Completed acquisition by JLA New Equityco Limited of Washstation Limited

Summary of provisional findings

1. The Competition and Markets Authority (CMA) has provisionally found that the completed acquisition by JLA New Equityco Limited (JLA) of Washstation Limited (Washstation) (the Merger) has resulted, or may be expected to result, in a substantial lessening of competition (SLC) in the market for the supply of managed laundry services to higher education customers under vend share agreements in the UK.

2. These are our provisional findings. We now invite any parties to make representations to us on these provisional findings. Parties should refer to our notice of provisional findings for details on how to do this.

Background: the Parties and the industry in which they operate

3. On 16 April 2018, the CMA referred the completed acquisition by JLA New Equityco Limited (JLA), through its subsidiary Vanilla Group Limited, of Washstation Limited (Washstation) (the Merger) for an in-depth (phase 2) inquiry by a group of CMA panel members (the Group).

4. JLA and Washstation (together, the Parties) overlap primarily in the supply, within the UK, of managed laundry services to higher education customers, such as universities, colleges and student accommodation providers, through so-called vend share agreements.

5. Vend share agreements are one of three types of commercial laundry services agreements. Under a vend share agreement, the provider supplies and installs the machines and carries out repair and maintenance works. The customer does not pay rent to the provider, but instead receives an agreed percentage of the revenues generated from end-users of the machines in the form of commission from the provider.

6. The other two types of commercial laundry services agreements are (i) fixed rental agreements; and (ii) maintenance and repair services agreements.

Together, fixed rental agreements and vend share agreements are commonly referred to as managed laundry services.

7. JLA, through its various subsidiaries, offers commercial laundry services (including managed laundry services), catering, heating and fire safety services to a variety of customers, such as care homes, schools, hotels, universities and hospitals. JLA offers managed laundry services to higher education customers through its subsidiary Circuit Launderette Services Limited.

8. Washstation is active in the provision of managed laundry services under vend share agreements, which it supplies to two types of commercial customers: higher education customers and hospitality and leisure customers.

9. The main providers of managed laundry services under vend share agreements to higher education customers in the UK, other than the Parties, are James Armstrong and Company Ltd (Armstrong), which was acquired by Hughes Electrical Ltd (Hughes) in January 2018, and Goodman Sparks Ltd.

The investigation

10. As part of our investigation, we received several submissions and responses to information requests from the Parties, held in depth-hearings with both higher education customers and providers of managed laundry services and commercial laundry services, and carried out an extensive review of internal documents held by the Parties. We also considered the results of customer research commissioned by the CMA.

Relevant merger situation

11. On 18 May 2017, JLA acquired all of the issued share capital of Washstation. We are satisfied that the Merger has resulted in a relevant merger situation because this transaction has resulted in the Parties ceasing to be distinct, and as a result they have a combined share of supply of more than 90% in the provision of managed laundry services to higher education customers under vend share agreements in the UK.

Counterfactual

12. To assess the effects of the Merger on competition we needed to consider what the competitive situation would have been absent the Merger (the counterfactual). In order to determine the counterfactual, we have considered, based on the evidence, what the most likely scenario would have been had Washstation not been acquired by JLA.

13. We considered two possible counterfactual scenarios in relation to the constraint from Washstation absent the Merger: (i) whether Washstation would continue to operate in the market as it did prior to the Merger (ie pre-Merger conditions), or (ii) whether it would continue to operate in the market but impose a lesser competitive constraint on JLA, as advocated by JLA.

14. We have provisionally found that Washstation would have continued to compete in the supply of managed laundry services to higher education customers as it had done prior to the Merger. This provisional finding is based on the following evidence and analysis:

   a. due diligence commissioned by JLA on Washstation's business indicates that the business was forecast to grow (revenues, profitability and cash flow) and our analysis indicates that Washstation had been on a growth path since 2010;

   b. while some additional finance may have been required to continue to develop the business and its continued expansion, we have seen some evidence that this was available to Washstation;

   c. Washstation's commission rates (ie the percentage of vend revenues paid to higher education customers) were not significantly different from those of JLA and while there may have been some uneconomic contracts, these are limited in number and do not appear to have been such as to cast material doubts on the ability of the Washstation business to continue to compete as it did pre-Merger; and

   d. while there have been some instances of customer dissatisfaction, this has resulted in the loss of a limited number of Washstation contracts and has not significantly weakened Washstation's ability to compete as it did pre-Merger.

15. We also assessed whether Hughes' acquisition of Armstrong was sufficiently likely at the time of the Merger to be incorporated in the counterfactual. We provisionally found that Hughes' expansion plans for the Armstrong business appeared, to some extent, to be linked to the Merger. Accordingly, the most likely counterfactual in relation to Armstrong is Armstrong continuing to operate under the pre-Merger conditions of competition.

16. Our provisional view is that the most likely counterfactual is the pre-Merger conditions of competition, with regard to the competitive constraint imposed on JLA by both Washstation and Armstrong.

Market definition

17. The purpose of market definition in a merger inquiry is to provide a framework for the analysis of the competitive effects of the merger.

18. The primary overlap between the Parties is in the provision of managed laundry services to higher education customers under vend share agreements in the UK.

19. In establishing whether the relevant product market should be broader than the activities in which the Parties overlap we assessed:

    a. the extent to which other means of procuring laundry services are demand-side substitutes for vend share agreements, and so represent credible outside options to customers; and

    b. the extent to which providers of managed laundry services to other sectors and through other contractual models are able to supply higher education customers, and so represent credible outside options to those providers with higher education experience.

20. Our investigation revealed that the majority of customers do not consider that alternative types of procurement, such as fixed rental agreements or outright purchase, to be alternatives to vend share agreements. In particular, almost all higher education customers used (and continue to use) vend share agreements for the supply of managed laundry services and very few customers have previously switched from vend share to fixed rental agreements. Some higher education customers expressed their preference for vend share agreements, mainly because they avoid the need for capital outlays by the customer (and the associated financial risks), do not require customers to assume operational responsibility for the laundry service, and provide a source of income (with the vend revenues generated by students being shared between service providers and the higher education customers).

21. We also provisionally found that higher education customers have some different requirements from customers in other sectors, due to their end- user profile, which may limit the ability of providers active in other sectors to quickly supply them (eg in terms of payment systems, online services and refurbishment). The evidence also indicated that overall, the set of firms active in serving the higher education sector is broadly different from the set of firms serving customers in other segments.

22. With regard to the geographic scope of the market, we have aggregated all contracts together and analysed the aggregate constraint that each managed laundry service provider within the higher education sector may impose on

each other. Therefore, we have provisionally adopted a national geographic market and not found it necessary to define a market narrower than the UK.

23. In summary, we have provisionally concluded that the relevant market should be defined as managed laundry services to higher education customers under vend share agreements in the UK.

Competitive assessment

24. We assessed the competitive effects of the Merger, including evidence on the strength of the constraints the Parties imposed on each other and the constraint imposed by other providers. To do this, we considered: (i) market shares over time and in respect of new contracts; (ii) contract sizes and commission rates; (iii) who JLA lost contracts to (‘switching ratio analysis’); and (iv) evidence from internal documents, third party hearings and customer research on providers’ strengths and weaknesses and the closeness of competition between them when contracts were awarded.

25. Taken together, the evidence on the effects of the Merger on competition shows that Washstation competed strongly against JLA, with Armstrong representing a much weaker constraint.

26. Evidence from past tenders and contract negotiations shows that JLA and Washstation were each other’s closest competitor, with Washstation accounting for the large majority of contracts lost by JLA. While Armstrong was the other most credible competitor, the available evidence indicates that Armstrong represented a weak constraint on JLA. Self-supply represented a very weak constraint.

27. Overall, all third parties the CMA had hearings with identified JLA and Washstation as close competitors. Customers only identified JLA, Washstation, Armstrong and Goodman Sparks as competitors in the supply of managed laundry services under vend share agreements (while some customers had, in some cases, received expressions of interest from other providers, none of these providers had ultimately been awarded a contract).

28. The submissions from competitors and other providers of laundry services indicate, at this stage, that, with the exception of Armstrong, other providers exert a very weak constraint on JLA. This is because alternative providers of laundry services: (i) currently only serve a very small number of higher education customers and/or are relatively small companies, with limited financial resources and/or a limited geographic presence, and (ii) are not actively competing for these customers and, in some cases, do not offer vend share agreements.

29. Internal documents also show that JLA perceived Washstation as a close competitor and took into account the risk of losing higher education customers to Washstation when formulating its offer. These documents also show that higher education customers used Washstation’s presence as a bargaining tool when negotiating with JLA. JLA also considered Armstrong to be a competitor for some customers, with little evidence of JLA monitoring other providers.

30. The results of the CMA’s customer research indicate that: (i) JLA holds an influential position in this market and that JLA and Washstation have the technology to offer a range of payment methods and online services, which other providers appear not to have; (ii) JLA and Washstation are the two main providers of managed laundry services, with the other most credible alternative being Armstrong.

31. On the basis of the evidence we have reviewed, we provisionally consider that the Merger is likely to result in an SLC in the market for managed laundry services to higher education customers under vend share agreements in the UK, subject to any countervailing factors.

32. For new contracts, the Merger may give JLA the incentive to deteriorate any element of the competitive offer, including both lowering the commission paid and service levels provided to customers. For existing contracts, the Merger may give JLA the incentive to deteriorate service levels, as it would have less incentive to offer more than the minimum services required under its contractual terms with customers.

Countervailing factors

33. We considered whether entry and/or expansion or buyer power could prevent an SLC from arising in this case.

34. Our review of the recent history of entry into the market indicated that there have been no recent examples of significant entry or expansion, apart from Washstation itself. Therefore, we examined specific barriers to entry and expansion which would be faced by any provider who wished to provide these services.

35. We provisionally found that a number of factors make entry and expansion difficult for some providers. These include: the cumulative cost of providing and implementing the services required by higher education customers (eg refurbishment, online and cashless payments services), the risk borne by the provider with vend share agreements, and the importance some customers attach to experience and reputation.

36. Even if these barriers to entry and expansion could be overcome by an experienced and well-financed party, higher education customers in general exhibit strong preferences in relation to the reputation of a prospective provider and the services that the provider should be able to offer.

37. Moreover, providers without an established presence in the sector may find it difficult to identify opportunities that are not publicly tendered (which account for a significant proportion of all potential opportunities). It can be difficult and costly for other providers, for example, to replicate JLA's established knowledge of the market, including when most existing contracts come up for renewal. Combined with the long-term nature of managed laundry contracts, the lack of transparency is likely to make initial entry more difficult, even for firms who are well-established in providing laundry services to other sectors. Therefore, the lack of transparency around opportunities available to competitors is likely to increase the costs of entry and reduce the likelihood of successfully winning contracts, even in a growing market.

38. Collectively these barriers may be material, costly to overcome and may deter both entry and expansion by existing providers. However, we cannot, in principle, exclude the possibility that they could be overcome by a proactive and determined provider, with the necessary financial backing. We therefore assessed whether any third parties have plans to enter and expand that are timely, likely and sufficient to prevent any SLC resulting from the Merger.

39. The only credible candidate for expansion we identified is Armstrong. While Armstrong has plans to expand its geographic coverage and now has access to greater financial resources, the evidence we have considered raises significant doubts about the robustness of its expansion plans in higher education. In particular, Hughes does not currently appear to have formulated a concrete plan for Armstrong's expansion in the higher education sector. Moreover, Armstrong lost its biggest ongoing contract and failed to win any large higher education contract. It also did not bid for any private higher education contracts.

40. Taking the evidence in the round, our provisional view is therefore that even if Armstrong may expand in the future, it is not likely that Armstrong would achieve a sufficient scale in a timely manner such that it would prevent any SLC arising.

41. We also provisionally found that no other possible entrant identified by JLA was likely to enter or expand in a timely and sufficient manner to constrain JLA such that it would prevent any SLC arising.

42. We received no evidence that buyer power or efficiencies would offset our concerns.

Provisional conclusion

43. We have provisionally concluded that the Merger has resulted, or may be expected to result, in an SLC in the market for the supply of managed laundry services to higher education customers under vend share agreements in the UK.