# Anticipated acquisition by Northgate Information Solutions Plc of Rebus HR Group Ltd

The OFT's decision on reference under section 33 given on 16 January 2004

**PARTIES**

Northgate Information Solutions plc (Northgate) supplies information technology (IT) solutions in the UK, US and Ireland. It licences computer software and provides associated consultancy services, operates maintains and manages IT based human resources (HR) activities, and sells accountancy software called FinanceLink. Rebus HR Group Ltd (Rebus) is the parent entity of a group of companies offering in-house IT solutions, hosting services, payroll software and outsourcing, employee information services and personnel services. It also has a 20 per cent stake in PS Financials, which sells accountancy software. It operates predominantly in the UK, but also in Australia, China, the Netherlands, New Zealand and Singapore. In the year ending 31 March 2003, Rebus' UK turnover was £73.7m.

**TRANSACTION**

Northgate proposes to acquire the entire business of Rebus and all of its subsidiaries. The proposal was pre-notified to the OFT on 16 December 2003. The statutory deadline, which has not been extended, expires on 16 January 2004.

**JURISDICTION**

As a result of this transaction Northgate and Rebus will cease to be distinct. The UK turnover of Rebus exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. A relevant merger situation is likely to be created.

**RELEVANT MARKET**

The parties overlap in the provision of IT services for the HR sector. There is also a small overlap in the provision of accountancy software, which is not considered further as the combined share of supply appears to be less than 1 per cent.

From a customer perspective, the services and products involved are used to meet company and statutory requirements in administering payroll, and for managing HR records such as attendance, sickness recording and training. Companies can either purchase the software (and have it tailored to their requirements if need be) or can outsource some or all of the elements for administration by the supplier (for payroll and pensions). From a supplier's perspective, IT services provided to the HR sector encompass software development and integration, consulting, software maintenance and support and IT and business management services (outsourcing payroll and pensions processing).

The parties consider that the relevant economic market for assessing this transaction encompasses all these services. They also consider that whilst the UK may be taken as the appropriate frame of reference, the global context and competitive constraints from outside the UK should not be ignored.

**Demand side substitution**

From the customer perspective each item of software (for example, HR as opposed to payroll), maintenance of the software and consultancy services are unlikely to be substitutable. Consequently, software developed for HR uses may be distinct from payroll or pension software. In practice, such software, development and consultancy is sometimes sold as a package. Customers are typically looking to upgrade their HR IT systems and this can require the software to be tailored (software development) and their staff to be trained to use the new systems (consultancy).

The other possible delineation is between the core software and associated services and the outsourcing of HR administration. The parties have pointed to four potential categories:

- *fully managed* – which means that the payroll input, Gross to Net calculation and issuing of Bankers Automated Clearing Services (BACS) and payslips are carried out by the supplier;
- '*bureau*' – where Gross to Net, BACS and payslips are carried out by the supplier;
- '*hosted*' – which means that the hardware only is managed by the supplier although this can include software maintenance and support; and
- *in-house* – where the customer has bought the software and consultancy services and will run the software on a system at its premises.

One customer considered fully managed services to be a substitute for bureau services and there appears to be some substitutability between these categories. One customer mentioned the possibility of returning to an in-house service but believed it would be too costly and time consuming, even in the face of a 5-10 per cent price increase. This constraint from in-house services could be asymmetric. Consequently, although the parties have provided examples of companies that have switched back to in-house supply from a demand perspective, it may be appropriate to examine separately the provision of basic software (and associated services) and outsourcing services (such as fully managed and bureau services).

Finally some third parties also draw a distinction among services provided to different sizes of customer. In particular, very large organisations were perceived to require more functionality in their software. Whilst it has not proved possible to confirm this, nor to determine the number of employees which characterises this type of firm, this factor has been taken into account in the analysis below.

**Supply side substitution**

From a supply side perspective, maintenance, development and consultancy are likely to come from the same set of core skills and consequently it would appear possible that companies active only in one sector could expand into another. In terms of HR software, the parties have informed the Office that this can take two years to develop, so it would not appear that similar companies not currently active in HR IT represent an immediate constraint.

One substantive difference in practice would appear to be between the provision of HR software and associated services and outsourcing. More firms are active in outsourcing, several of which effectively sub-contract the software element (e.g. Capita).

**Geographic market**

In previous software cases we have taken the view that the relevant economic market is likely to be the provision of the software in the UK, while recognising that such software can be written abroad. The same factors appear to be present here, as the software needs to meet the UK statutory requirements[1] and thus would need at least to be tailored for use within the UK. The parties consider that conversion of software from a similar regime (e.g. the Republic of Ireland) would cost around £500,000. For more other jurisdictions (e.g. Italy), this could be in the order of £5million. Whilst there have been companies that have made this transition (e.g. SAP) a cautious view of constraints coming only from current suppliers to the UK has been adopted for the purposes of this analysis.

**Conclusion**

It is not clear that the relevant frame of reference for the analysis of this merger would be all IT services to the HR sector within the UK. Unresolved issues include whether HR IT outsourcing and software and related services are subject to differing constraints, whether payroll is distinct from other types of HR software, and whether the size of the company supplied should be a relevant delineation. However, we have not needed to conclude on these matters given that even on the narrowest frame of reference concerns do not appear to arise.

**HORIZONTAL ISSUES**

**Market shares and bidding data**

The table below shows the parties' shares by type of IT service to the HR sector within the UK. One competitor provided figures from an independent report broken down into

[1] These would include tax, National Insurance and legislative reporting (e.g. monitoring of staff race, religion or sex).

HR and payroll separately for the public sector; here, the highest shares of the parties were slightly lower than those shown below.

**Shares of supply by HR IT sector, 2002, by value**
See note 1 on percentages and note 2 on totals.

| Suppliers | All IT Services for HR Sector | HR software development, integration, management, maintenance and consultancy | IT based HR outsourcing |
|---|---|---|---|
| Rebus | [5-10] per cent | [20-25] per cent | [0-5] per cent |
| Northgate | [0-5] per cent | [10-15] per cent | [0-5] per cent |
| **Combined** | **[5-15] per cent** | **[30-40] per cent** | **[0-5] per cent** |
| **TOTAL (£m)** | **[ ]** | **[ ]** | **[ ]** |

*Source: the parties*

It appears that Rebus has the largest installed base[2] although the parties were unable to estimate shares of supply. This is to some extent reflected in the table above due to ongoing maintenance revenues[3]. The parties have also estimated that over the last 18 months, Northgate (and its recently acquired firms[4]) tendered [ ] (see note 2) times ([10-15] per cent of the estimated base[5]) (see note 1) and won [ ] (see note 2), whilst Rebus tendered [ ] (see note 2) times ([10-15] per cent of the estimated base) (see note 1) and won [ ] (see note 2). On this basis, the parties estimate that they represent [5-10] per cent (see note 1) of current sales across all IT services in the HR sector.

Whilst information based on size of firm supplied, or types of contract is limited, the bidding data received does shed some light on these issues. From the parties' bidding data, we can note the following:

- Together Northgate and Rebus bid for [ ] (see note 2) contracts representing approximately (i) [20-30] per cent of all contracts tendered (if the total is accurate); or (ii) [20-30] per cent if organisations of over 25,000 employees are excluded; or (iii) [20-30] per cent if organisations of over 10,000 employees are excluded (see note 2);
- Of these Northgate and Rebus won [ ] (see note 2) representing less than 10 per cent of contracts (on any of the above bases; even if all firms with over 1,000 employees are excluded the figure is still less than 20 per cent);
- Rebus's incumbent position does not appear to grant any specific advantage, it won more contracts where neither it nor Northgate was the previous supplier ([ ] per cent (see note 2) of those bid for), than when it was ([ ] per cent (see note 2) of those bid for);

---

[2] This is supported by internal documents from the parties and independent research reports.
[3] [ ] per cent (see note 2) of Rebus's current software related revenue is attributable to on-going maintenance of legacy software.
[4] Northgate has recently acquired PWA Group Ltd, PBSD Ltd (Prolog) and Carapeople UK.
[5] The parties estimate that 6,300 public and private organisations exist in the UK with more than 250 employees and they typically review their systems every 5 years. Thus over an 18 month period they expect 1,890 contracts to be reviewed. If we exclude employers of over 25,000 employees this would reduce to 1772, excluding employers of over 10,000 employees reduces this further to 1631.

- Northgate competed on [25-35] per cent (see note 1) of bids Rebus competed for and Rebus competed on [5-10] per cent (see note 1) of bids Northgate competed for (this reflects shortlisted bidders);
- If we look at purely HR software or pay software as the core product with potentially the highest barriers to entry (given development costs), the situation is generally that Rebus loses more bids than across all IT HR services. Its greatest win rate is within payroll & HR combined contracts, but here the parties still lose over one third of contracts. The bidding data show the following companies are also winning these contracts: Ceridian; CMG; Midland; Snowdrop and Selina (third parties have also mentioned other suppliers).

**Non-coordinated effects**

From the share information provided above, concerns appear to arise potentially only within HR software development and associated services (integration, management, maintenance and consultancy) where the HHI indicates a moderately concentrated industry structure (the post-merger HHI would be 1332, representing an increment of 463) although even here shares are relatively modest. There is some evidence from Northgate's internal documents to support this. [ ] (see note 3).

Competition within this sector can be summarised as a series of bidding competitions. The tender process is very thorough reflecting that, for customers, these contracts occur infrequently[6], represent a significant expense and seem to be operationally important. Suppliers appear to be differentiated both on size of customers being addressed and the compatibility of their software with other IT systems.

Where competition is characterised as a series of bidding competitions, and the number of credible bidders is of significance, shares of supply may not be the most appropriate guideline to market power. Whilst customer responses varied in terms of who they viewed as credible suppliers and the extent to which they perceived Rebus and Northgate are close rivals, customers expressed little if any concern. They all named several other credible bidders for the last tender and generally named other suppliers who did not make the shortlist but who were nonetheless considered credible suppliers. Several also commented that Rebus and Northgate were addressing different customers and they did not therefore consider them substitutable (some took a contrary view on this point). It also appears that Rebus retains some advantage from its large installed base in making the shortlist but this does not appear to help it in winning competitions.

In sum, many other suppliers remain post-merger, and customers appear unconcerned. Consequently, the OFT does not believe that competition concerns arise from this merger.

**Barriers to entry and expansion**

The parties consider that barriers to entry are low. In particular, they have pointed to the threat of entry from Microsoft which is believed to be preparing to enter this sector. The parties provided press comments which support this belief.

[6] The parties believe this to be roughly every three to five years.

**Buyer power**

The customer base appears potentially to cover most businesses (as well as other organisations such as universities) within the UK. Consequently, customers are very fragmented and it seems unlikely that countervailing buyer power would act as a significant constraint.

## VERTICAL ISSUES

Currently both parties' software is non-exclusively sub-contracted to consultancies that offer outsourcing services and therefore compete with the parties. The parties state that in this respect software providers are approached on an ad hoc basis. Northgate currently works with [ ] (see note 3) and is also a sub-contractor to [ ] (see note 3) at Cumbria County council. Rebus is used by a wider variety of companies including: [ ] (see note 3). There is one exclusive arrangement, between Rebus' SME division (Moorepay) and two clearing banks: [ ] (see note 3). These banks provide payroll processing leads for the very small end of the SME sector in return for a commission. The parties believe competitors have similar arrangements (e.g. [ ] see note 4).

There has been no evidence that the merger will change the parties' incentives in this respect and the Office has received no complaints to this effect. To some extent, the position of these companies is similar to customers seeking a software solution for in-house supply. As these types of customers have other supply alternatives and it would appear unlikely that any foreclosure concerns could arise. Accordingly it would seem that no significant vertical issues are raised by this acquisition.

## THIRD PARTY VIEWS

Several customers and competitors were contacted during the course of this investigation. Those customers that responded were generally unconcerned. One competitor raised concerns that it may lose business to the larger competitor due to large companies' tendency to go with whom they know.

## ASSESSMENT

The parties to the merger are providers of IT services to the HR sector and of outsourcing services to the HR sector. Combined they represent up to [30-35] per cent (increment [10-15] per cent) (see note 1) of HR software and associated services within the UK. Customers of these services purchase infrequently through a formal tender process and consequently the number of credible bidders for these services is significant. In this respect several credible suppliers remain including Midland, Frontier, Snowdrop systems, SAP, PeopleSoft, Oracle, Sage and others.

One competitor expressed some concern but customers were largely unconcerned by the acquisition, based on their recent experiences in tender processes.

The OFT does not therefore believe that there is a significant prospect that the merger would substantially lessen competition. Nor does it believe that there is a credible alternative view that the merger might substantially lessen competition.

## DECISION

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

## NOTES

1. Actual figures replaced by a range at the request of the parties

2. Figure(s) deleted at the request of the parties

3. Text deleted at the request of the parties

4. Text deleted for confidentiality