three to five years to the winning bidder. Once the contract has been awarded, the opportunity for further competition for licensing applications or services in relation to that customer is very limited until the contract is put out to tender again. In addition, customers indicated that in many cases contracts are 'rolled over' beyond the initial contracted term, and as such the actual length of time between tendering is generally longer than three to five years.

23. The OFT has seen no evidence pointing towards any competitive interaction during a given contractual period. Further, given the length of the contracts negotiated in this instance, and the general practice of rolling over contracts after the initial period, the OFT considers it likely that market shares estimated on a legacy basis may give a distorted picture of competition. In addition, the OFT is of the view that issues relating to possible incumbency advantage are captured in the set of data based on winners of new businesses. Therefore, the OFT considers that in this instance it is appropriate to place more weight on competition for new contracts/business in order to assess the level of competition between the parties and their competitors in the supply of licensing software. This approach is consistent with that taken by the CC and OFT in previous cases (Capita/IBS and Northgate/Anite).[7]

24. For this reason, the OFT has examined data on new business won below.

New businesses

25. Shares of supply based on the number of new contracts won as identified by the parties, based on SOCITM data, for the 18 months prior to March 2011 are set out in Table 2 below.

[7] Anticipated acquisition by Northgate Information Solutions UK Limited of Anite Public Sector Holdings Limited OFT 2008.

Table 2: Winners of new business for the 18 months prior to March 2011

Type of product		Lalpac	Idox	Northgate	Civica	Total
Integrated PMS services including licensing software	Number	[ ]	[ ]	[ ]	[ ]	[ ]
	Per cent	0	41	15	44	100
Licensing software only	Number	[ ]	[ ]	[ ]	[ ]	[ ]
	Per cent	67	17	0	17	100
Total	**Number**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
	Per cent	**10**	**38**	**13**	**40**	**100**

Source: Parties' submission based on SOCITM data

26. Although Table 2 suggests that the parties' combined market share of new business is higher than their combined market share of legacy contracts, the data indicates that Lalpac won only 10 per cent of contracts where licensing software was included. Idox and Civica both won approximately 40 per cent of contracts and Northgate won 13 per cent of contracts. Third parties confirm that Civica and Northgate are considered to be close competitors to Idox for integrated PMS services that include licensing software.

27. Moreover, the data reveals that the competitive constraint placed on Idox by Lalpac is of limited significance relative to other constraints operating within the market.

28. In particular, of the [ ] contracts competed for in the 18 months prior to March 2011 over 80 per cent ([ ] contracts) were for integrated PMS services including licensing and Idox won over 40 per cent of these ([ ] contracts). There is no evidence of Lalpac competing directly for licensing software within an integrated PMS product or jointly bidding with a provider of other PMS services in order to compete with Idox. For customers who purchase an integrated PMS services (as most do) Idox competes primarily with Northgate and Civica and this was confirmed by both customers and competitors in their responses to the OFT.

29. The data further reveals that the constraint placed by Idox on Lalpac is limited. Of the [ ] contracts for standalone licensing software in Table 2, Idox and Lalpac only competed directly on [ ] occasions, winning [ ] each. Consistent with this, Idox and Lalpac further supplied evidence on all contracts for standalone licensing software that each had competed for since 2006. Of the [ ] such contracts, Idox and Lalpac had only competed against each other on [ ] occasions (20 per cent). In these [ ] cases Idox, Lalpac and Northgate each won [ ], indicating that — on the few occasions that they competed head-to-head — Northgate was as close a competitor to the parties as they were to each other. Idox submitted that on average the value to it of a standalone licensing tender is £ [ ] over the five year term of the contract, approximately £ [ ] per annum. Lalpac's contracts have a similar value.

30. The OFT's market testing corroborates the view that emerges from the bidding data. The majority of LA responses stated that they did not consider Idox and Lalpac to be close competitors. One LA noted that Lalpac are an acknowledged specialist in the licensing field and in particular that 'Lalpac seem to focus primarily on the Licensing area..., whereas Idox have a much wider business area coverage including Planning, Environmental Health, etc.' A third party commented that while other suppliers had developed licensing modules, they tended to be a 'bolt-on' to their core software and were not as effective. Competitors in licensing software also considered that while Idox and Lalpac are competitors they are not close competitors. Indeed, third parties considered Civica and Northgate as closer competitors to Idox, since all supplied integrated PMS services, than Lalpac.

Conclusion

31. On the basis of the above, the OFT concludes that Idox and Lalpac do not place a significant competitive constraint on each other. Accordingly, the OFT does not consider that the merger gives rise to a realistic prospect of a substantial lessening of competition on the basis of unilateral effects in the market for the supply of licensing software to local government.

BARRIERS TO ENTRY AND EXPANSION

32. The parties submit that barriers to entry into the market for the provision of licensing software are low. The parties highlighted the entry of Flovate with the LicenseFlo product as an example of entry within the last five years. The parties state that for a company already operating in the PMS market the development of a licensing software product would take approximately six months and cost between £50,000 and £250,000. The parties put forward Capita, Oracle, and Orchard as current PMS suppliers to local government who could easily enter the market for licensing software.

33. A third party, [ ], considered the main barrier to entry to be the need to have an established reputation for providing software to local government; this was also highlighted by several other third parties.

34. With respect to those companies already supplying LAs with software, comments received by the OFT suggest that barriers to entry are not insurmountable. The OFT received estimates for the cost of entry ranging from £250,000 to £500,000 with development time of nine to12 months. However potential entrants also stated that the low value of licensing software contracts and the low number of contracts competed for per year meant that they were unlikely to enter in response to a five per cent price increase.

35. In terms of barriers to expansion the parties state that the nature of the licensing software product means that firms already supplying the product do not face significant barriers to expansion. In its decision on Capita/IBS the CC considered the barriers to expansion were not insurmountable for the two main competitors in the market for the supply of R&B software to LAs.

36. Overall, given the OFT's conclusion above on unilateral effects, it has not needed to conclude on whether entry and expansion would be sufficient to countervail any potential substantial lessening of competition.

THIRD PARTY VIEWS

37. Where relevant third party comments have been included above. The OFT did not receive any significant competition concerns from competitors, with at least one third party responding that the parties are not close competitors. The majority of customers were also largely unconcerned by the merger, though some were concerned that they may be forced to migrate from the Lalpac product to the Idox product post-merger. Set against this Idox told the OFT that they will continue to offer the Lalpac product post merger and the OFT's analysis of potential unilateral effects does not suggest that Idox would have sufficient market power post-merger to force customers to migrate.

ASSESSMENT

38. Both parties are active in the provision of IT solutions to Local Authorities in the UK. The OFT considers the impact of the transaction on the basis of the narrowest frame of reference, namely the provision of licensing software.

39. The parties' combined market share of legacy contracts is high but the OFT considers that in this case the effect of the merger on competition is best considered in respect of new contracts.

40. Here the OFT notes that of the contracts including licensing software competed for in the last 18 months, the parties have only competed directly in five per cent of cases. Lalpac has never competed for an integrated PMS contract, and indeed has no integrated PMS service to offer, and in the last five years the parties only competed directly for 20 per cent of all contracts for standalone licensing software contracts for LAs. In these contracts, Northgate was as close a competitor to the parties as they were to each other. The OFT therefore believes that Idox and Lalpac do not place a significant competitive constraint on each other.

41. No material third party concerns were raised with respect to the proposed transaction.

42. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

43. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.