

Anticipated acquisition by Cegedim SA of Enigma Health UK Plc

The OFT's decision on reference under section 22 given on 22 March 2005. Full text of decision published 25 April 2005

Square brackets indicates text removed at the request of the parties or third parties for reasons of commercial confidentiality

PARTIES

1. **Cegedim SA** (Cegedim) is based in France and is mainly active in the provision of software applications and IT services to the healthcare market, including doctors, pharmacists and pharmaceutical companies. Cegedim owns NDC Health Limited (NDC)¹ and Infopharm Limited. NDC supplies pharmacy management systems, i.e. software applications used by retail pharmacies to assist in their dispensing and re-ordering routines including reimbursement for prescriptions. These systems can also be used to collect anonymised prescription data which can be 'sold' to data providers. Infopharm is a data provider active in the supply of specialised pharmaceutical data.
2. **Enigma Health UK Plc (Enigma)** was pre-merger owned by UniChem Limited, itself a wholly owned subsidiary of Alliance UniChem Plc. Enigma's UK turnover amounted to £4.2 million in the calendar year 2003. It supplies software applications to retail pharmacies to assist in their dispensing and re-ordering routines.

TRANSACTION

3. On 10 December 2004 Cegedim, through a special purpose vehicle, unconditionally acquired the entire issued share capital of Enigma. The extended statutory deadline is 13 April 2005 and the administrative timetable expires 22 March 2005.

¹ Now named Cegedim RX Ltd.

JURISDICTION

4. As a result of this transaction Cegedim and Enigma have ceased to be distinct. The parties overlap in the supply of pharmacy management systems to pharmacies in the UK with a share of supply around 50 per cent. Consequently, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. A relevant merger situation has been created.

RELEVANT MARKET

Product market

5. As described above, NDC and Enigma overlap in the supply of pharmacy management systems to pharmacies in the UK. These systems can be (and are) also used to collect information about prescriptions dispensed which can be marketed and sold by the pharmacies to data providers. There is also a potential vertical effect arising from this merger since Cegedim owns Infopharm, a provider of specialised pharmaceutical data services active in the UK. Each of these markets is considered separately below.

Supply of pharmacy management systems

6. Pharmacy management systems are used by retail pharmacies to assist in their dispensing and re-ordering routines. Their most important function is to check the financial validity and accuracy of the pharmacist's claim for reimbursement for drugs dispensed under prescription. The systems also check for possible adverse reactions against drugs previously dispensed to the patient; monitors the levels of stock held by the pharmacist; and is the means by which a pharmacist can make orders to their full line pharmaceutical wholesaler (or 'short liner' where these suppliers are used).
7. In assessing the appropriate scope of the products and services relevant to the merger situation, the OFT has considered whether, as Cegedim has contended:
 - GP management software could be considered a substitute for pharmacy management systems, and
 - whether DOS and Windows based pharmacy management systems should be considered to fall within the same frame of reference.
8. Notwithstanding a certain degree of functional similarity between GP and pharmacy systems, our investigation has revealed that GP systems - which are primarily electronic patient records, although including details of medicines prescribed – are not sufficient demand side substitutes for pharmacy systems.

The most compelling evidence is that dispensing doctors tend to have two separate software systems for their GP records and pharmacy records rather than expanding one system that fulfils both functions. As regards supply side substitutability, third parties estimate development costs associated with modifying GP system software to include a pharmacy system module to be in the region of £500,000. GP systems providers are therefore more appropriately considered as potential entrants rather than as supply side substitutes.

9. With regard to DOS- or Windows-based systems, it has been put to the OFT that the bulk of DOS systems could in any event run on Windows. Moreover, most software providers seem to offer both a DOS- and a Windows-based product, and continuously upgrade their customers' systems. Also, some DOS based pharmacy software systems are in the process of being replaced by Windows systems to comply with the National Programme for Information Technology (NPfIT)². More than £50 million is available from the Department of Health to help this transition. As a result of these factors, it appears appropriate to regard DOS- and Windows-based systems under the same frame of reference.

Procuring the supply of prescription data

10. The parties' pharmacy software products are used to produce prescription data, which is supplied to specialised pharmaceutical data providers, such as IMS and Taylor Nelson Sofres (TNS), which collate and sell that information in the form of marketing reports to pharmaceutical manufacturers, healthcare companies, and the NHS. This prescription data measures broad movement of pharmaceutical products out of pharmacies and into the hands of patients at the prescription (doctor) level. It is primarily used for marketing purposes and to reward sales staff. Generally, pharmacies will be 'recruited' to supply this data by the supplier of its pharmacy management system. Pharmacies receive a payment for providing this data, either directly from the data provider or indirectly by means of a discount to the cost of the pharmacy management system from the system supplier.
11. The Monopolies and Merger Commission (MMC) - now the Competition Commission (CC) - in 1999 considered the supply of specialised pharmaceutical

² National Programme for IT in the NHS (NPfIT) aims to create a new computer network to link up GPs, hospitals and pharmacies, to improve sharing of patients' records across the NHS. Health care records, appointment details, prescription information, and up-to-date research into illnesses and treatment will be stored electronically and accessible to patients and health professionals.

data services.³ The MMC defined the relevant frame of reference as specialised pharmaceutical data services and comprising two basic types of services: wholesale data services and prescription data services. The former is based on data relating to deliveries of pharmaceuticals to pharmacies which is provided by wholesalers.

12. Given that the MMC found in 1999 that prescription data services had the potential to compete with wholesale data services, the OFT has considered whether prescription data and wholesale data are substitutable. It notes, however, that competition between prescription data services and wholesale data services does not appear to have materialised to date.
13. Furthermore, the extent to which wholesale data is substitutable for prescription data appear to be limited. Both the parties and third parties confirm that prescription data provides more disaggregated information than wholesale data and therefore enables the provision of data services with a high degree of granularity, notably GP-level prescription data services which are provided in relation to groups of 50 GPs.
14. It has been submitted to us that data from 'multiples' (defined as pharmacies in chains of ten or more) would not amount to a sufficient substitute for data from independent pharmacies, as these multiples tend to have group policies in the way that they dispense generic prescriptions. Hence the data collected from each multiple would tend to reflect these separate commercial policies. However, other third party data providers, for example IMS, do not distinguish further between multiples and independent pharmacies. On balance, it therefore does not appear that prescription data supplied by independent pharmacies and multiples respectively would constitute separate frames of reference.

Supply of specialised pharmaceutical data

15. Cegedim is, through Infopharm, also active in the supply of specialised pharmaceutical data services to pharmaceutical manufacturers and healthcare companies. Pharmaceutical business information is important to pharmaceutical and healthcare companies in order to assess their market position, identify areas of product development and focus their sales activities. Pharmaceutical data services can be based on prescription data or on wholesale data. The extent to which these two data sources are substitutable is considered in the subsequent paragraphs. Infopharm currently only offers wholesale data services.

³ IMS Health Inc. and Pharmaceutical Marketing Services Inc. A report on the merger situation. 25 February 1999, Cm 4261. The OFT has also recently assessed the sector as part of the review of undertakings given by IMS Health as a result of the 1999 MMC report, see press release 32/05, 18 February 2005.

Frames of reference

16. In light of the above considerations, the competition assessment will focus on the following product frames of reference:

- supply of pharmacy management systems
- procuring the supply of prescription data
- supply of prescription data services.

Geographic scope

Supply of pharmacy management systems

17. Both NDC and Enigma supply nationally. While individual pharmacies or local chains could source their pharmacy management software locally, larger chains would require software suppliers that provide national coverage for installation and servicing. From the supply side, overseas systems suppliers may be in a position to provide pharmacy management systems in the UK.⁴ However, the need to include specific drug tariff prices and wholesaler product ordering codes – and the time and cost involved in doing so - suggests that those companies not currently operating in the UK are more appropriately considered as potential new entrants than as offering supply side substitution. The geographic frame of reference is therefore considered to be UK wide.

Procurement of prescription data and the supply of specialised pharmaceutical data

18. Although purchasers of prescription data may require data in relation to particular regions and localities, these areas can be in any part of the UK since data service providers offer nationwide coverage for their services. Accordingly, the geographic frame of reference for the procurement of prescription data and the supply of specialised pharmaceutical data should also be considered as UK wide.

HORIZONTAL ISSUES

Pharmacy management systems

19. The shares of supply by number of terminals is set out in Table 1 below

⁴ For example Systems Solutions, which supplies pharmacy management software to Boots, is based in Ireland.

Table 1: Share of supply, by terminal numbers

Supplier	Number of dispensing terminals	Share of supply
NDC	2,070	17.0%
Enigma	4,176	34.3%
Link (AAH)	3,440	28.3%
Hadley Healthcare	630	5.2%
Systems Solutions	1,268	10.4%
Park Systems	350	2.9%
Others	230	1.9%
Total	12,164	100.0%
Cegedim post-merger	6,246	51.3%

Source: the parties

20. This shows that, post-merger, Cegedim is the largest provider of pharmacy management systems, to just over 50 per cent of pharmacies with an increment of 17 per cent. The next largest competitor is Link, the pharmacy management software supplied by the pharmaceutical wholesaler AAH, with just under 30 per cent of all dispensing terminals.
21. Considering the counterfactual, the OFT notes that some of the available evidence indicates that Enigma and NDC may not have been each other's closest competitors pre-merger. It would appear that in 2004, Enigma was more closely competing with the second largest provider of pharmacy management systems, Link, not NDC. There is also evidence to suggest that Enigma may not have been an effective competitor going forward on the basis that its new Windows-based software product is perceived as weak.⁵
22. Post-merger there will remain three competitors which have a market position of some significance – Link, Systems Solutions and Hadley Healthcare. Furthermore, although it has been submitted that barriers to entry exist in the form of high entry costs (the parties estimate that product development costs for a new entrant to gain a 5 per cent share of supply could amount to £1.2 million) and switching costs, this argument is undermined by the fact that there has been new entry and switching on a material scale. For example, recent new entrants include Software Solutions, which supplies the Boots chain of chemists and RX Systems, which is linked to the pharmaceutical wholesaler, Phoenix. In terms of switching, Tesco switched from NDC to Hadley Healthcare in 2003, Boots switched from its own legacy system to Software Solutions in 2004, North West Co-op from Enigma to Hadley Healthcare in 2002 and Howard & Palmer moved from Enigma

⁵ Cegedim considers that the product was rushed to market before it was completely developed.

to AAH's 'Link' System in 2004. In addition, Rowlands (with some 350 outlets) has recently indicated it will switch from Enigma to RX Systems. It has been submitted to us that, in general, independent pharmacies face lower switching costs than chains.

23. Third parties have submitted that ownership links between pharmaceutical wholesalers and major pharmacy management software providers have in the past acted as a barrier to entry and potentially distorted competition in the supply of pharmacy management software.⁶ The OFT has been told that historically at least, wholesalers would offer support to the pharmacy, such as the provision of hardware or software systems at reduced prices or free of charge, in return for continued pharmacy custom from that wholesaler. While Cegedim has told us, that Enigma at least was not run on this basis by UniChem, the acquisition of Enigma by Cegedim has removed the vertical link that previously existed between Enigma and UniChem. This might be expected to foster competition in the supply of pharmacy management software to UniChem's wholesale customers in the medium to long term and therefore could provide an opportunity for a new entrant to acquire market share, or for an existing supplier to expand its operations. UniChem's wholesale customers account for around 7 per cent of all management systems.
24. Finally, although some customers expressed concerns about the impact of the merger in relation to the supply of pharmacy management systems, the majority were unconcerned.

Procuring the supply of prescription data

25. As mentioned above, pharmacies are usually recruited to supply prescription data by the supplier of its pharmacy management system. In turn, the system suppliers tend to have data supply agreements with the major data providers, of which there are currently only two, IMS and TNS. IMS has data supply agreements with both Enigma (effective till []) and NDC (until []) - as well as with other system suppliers. The Enigma/NDC agreements set out the detail of the information to be provided and the standards of accuracy that must be met. TNS acquired data from [].
26. In terms of shares of supply, there are no precise figures but taking into account the various forms of direct supply of data,⁷ it might be expected that Cegedim's potential share of the supply of prescription data would be lower than its share of

⁶ For example, the 'Link' pharmacy management systems is associated with the pharmaceutical wholesaler AAH, while Enigma was pre-merger part of UniChem.

⁷ It should be noted that only about 70 per cent of pharmacies using Enigma's software also supply prescription data. IMS also has direct data contracts with a number of substantial pharmacy chains (including []).

the supply of pharmacy management systems. Moreover, the data itself is 'owned' by the pharmacy and so can only be supplied with the consent of the pharmacy concerned; this seems to be reflected in the fact that the pharmacies receive considerably more than the systems providers for supplying this data.

27. Currently, IMS sources data from about [5000 – 7000] pharmacies, whereas TNS obtains data from about [500 – 1000] pharmacies. IMS and TNS currently appear to be the only two purchasers of prescription data from the pharmacies. Accordingly, IMS currently holds a near-monopsony position in this segment and therefore enjoys strong negotiating power vis-à-vis the parties.

Supply of pharmaceutical data products

28. There is no horizontal issue in this sector since Enigma did not supply any pharmaceutical data services pre-merger. The potential for vertical effects is considered below.

Buyer power

29. Larger pharmacy chains may well enjoy a degree of buyer power over the pharmacy systems suppliers, and be able to use this in the negotiation of both the terms of supply of the systems and the data being provided through those systems. Some customers also suggested that they regularly monitor prices charged by their suppliers' competitors. While buyer power might be limited to an extent by switching costs, the examples mentioned above suggest that pharmacy chains would consider and opt for alternatives, if prices increased.

VERTICAL ISSUES

30. As a result of the merger, the parties supply pharmacy management systems to just over 50 per cent of UK pharmacies. As mentioned above, these systems are also used to provide anonymised prescription data to data providers (IMS and TNS). Cegedim also operates downstream, in that its subsidiary, Infopharm provides wholesale data services.
31. Some third parties have submitted that Cegedim would post-merger be able and have the incentive to foreclose their access to prescription data, in order to offer its own prescription data services. Foreclosure could take the form of a refusal to supply or degradation in the quality of data in terms of substance and timeliness. This, in turn, could prevent the data service providers providing prescription data services at all or reduce the quality of such services because they no longer have access to a sufficiently wide sample of pharmacies. It has been argued that it

would be much more costly to collect the necessary data directly from the individual pharmacies.

32. In the short to medium term, the contracts between NDC and Enigma and the prescription data providers will remain in place for a number of years. This would prevent any immediate foreclosure by the parties. The contracts prescribe quality and timeliness of the data supply, prohibiting any immediate foreclosure or deterioration of the data quality and/or timely delivery.
33. Beyond that timescale, the OFT does not believe that Cegedim has the ability to foreclose TNS []. IMS, however, requires a [] sample of pharmacies for the services it offers and accordingly the OFT has accepted in carrying out its analysis that Cegedim may have the ability to adversely affect IMS' product quality by foreclosing its access to prescription data from Cegedim-supplied pharmacies.
34. In terms of incentives for foreclosure, it appears, on the basis of the available data, that by foreclosing IMS, Cegedim would have to forego annual revenues of around £[]. But Cegedim would continue to face outgoings of about £[] (on the basis of the current payments to pharmacies). Against this, the value of IMS' services offering based on prescription data is at most £[] (and may be less than £[]). On the basis of this data, the OFT does not believe that Cegedim would have the incentive to foreclose. At most, it would forego upstream revenues of £[] to gain gross downstream profits of at most £ [] (i.e. £[], less than annual outgoings of £[]). However, this does not take into account any additional costs that Cegedim would face in supplying pharmaceutical data services based on prescription data, such as model development and marketing expenses.⁸ Moreover, the suggested profits assume that Cegedim would be able to fully foreclose IMS and take its entire market share. This must be a 'bold' assumption given that IMS would continue to have access to all of the pharmacies that are not currently supplied by Cegedim as well as those pharmacy customers with which it has direct data arrangements. On more realistic assumptions on available revenues from the product in question, and the share of that that Cegedim may capture, the foreclosure strategy would actually result in losses for the parties.
35. [], there is no evidence in the parties' business documents to suggest that this transaction was motivated by an intention to foreclose downstream. The main rationale for the merger appears to be the achievement of economies of scale and to turn around Enigma's business, which is currently loss-making.
36. The OFT, for the reasons set out above, believes that Cegedim post-merger does not have sufficient incentive to foreclose the supply of pharmaceutical data.

⁸ [].

Indeed, Cegedim's (actual or potential) entry in the prescription data services sector might even increase competition vis-à-vis IMS and TNS in this sector.

THIRD PARTY VIEWS

37. On the supply of pharmacy management software, the response rate to our inquiries was low and the majority of respondents were unconcerned. There were more vociferous concerns as regards the ability to continue to access prescription data from pharmacies supplied by the parties which are addressed above.

ASSESSMENT

38. This acquisition results in a merger of the first and third largest providers of pharmacy software systems, with the new entity having just above 50 per cent share of supply and an increment of 17 per cent. These software products are also used to collect prescription data from the pharmacy, which is in turn collected and sold by data providers to the pharmaceutical and health industry.
39. Notwithstanding the parties' share of supply in pharmacy management systems post-merger, there will remain three competitors with a material market position. There is also evidence of new entry and switching which is sufficient to counteract claims that barriers to entry are high. Furthermore, this transaction removed the vertical link between the target and the pharmaceutical wholesaler UniChem which might previously have acted as a barrier to entry to those software providers not associated with a major pharmaceutical wholesaler. Moreover, Enigma has encountered some problems in developing its new Windows-based product and may therefore not have been a strong constraint on NDC going forward.
40. Third parties have been largely unconcerned about the horizontal effect of this transaction.
41. In light of the above considerations, the OFT does not believe that it is or may be the case that this transaction may be expected to result in a significant lessening of competition in the supply of pharmacy management software systems.
42. More concern was expressed about the vertical effect of the transaction and possible foreclosure resulting from Cegedim's ability to deny access to prescription data extracted by the pharmacy management software. However, the current contracts between the NDC and Enigma and the data providers will remain in place for a number of years. These contracts will prevent foreclosure in the short to medium term as they prescribe data quality and timeliness of supply. Longer term, on the basis of the available data on the total size of the market for

prescription data products and the cost of new entry, it does not appear rational for Cegedim to foreclose the providers of prescription data products downstream and seek to replace these with its own prescription database. Such a strategy would seem even less plausible if additional costs for product development and marketing are taken into consideration. Moreover, data providers would still have the means and ability to source data from pharmacies not supplied with a pharmacy management system by Cegedim as well as through direct supply contracts with pharmacies that are supplied by Cegedim. Furthermore, entry by Cegedim into the prescription data services sector should introduce competition which does currently not appear to be a significant feature in the market for the provision of data.

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

DECISION

44. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.