
Completed acquisition by Northgate Information Solutions plc of Services and Systems Solutions Ltd

The OFT's decision on reference under section 22 given on 5 May 2005. Full text of decision published 16 May 2005.

Please note that square brackets indicate information excised, or exact figures replaced by a range, for reasons of commercial confidentiality.

PARTIES

1. **Northgate Information Solutions plc** (Northgate) is a UK company operating in the supply of software and IT services to public and private customers in the UK, US, Ireland, Australia, New Zealand, China and Singapore. It licences software applications and provides IT services, hardware maintenance and payroll outsourcing.
2. **Service and Systems Solutions Ltd** (SX3) is an indirect subsidiary of Viridian Group plc. It provides software and IT services, primarily focused on the UK public sector. In the financial year ending 31 March 2004, its turnover was £117.3 million, of which approximately £1.2 million was generated outside the UK.

TRANSACTION

3. The transaction completed on 25 April 2005. The statutory deadline therefore expires on 24 August 2005; the administrative timetable expires on 27 May 2005.

JURISDICTION

4. As a result of this transaction Northgate and SX3 have ceased to be distinct. The UK turnover of SX3 exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

Product scope

5. The parties overlap in the provision of software and ancillary services to local authorities (and housing associations) for:
 - revenues and benefits, which are used for back-office management of council tax, domestic rates, housing benefits and council tax benefits;
 - social housing, which are used by local authorities and housing association for the management of social housing stock;
 - land and property, involving the management of local authority regeneration and planning functions; and
 - customer relationship management (CRM)/ e-government - to help local authorities to respond to customer needs and monitor outputs.
6. There appears to be little demand-side substitutability between the different categories of software products mentioned above. Most local authorities seem to have a need for software from each of the categories. One third party suggested further segmenting 'land and property' into planning and building control which could be considered to be separate from other software in land and property. However, the data supplied by the parties appears to indicate that local authorities generally purchase an integrated system. In any event, even on the basis of planning and building control being considered separately, this transaction does not raise any competition concerns and the question can therefore be left open.¹
7. It also does not appear that the products are substitutable from the supply side. While providers of IT services to local authorities supply a number of products across the range of categories, they tend to be stronger in particular product categories. Furthermore, many players only operate in certain product areas. The parties estimated that it would take 1-2 years to develop a software solution for 'land and property'; and around two years for 'benefits and revenues' (provided sectoral experience). The length of time taken to develop the software therefore suggests that providers of different software products to local authorities are more accurately considered as potential new entrants than actual competitors.
8. The parties also overlap in the provision of managed services/ outsourcing, such as application and server hosting. On the basis of the available information it appears that there may be some demand side substitution from self-supply, and possibly some supply side substitution from software applications providers. In

¹ See below paragraph 17.

any event, no competition concerns are raised even on the narrowest possible frame of reference and it is therefore not necessary to conclude.

Geographic scope

9. The parties submitted that there are significant requirements for software to suit national legal, tax and regulatory requirements, which are not generally suitable for supply in other countries. Notwithstanding that in most cases EC public procurement rules generally require local authorities to advertise contracts over £140,000 at a European level, in practice, the most likely bidders would be UK companies.
10. While sometimes different regulatory requirements across the UK require some amendment of the software, the majority of the competitors contacted by the OFT operated across the UK. This suggests that such requirements are not difficult to comply with and the relevant geographic frame of reference is therefore considered to be the UK.

HORIZONTAL ISSUES

Shares of supply

11. Table 1 shows the parties' UK shares of supply by value of sales in 2003-4, in the various segments of software and ancillary service provision and in IT outsourcing and managed services.

Table1: Shares of supply, by value

		Northgate	SX3	Total sector size	Northgate post-merger
Revenues and benefits	Sales (£m)	[0-10]	[5-15]	[35-45]	[5-15]
	% Share	[0-10]	[25-35]		[25-35]
Social housing	Sales (£m)	[0-10]	[10-20]	[50-60]	[10-20]
	% Share	[0-10]	[20-30]		[20-30]
Land and property	Sales (£m)	[0-10]	[0-10]	[20-30]	[0-10]
	% Share	[5-15]	[0-10]		[10-20]
Planning and building control	Sales (£m)	[0-10]	[0-10]	[5-15]	[0-10]
	% Share	[5-15]	[0-10]		[15-25]
CRM and e-government	Sales (£m)	[0-10]	[0-10]	[40-50]	[0-10]
	% Share	[5-15]	[0-10]		[10-20]
Outsourcing and managed services to local government	Sales (£m)	[0-10]	[5-15]	[150-160]	[10-20]
	% Share	[0-10]	[0-10]		[5-15]

Source: the parties

Table 2: Shares of supply, by installations²

	% Share		
	Northgate	SX3	Northgate post-merger
Revenues and benefits	[0-10]	[25-35]	[25-35]
Social housing	[0-10]	[5-15]	[5-15]
Land and property	[5-15]	[0-10]	[10-20]
Planning and building control	[0-10]	[0-10]	[5-15]

Source: the parties' estimates

12. There appear to be significant differences in the parties' shares of supply in relation to certain product categories (social housing and planning and building control) by the two calculations. This is considered to be mainly due to Northgate

² Data relates to 2004 for Revenues and Benefits and for Software and Ancillary Services to Local Government altogether; and for 2003 for all other applications.

having a lot of legacy product installations that it no longer markets, while SX3 offers a currently strong product.

13. Each of the product categories is considered separately and for the reasons set out below, the OFT believes that the merger does not raise any competition concerns in any of these sectors.

Revenues and benefits

14. The parties' shares of supply post-merger are highest in revenues and benefits. In this segment SX3 is the market leader, with Capita being the second largest [] and Anite the third []. However, the increment of a merger with Northgate is small. Northgate has [0-10] per cent of installations, but only [0-10] per cent by sales in 2003-4. It has also been submitted that Northgate's product is more of a complement rather than a direct substitute to regular revenues and benefits software. This is also supported by the bidding data provided by the parties, which show that, over the past three years, SX3 and Northgate did not compete against each other on any tenders in revenues and benefits.

Social housing

15. SX3 is again one of the main suppliers in this sector. By installations, it is second behind Comino (which has []). While SX3 appears to have a particularly strong product offering at the moment and its share of supply by sales in 2003-4 is much higher than its share of supply by installations, Northgate is presently considered to be a weak competitor offering only a legacy product. The increment amounts to less than 1 per cent share of supply by sales and by installations.

Land and property

16. The parties' post-merger shares of supply in land and property amount to around [10-20], both by sales in 2003-4 and by installations. Notwithstanding the increment of [0-10] per cent³ ESRI/ CAPS will remain the market leader, []. However, recent bidding data provided by the parties suggests that the parties may not have competed particularly closely pre-merger.
17. If planning and building control were considered separately from land and property control, the parties' share of supply with respect to the number of installations would decrease and their share in terms of sales would increase slightly in 2003-4. However, on that basis, it appears that the market structure in land and

³ In HHI terms, it leads to a post-merger HHI of 1936, with an increment of 153.

property is to a large extent mirrored in planning and building control. As a result, the OFT believes that assessing planning and building control separately does not lead to any material difference with regard to the transaction's impact on competition.

CRM and e-government

18. While there is an overlap in the supply of CRM and e-government software (resulting in a post-merger share of supply of [10-20] per cent), it should be noted that SX3 does not market its own product. It merely distributes solutions which it licences on a non-exclusive basis from third parties.

IT outsourcing and managed services

19. The parties will only have [0-10] per cent share of supply post-merger and will continue to face competition from large players such as ITNet and BT [...].

Barriers to entry and expansion

20. The parties estimated the cost of product development for integrated land and property software to be in the region of £4-6 million, with a development time of about 1-2 years. Both the parties and third parties estimate the development of a revenues and benefits system to be in the region of £5-10 million, and to take around two years (provided the entrant has sectoral experience). These timescales suggest that timely entry may be difficult, which may be further compounded by local government requirements.
21. It has also been submitted to us that there may exist some barriers to expansion to the extent that local authorities have long term contracts and therefore only demand replacements for the software products in question at particular times. However, it appears that until 2007 more sites are likely to come up for renewal due to local authorities needing to comply with guidelines for web enablement. Furthermore, there are examples of companies that have expanded their position significantly in the last few years.
22. Overall, barriers to entry and expansion are therefore not considered to be insurmountable.

Buyer power

23. Due to the fragmentation of supply, local authorities have significant choice amongst suppliers. One third party suggested that larger local authorities may in fact have less buyer power than the smaller ones (given that they could only

choose one of the large software suppliers). However, except for one third party comment, we have no evidence to support this and the parties' own shares of supply of land and property software to the top 20 per cent of local authorities did not differ markedly from their shares of supply to all local authorities. Notwithstanding the cost of switching, most local authorities contacted by the OFT confirmed that they have in the past switched supplier. Overall, it is therefore assumed that local authorities will exert some buyer power vis-à-vis the suppliers.

THIRD PARTY VIEWS

24. Third parties contacted by the OFT were generally unconcerned about this transaction. Specific concerns submitted have been dealt with above.

ASSESSMENT

25. The parties have material overlaps in the provision of software and ancillary services to local authority and housing associations and in the provision of managed services/outsourcing. However, in most categories the increment is very small and on the basis of the data supplied to the OFT, it is considered that Northgate and SX3 were not particularly strong competitors pre-merger. Shares of supply are highest in land and property software but in any event, two strong competitors and many smaller players remain in this sector post-merger, which are considered to constrain the parties.

26. Local authorities possess some buyer power and barriers to entry or expansion are not considered insurmountable. The majority of third parties contacted were unconcerned about this transaction.

27. 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

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