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Determination

Cengage Learning Holdings II, Inc. and McGraw-Hill Education, Inc [2020] NZCC 10

The Commission:	Anna Rawlings Derek Johnston Dr John Small Sarah Court
Summary of application:	An application from Cengage Learning Holdings II, Inc. and McGraw-Hill Education, Inc. seeking clearance to merge their global publishing businesses into a new, yet to be incorporated entity.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to the Proposed Acquisition.
Date of determination:	14 April 2020

CONTENTS

The proposed acquisition

1. On 30 October 2019, the Commerce Commission registered an application (the Application) from Cengage Learning Holdings II, Inc. (Cengage) and McGraw-Hill Education, Inc. (McGraw-Hill) (together the Applicants) for clearance to merge their global publishing businesses into a new, yet to be incorporated entity (the Proposed Acquisition). The Application relates to the Proposed Acquisition to the extent that it affects markets in New Zealand.

Our decision

2. The Commission gives clearance to the Proposed Acquisition as it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

3. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[1]

The substantial lessening of competition test

4. As required by the Act, we assess mergers and acquisitions using the substantial lessening of competition test.

5. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[2]

6. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price that would exist in a competitive market (the competitive price),[3] or reduce non-price factors such as quality or service below competitive levels.

When a lessening of competition is substantial

7. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[4] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[5]

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019).

[2] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

[3] Or below competitive levels in a merger between buyers.

[4] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

[5] Ibid at [129].

8. As set out in our guidelines, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[6]

9. A lessening of competition or an increase in market power may manifest itself in a number of ways, including higher prices or reduced services.[7]

10. While we commonly assess competition effects over the short term (up to two years), the relevant timeframe for assessment depends on the circumstances. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.[8]

When a substantial lessening of competition is likely

11. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.[9]

The clearance test

12. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[10] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

The parties

The Applicants

13. Cengage is a global education and technology firm based in the USA.

14. In New Zealand, Cengage supplies educational products including textbooks (in print and digital formats) and other supporting learning materials (defined below) to the following sectors:

    14.1 primary schools;

    14.2 secondary schools; and

    14.3 higher education institutions (HED sector), comprising vocational, undergraduate and post-graduate university levels.

15. McGraw-Hill sold its secondary school publishing business to Cengage in 2010 so there is no overlap in the secondary school sector and we do not refer to it again.

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6 *Mergers and Acquisitions Guidelines* above n1 at [2.23].

7 Ibid at [2.21].

8 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [131].

9 Ibid at [111].

10 Section 66(3)(a).

16. Cengage employs New Zealand-based sales representatives in each of the primary and HED sectors.

17. McGraw-Hill is a global learning science company and like Cengage its businesses are primarily located in the USA.

18. In New Zealand, McGraw-Hill supplies educational products, including textbooks and supporting learning materials, predominantly to the HED sector and to a lesser degree to the primary sector. It employs one sales representative in New Zealand focused on the HED sector.

Other parties

19. Apart from Cengage and McGraw-Hill, there are two other major educational publishers who supply educational products, including textbooks and other supporting learning materials in New Zealand across a broad range of subject categories and sectors.

    19.1 Pearson plc (Pearson) is a UK based company which is one of the largest global educational publishers. It supplies educational products to the primary and HED sectors in New Zealand. In the HED sector, Pearson publishes textbooks and other supporting learning materials in a wide range of subject categories. These products are sold and distributed in New Zealand by Edify Limited, an Auckland-based publisher and distribution company.[11]

    19.2 John Wiley and Sons, Inc (Wiley) is a US-based global educational publishing company specialising in academic publishing and instructional materials. In New Zealand, Wiley supplies textbooks and other supporting learning materials to the HED sector in a range of subject categories using a third-party distributor. Wiley employs one New Zealand-based sales representative.

20. There are a number of other educational publishers supplying textbooks and other supporting learning materials across a range of different subject categories to the HED sector in New Zealand either directly or through third party distributors. These include Macmillan Education (Macmillan), Taylor & Francis Group (Taylor & Francis), Oxford University Press (OUP) and Cambridge University Press (CUP). Taylor & Francis employs one New Zealand-based sales representative while Macmillan and CUP have Australian-based sales representatives, who visit New Zealand periodically.

21. There are also specialist publishers supplying textbooks and other supporting learning materials to the HED sector in New Zealand, which focus on a single or narrow range of subjects. These include LexisNexis (law), Thomson Reuters (law, tax and accounting), Elsevier (health and science), and specialist foreign language publishers (see below for further details).

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[11] Edify also distributes educational products in New Zealand on its own behalf as well as for Oxford University Press and Pearson, employing two sales representatives in the HED sector.

22. In addition, there are a small number of New Zealand-based publishers, such as Auckland University Press, that publish textbooks with New Zealand content for the HED sector.

Industry background

23. The Proposed Acquisition relates to the educational publishing industry, specifically the supply of textbooks and other supporting learning materials, to the HED sector, and to a lesser extent, the primary school sector.

24. Educational publishing involves the development, publishing and supply of textbooks and supporting learning materials for use by teachers and students in the primary and HED sectors. Textbooks can be in printed and digital formats (also known as eTextbooks however we refer to both products collectively as 'textbooks').

25. Supporting learning materials are materials which assist a teacher or lecturer in delivering course content, often to use or adapt as they see fit. Supporting learning materials can be a significant resource for teachers and lecturers and similarly can be a significant investment for publishers. Supporting learning materials can be simple coursework supplements or teaching presentation slides but can also include sophisticated online resources for students such as quizzes which identify individualised learning issues of students, and test banks containing the answers to previous examination questions. Supporting learning materials appear to be particularly important to coordinators of courses with large cohorts of students, usually first- and second-year undergraduate courses, compared to courses with fewer students, typically third-year undergraduate and post-graduate courses.

26. While Cengage is active in the supply of educational products to the primary school sector, our investigation confirmed that McGraw-Hill has minimal involvement in that sector. Therefore we consider that the Proposed Acquisition is unlikely to result in any major change to the market circumstances in the primary school sector.

27. We elaborate on our view of the primary school sector below and we also consider whether businesses supplying the primary school sector could potentially expand into the HED sector. Otherwise, we do not examine the primary school sector further and we focus on consideration of the effects of the Proposed Acquisition in the HED sector.

Overview of HED sector

28. A key feature of the HED sector is that while students are the ultimate consumers of textbooks and supporting learning materials, our investigation has identified that course coordinators (typically the main lecturer teaching a given course) are generally responsible for selecting a textbook for a course. If a textbook is adopted for a particular course, the course coordinator will often gain access to a range of supporting learning materials. Since course coordinators are the primary decision makers when deciding on whether to adopt a textbook for a particular course, the focus of our investigation has been on the adoption process .

29. As such, educational publishers compete against each other for their textbooks (with their supporting learning materials) to be adopted by the course coordinator, and the sale of textbooks to students is an outcome of the adoption process. We use the industry term ‘adoptions’ to refer to this process in this decision.

30. In the HED sector, competition is therefore ‘for the market’ rather than in the market. This is an important point in our competitive analysis which we return to below. For now, we note that unlike many other for the market products, price is not a key determinant of market outcomes. Educational publishers appear to compete to secure textbook adoptions with course coordinators based largely on non-price factors. These non-price factors are an important part of the value proposition provided by publishers to course coordinators.

31. For example, the course coordinators we spoke with stated that when deciding which textbook to adopt they look for: [12]

    31.1 content that is up-to-date and aligns with their course requirements;

    31.2 the quality of any supporting learning materials offered by publishers, e.g. review questions, case studies and test banks with solutions;

    31.3 whether any technology is offered such as web-based platforms; and

    31.4 service support provided by the sales representative, particularly if the supporting learning materials are provided through web-based platforms.

32. While course coordinators we spoke with advised that they are keen to ensure that students are not priced out of the market by an overly expensive textbook, price is generally not the major consideration when selecting a textbook for their courses.[13] Instead, course coordinators focus on the relative quality of the textbooks under consideration. As such, it appears unlikely that course coordinators would switch textbooks based on price unless the difference between the course coordinator’s preferred option and a cheaper, slightly lower quality option was substantially greater than what the Commission would usually consider to be significant. [14]

33. As such, we consider that competition between rival publishers is primarily on the basis of the quality of textbooks and their supporting learning materials rather than

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[12] For instance, Commission interviews with
[ ].

[13] For example, Commission interviews
[ ].

[14] In the context of the hypothetical monopolist test, the Commission usually considers a price rise of 5% to be small but significant. *Mergers and Acquisitions Guidelines* above n1 at [3.18].

wholesale or retail prices. We have therefore focused on the potential effect of the Proposed Acquisition on the quality, rather than the prices, of these products.[15]

34. Due to its size, compared to many other countries, New Zealand has relatively few universities and, as such, there are likely to only be a limited number of different offerings of any individual course (e.g., introductory microeconomics) in New Zealand. We consider that this may affect how educational publishers compete in the HED sector in New Zealand compared to other countries where there are many different instances of the same course being offered. For example, we consider that when competing for adoptions in New Zealand, it is unlikely that publishers would be interested in entering to compete for the supply of textbooks only at a single course level given the low number of students that should potentially purchase it.

How content is created

35. Broadly speaking, we have identified three models employed by educational publishers for developing content for the HED sector in New Zealand (some publishers use multiple models).

    35.1 Pre-existing international textbooks: published for global consumption or for a major market of broad application (e.g., the USA).

    35.2 Adapted international textbooks: textbooks developed overseas but adapted by publishers with local content (for example, a sociology textbook from the USA with a chapter on US social policy replaced with a chapter on New Zealand social policy). We note in New Zealand's case, this is often actually using Australian-generated ("Australian Edition") content as these adaptions often also align with New Zealand laws, standards, conditions and practices.

    35.3 New Zealand specific content: the publication of local content is undertaken by some specialist New Zealand publishers, such as Auckland University Press (e.g., sociology and criminal justice titles with a New Zealand focus).

36. Several of the global publishers noted that due to the small size of the New Zealand market they do not currently publish any locally generated content.[16]

37. Under each of these models, the publisher will seek an author and once secured, the publisher will enter into a contract with the author which would typically include payment by royalty (or occasionally a flat fee). A new contract is signed for each edition of the original title. Although authors are contracted exclusively to a

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15 Rather, price appears to be constrained by factors unlikely to change with the Proposed Acquisition: maximising profitability and sales *after* an adoption has been secured, and alternatives such as library copies and 'white space', are discussed below.

16 For example, Commission interviews with [ ].

publisher in respect of a specific title, authors are typically free to develop other titles with other publishers in other (including similar), subject areas.[17]

How textbooks and supporting learning materials are distributed

38. Some publishers, such as Cengage, distribute their products in New Zealand directly, while other publishers, including McGraw-Hill and Pearson, use third-party distributors.

39. Students will generally purchase a textbook for their course from a bricks and mortar retailer, such as a bookstore located on campus, or online, including from the publisher or from aggregators such as Fishpond.

40. In addition to purchasing a new copy of a textbook, students may also purchase second-hand copies of textbooks or use library copies.[18]

Industry trends

41. A major feature of the educational publishing industry during the past decade has been the emergence and growth of digital technologies. This includes the provision of content delivered through different channels.

    41.1 Textbooks in digital format (e.g., eTextbooks).

    41.2 Digital platforms or portals to provide textbooks and supporting learning materials to students. This content includes interactive or stand-alone products such as quizzes, tutorials etc that complement the material in a textbook. For example, each of the Applicants has invested in the development and expansion of technology platforms and digital products such as Cengage's MindTap and McGraw-Hill's Connect platforms.

    41.3 Digital subscription services which give students access to some or all of a publisher's digital products, including textbooks, for a single subscription fee. In particular, Cengage has introduced "Cengage Unlimited" in the USA which provides students in the HED sector with access to all of Cengage's digital products (digital platforms, eTextbooks, and online study tools) it has on offer. However, we understand that Cengage does not offer this service in New Zealand and [ ]. Perceived benefits include lower prices to students, a steady income stream for publishers, and more frequently updated (loose-leaf) content.

42. The emergence of these technologies has had a major impact on publishers, including on how educational products are developed and delivered. For example, and as noted by the Applicants, alternative channels have developed for the delivery of educational products, including:

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17 Application at [5.4] and the Applicant's response to the Commission's Statement of Issues (20 February 2020) at [1.3 (b) (iv)].

18 For instance, see Commission interview with [ ].

42.1 students obtaining content from what is referred to as 'white space' (e.g., the purchase of second-hand textbooks, obtaining illegal copies online of textbooks and borrowing textbooks from libraries); and

42.2 the increasing use of Open Educational Resources (OER) (i.e., openly licenced and freely available educational products which are often self-supplied by lecturers).

43. The digital trend is expected to continue and is likely to place further pressure on the traditional printed textbook model, as the cost of published printed textbooks remains relatively fixed while sales, which have already declined in recent years, continue to decrease.

44. However, we have found little evidence that course coordinators considered the online platforms, white space, digital subscription services or OER to be complete alternatives to adopting a textbook. As such, we consider that demand for publishers to produce textbooks in a printed format will continue in New Zealand for the foreseeable future.[19] Further, the use of digital content in New Zealand appears to be less advanced than in countries like the USA, and therefore printed textbooks are likely to continue to be demanded by students in the future, although possibly in increasingly smaller volumes.

Market definition

45. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.

46. We define markets in the way that best isolates the key competition issues that arise from a merger.[20] In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

Applicants' view of the relevant markets

47. The Applicants submitted that the market relevant to our assessment of the Proposed Acquisition is the supply of educational publishing in New Zealand, which includes primary and secondary school and HED providers.[21]

48. In addition, the Applicants submitted that it is not necessary to adopt a narrower definition of the product market because:[22]

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19 Commission interview with [ ].
20 *Mergers and Acquisitions Guidelines* above n 1 at [3.10]-[3.12].
21 Application at [6].
22 Application at [6.10].

48.1 most of the major publishers operating in New Zealand operate in more than one educational sector and it is relatively easy to switch between supplying different sectors; and

48.2 although major publishers may be stronger in particular subject(s) within an educational sector, it is relatively easy to switch between subjects by sourcing a relevant author.

Our assessment of the relevant markets

49. While we agree with the Applicants that some global publishers (e.g., Cengage, Pearson, OUP and CUP) are active in both the primary school and HED sectors, we consider that there are features that distinguish the supply of educational products in those sectors and mean they are unlikely to be close substitutes for one another. For example, publishing for primary school students involves the creation of different materials than for the HED sector with primary schools requiring learning materials to assist students primarily with literacy and numeracy,[23] while the HED sector requires textbooks and other learning materials in a wide range of different subjects for tertiary education students.

50. We also note that there are a range of publishers that are only active in either the HED or the primary school sectors. For example, Wendy Pye Publishing Ltd is only involved in the supply of learning materials to kindergartens and primary schools.[24] We also consider that it is unlikely that publishers would commence supplying a new sector without significant investment in additional resources. Given these factors, we consider that the conditions of competition vary significantly between the two sectors, and therefore we do not consider that it would be appropriate to consider them to be in the same market.

51. Based on the available information and for the purpose of our analysis, we consider, as explained further below, that the relevant markets in which to assess the impact of the Proposed Acquisition are the national markets for the supply of:

51.1 educational publishing products to primary schools (primary school market);[25] and

51.2 textbooks and supporting learning materials to the HED sector, broken down by subject area, or in the case of the foreign languages and literature and quantitative business subject areas, into narrower markets; namely Spanish language textbooks in the foreign languages and literature subject area and separately project management and operations management textbooks in the quantitative business subject area[26] (together the HED market(s)).

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23 For example, Commission interview with Wendy Pye Publishing Ltd (21 November 2019).

24 Ibid.

25 Since the Proposed Acquisition does not involve any overlap in the supply of educational publishing to secondary schools, no further consideration of that market is required in these reasons.

26 See paragraph 70 for further details.

Primary school market

52. We consider that the Proposed Acquisition would result in minimal overlap in the primary school market. The evidence indicates that while Cengage is viewed as a major participant, McGraw-Hill is not seen as having much presence in this market,[27] and we did not find any evidence of close competition between the Applicants. Further, we do not consider that it is likely that the Applicants will become close competitors in future such that any existing overlap would be likely to increase. Consequently, it is unlikely that the Proposed Acquisition would result in a substantial lessening of competition in respect of the publishing and supply of educational publishing products to primary schools and therefore we do not consider that market further in these reasons.

Markets within the HED sector

53. As noted, the key area of overlap between the Applicants is in the supply of HED textbooks and supporting learning materials in New Zealand.

54. For the purpose of analysing the competitive effects of the Proposed Acquisition, we define markets in a way that allows us to consider all the relevant competitive constraints, and the extent of those constraints. However, we consider that it is difficult to draw bright lines around particular product markets because of the differentiated nature of the relevant products that may separate product markets inside the market from those outside. Therefore, we have considered various potentially relevant product markets, which we discuss below.

55. In considering the relevant markets for the HED sector, we note that:

    55.1 the Applicants and their major rivals, Pearson and Wiley, offer a range of titles for different courses within several subject areas; and

    55.2 several specialist publishers, such as Thomson Reuters and LexisNexis, focus on courses in some of these subject areas.[28]

56. We considered three potential dimensions for the product markets in the supply of HED textbooks and supporting learning materials:

    56.1 the HED sector in its entirety;

    56.2 subject areas (e.g. accounting, economics, management etc); and

    56.3 course level (e.g. introductory accounting, intermediate microeconomics etc).

[27] For example, Commission interviews with [ ].

[28] For example, Thomson Reuters offers legal, tax and accounting titles in New Zealand. Commission interview with Thomson Reuters (13 December 2019).

Demand side substitutability

57. A course coordinator is only likely to consider textbooks that are close substitutes to be suitable for their particular course(s). For example, a course coordinator teaching introductory economics is unlikely to consider textbooks covering advanced economics to be a close substitute for a textbook covering introductory economics. This accords with the evidence we collected from speaking with course coordinators and analysing the Applicants' sales reports.[29, 30]

Supply side substitutability

58. A key issue in defining the product market in this case is the degree of supply-side substitutability; namely the extent to which publishers could easily change their portfolio of textbooks and therefore place constraint on rival publishers, even if they do not currently offer titles in a given course.

59. As noted in the Commission's Mergers and Acquisition Guidelines,[31] one of the factors we consider when considering supply-side substitution is whether firms would easily, profitably and quickly (generally within one year) switch production to the products or locations in question without significant cost (i.e., they are near competitors).

60. As a starting point for considering supply-side substitution, we consider that the prevalence of publishers offering a wide range of titles within particular subject areas provides some evidence that it may be appropriate to define a product market wider than at the course level.

61. Although the four major publishers offer a broad range of titles across most subject areas, it appears that conditions of competition can vary across subject areas. For example, market participants often refer to competitors being strong in a particular subject area.[32] In addition, there are a number of specialist publishers, such as Thomson Reuters and Elsevier, who develop a range of titles for specific subject areas only.[33] This suggests that subject area may be the appropriate level to consider the competitive effects of the transaction.

62. As noted above, the key question in deciding whether it is appropriate to widen markets based on supply side substitution is whether publishers can easily change their portfolio of textbooks within and across subject areas.

63. Our investigation suggests that there are several reasons why publishers can switch relatively easily within a subject area but not as easily into other subject areas:

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29 For instance, Commission interviews with
[ ].

30 [ ].

31 *Mergers and Acquisitions Guideline* above n1 at [3.16.2].

32 For example, Commission interview with [ ].

33 For example, Thomson Reuters specialises in the supply of legal, tax and accounting publications in New Zealand. Commission interview with Thomson Reuters (13 December 2019).

63.1 Publishers are able to use existing titles to develop other titles in the same subject area,[34] as they build up knowledge of the subject which allows them to be better placed to identify gaps and opportunities for new titles.

63.2 Reputation can be an important aspect of getting new titles adopted and having a reputation for a particular subject area could help adoptions of new titles in the same area.[35]

63.3 Publishers with a title in a subject area would already have their sales representatives visiting existing course coordinators in the relevant faculty and therefore would be able to take advantage of the reputation already developed to market additional titles at relatively little additional cost to other course coordinators in the same faculty. In contrast, launching into a new subject area would potentially require sales staff to establish new relationships with other course coordinators and the need to fit additional meetings into a schedule if time allows.[36]

64. As noted above, in the interviews we conducted, market participants regularly referred to publishers having a strong or weak presence in a subject area, which suggests that subject area may be the appropriate dimension to consider when assessing the closeness of competition between the parties.

65. On balance, we consider that for the most part, subject area product markets provide the most appropriate way to analyse the Proposed Acquisition and so isolate the relevant competitive effects of the Proposed Acquisition. However, given the range of courses offered within subject areas, we consider that it may also be appropriate to assess the closeness of competition between publishers within a subject area, for example by considering the number of overlaps more narrowly at course level. Our approach to assessing closeness of competition is set out further in the competitive effects section below.

The relevant subject area product markets

66. We used as a starting point the US Pub Track classification system, created by Nielsen for the US HED.[37] This classification was also used by the Applicants to identify the areas of overlap between them. However, we recognise that the Nielsen classification system does not provide a complete way to define the relevant product markets to identify potential competition concerns as it is not always straightforward to draw clear lines between subject areas.

67. We initially identified the subject areas listed in Attachment A as relevant markets in which overlap would result from the Proposed Acquisition. However, we narrowed this down to seven subject areas (management, marketing, finance, mathematics, quantitative business, foreign languages and literature, and physical education). This

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34 For instance, Commission interviews with [ ].

35 For instance ,Commission interviews with [ ].

36 Commission interview with [ ].

37 This system was created by Nielsen for the US HED sector until it was discontinued in 2017.

was because further analysis indicated that these subject areas would result in sufficient overlap post-acquisition to raise potential competition concerns. We excluded from further analysis the remaining subject areas because the overlap was not considered to be sufficient to raise potential concerns.

68. In the foreign languages and literature and quantitative business subject areas, we consider that the Nielsen classification did not appropriately define the relevant product markets as they did not enable us to properly assess the competitive impact of the Proposed Acquisition in those areas. Therefore, we have assessed the competitive effects of the Proposed Acquisition in product markets within narrower subject areas than the Nielsen classification.

69. For the purpose of considering the Proposed Acquisition in these subject areas we consider narrower market definitions help us to more clearly isolate and analyse the competitive effects from the Proposed Acquisition. Further, we consider that a conservative approach is appropriate in this case as if we do not find competition concerns using a narrow market definition then no competition concerns are likely to be raised if a wider market definition is employed. We have therefore defined narrower markets as follows.

69.1 Foreign languages and literature: we note that the only overlap identified between the Applicants from the Proposed Acquisition in this subject area relates to the supply of Spanish language textbooks. Therefore, to assess the competitive effects of the Proposed Acquisition we have defined a narrower product market for textbooks in Spanish language courses.

69.2 Quantitative business: we note that the Applicants submitted that quantitative business is not an appropriately defined market. Instead, they consider that quantitative business is a discipline that sits within the business category.[38] We agree that quantitative business might fit more appropriately in another subject area, such as business, or may be broken down into separate courses (e.g., project management). Since the only overlap between the Applicants in this subject area arises in project management and operations managements,[39] we have defined two separate markets for textbooks in those courses for the purpose of analysing the Proposed Acquisition.

70. For both the foreign language and quantitative business subject areas we found that some publishers offer titles across a range of different courses, while others focus on a narrower range of courses, such as only Spanish language courses. This may suggest supply-side substitutability and that the product markets could in fact be wider than as defined above. As explained above, in this case we have not

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38 The Applicant's response to the Commission's Statement of Issues at [3.19].

39 Operations management is an area of management concerning the process for the production of goods and services. It involves planning, organising, coordinating and controlling all the resources required to produce a company's goods and services.

considered it appropriate to widen these product markets as no concerns arise even on the basis of an assessment on a narrower product market.

Distinction between upper level and lower level courses

71. We also considered whether it was appropriate to define separate product markets for upper level and lower level courses.

72. On the basis of evidence provided by [ ],[40] it appears there may be a distinction between upper level and lower level courses. Lower level courses are usually first- or second-year undergraduate courses with large numbers of students and are taught relatively consistently across Universities (e.g., introductory economics). Upper level courses (i.e., third year and post-graduate courses) generally have much fewer students and, in some cases, are more personally tailored to the course coordinators' research interests.

73. The four major global publishers (Pearson, Wiley, Cengage and McGraw-Hill, often referred to as the 'Big Four') appear to compete particularly closely in the lower level courses, whereas the smaller publishers tend to focus their attention on upper level courses. We were told that this is due to the higher cost of meeting the increased demands for supporting learning materials, which often require investing in online platforms and sunk cost investments in teaching resources.[41] We note that the four major publishers also compete for adoptions in the upper level courses.

74. The Applicants submitted that it is not appropriate to distinguish between lower and upper level courses. While acknowledging that supplementary resources are offered to compete for some lower level courses which require supplementary materials, the Applicants contend that multiple publishers, including publishers from outside the major four, offer such materials and that these are not sophisticated.[42]

75. We consider that there is no clear line to distinguish between the different levels, with courses instead being across a broad spectrum ranging from courses with very large student cohorts to those with very low student numbers.

76. On the basis of the information before us we consider that it is not helpful to define separate product markets for upper level and lower level courses. However, the distinction between upper and lower courses is relevant to our assessment of the closeness of competition in the competition assessment section.

Functional dimension of the market

77. While the Applicants make some direct sales of textbooks (primarily eTextbooks), we understand that most sales to students are indirect and are made via bookshops (online or on campus). We therefore consider that the relevant functional dimension

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40 Commission interviews with [ ].

41 Commission interviews with [ ]).

42 Response from the Applicants to a request for further information from the Commission (3 March 2020) at [2 and 3].

of the product markets is the wholesale supply of HED textbooks and supporting learning materials.

Geographic dimension of the market

78. We consider that the relevant geographic market is likely to be national in scope. The major publishers employ sales representatives who operate nationwide and each publisher supplies textbooks and other supporting learning materials to the HED sector either directly or through third parties throughout New Zealand.

Conclusion on market definition

79. We therefore define the relevant markets as the national markets for the wholesale supply of HED textbooks and supporting material by subject area. Primarily we have defined markets as the subject areas used in the Nielsen classification. However, in respect of the foreign languages and literature and quantitative business subject areas, we define narrower course-based markets; namely the national markets for the wholesale supply of HED Spanish language textbooks and separately the wholesale supply of HED project management and operations management textbooks.

With and without scenarios

80. To assess whether a merger is likely to substantially lessen competition in a market, we compare the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[43]

With the Proposed Acquisition

81. In the factual scenario, the Proposed Acquisition would combine the global educational publishing businesses of Cengage and McGraw-Hill. In doing so, it would reduce the number of major publishers in the relevant markets by one, leaving the merged entity and two other major publishers (Pearson and Wiley), as well as a long tail of smaller publishers.

Without the Proposed Acquisition

82. In our view the likely counterfactual is the status quo, with the Applicants continuing to compete with each other as well as their rival publishers in the relevant markets.[44]

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43 *Mergers and Acquisitions Guidelines* above n1 at [2.29].

44 Application at [3.8]. We also considered whether, absent the Proposed Acquisition, the Applicants would have been close competitors in an emerging market for the supply of digital educational publishing services such as subscription services. However, we have found no evidence that the Applicants are currently providing such services in New Zealand [ ] and therefore considered any competition concerns relating to this issue in New Zealand would be overly speculative.

How the Proposed Acquisition could substantially lessen competition

83. We have considered whether the Proposed Acquisition could have the effect of substantially lessening competition due to:

    83.1 unilateral effects, by giving the combined Cengage and McGraw-Hill the ability to profitably reduce quality (such as reducing the range of textbooks, the quality of content in textbooks, the quality and range of supporting learning materials, or the quality of support services offered by publishers, such as technical support); and

    83.2 coordinated effects by:

        83.2.1 enhancing the prospects for market allocation of textbooks by subject area; and/or

        83.2.2 a general softening of competition resulting in, for example, longer periods of time between publication of new editions, or failure to update to include recent material.

84. Given the Applicants' involvement in different functional levels relating to the supply of educational products, we also considered whether the Proposed Acquisition could have the effect of substantially lessening competition due to vertical effects, by foreclosing rivals from competing effectively. However, we concluded that the merged entity was unlikely to have:

    84.1 sufficient market power at any level of the educational products supply chain to enable it to foreclose competitors; and

    84.2 the incentive to foreclose rivals because such a strategy was unlikely to be profitable.

Competition analysis

85. For the reasons outlined below, we are satisfied that the Proposed Acquisition is unlikely to substantially lessen competition in the relevant markets due to unilateral or coordinated effects.

    85.1 The Applicants are not each other's closest competitor in the relevant product markets and would continue to face sufficient competitive constraint from Pearson, the largest supplier, and Wiley. Therefore, the combined entity would not be likely to have the ability to unilaterally reduce quality in those markets.

    85.2 Additionally, smaller publishers (such as OUP and CUP) are likely to provide some constraint on the merged entity, particularly for upper level courses but also in certain "niche" subject categories in lower level courses in which they compete.

85.3 We consider it unlikely that the relevant markets contain the necessary features to facilitate coordination or that the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Competition analysis - unilateral effects

86. Unilateral effects may occur when a firm acquires a current or potential competitor that would otherwise provide a competitive constraint.

87. The Proposed Acquisition would combine the businesses of two of the four major global publishers in the national markets for the supply of HED textbooks and supporting learning materials, broken down by subject area with the exception of foreign languages and literature, which we have broken down into Spanish language textbooks, and quantitative business, which we have broken down separately into project management and operations management textbooks.

The Applicants' submissions

88. The Applicants submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any of the relevant markets or in any educational sector due to unilateral effects, submitting that:[45]

88.1 the Applicants are not each other's closest competitor with different product offerings and a largely complementary range of products;

88.2 in the HED sector, the parties only overlap in nine subject areas, and these overlaps are minimal with strong competition provided by other publishers;

88.3 the education publishing industry is highly dynamic and faces significant digital disruption;

88.4 the Applicants are constrained by customers bypassing educational publishers through the increased use of white space and OER; and

88.5 there are no material barriers to entry into educational publishing.

Our assessment of existing competition

89. As noted, the Applicants compete against each other to win adoptions from course coordinators across a wide range of subject areas. The competition is to have textbooks adopted by course coordinators and is primarily driven by non-price factors.

90. In addition to each other, we consider that the Applicants face strong competition from Pearson and Wiley across all the relevant subject areas. Although Wiley has lower sales in some subject areas, it offers titles across all subject areas. Further, our investigation shows that Pearson, currently the largest global educational publisher,

[45] Application at [1.2].

competes strongly for adoptions across its broad portfolio of offerings, including in all relevant markets.

91. The Applicants also compete with a large number of smaller publishers such as OUP, CUP, Macmillan and Taylor & Francis. These smaller publishers tend to focus on a narrower range of subject areas primarily in upper level courses, so generally provide only a limited existing competitive constraint.[46]

92. However, we have been provided with some examples of these smaller publishers winning the adoption of textbooks in lower level courses. For example, Macmillan was successful in supplying the first-year psychology course textbook at the University of Canterbury.[47] In addition, the Applicants have provided examples of publishers outside the major four, including Sage Publishing and Taylor & Francis, winning adoptions in lower level courses.[48]

93. On the whole, the evidence suggests that the Proposed Acquisition would reduce the number of major publishers supplying textbooks and supporting learning material into New Zealand from four to three. For instance:

    93.1 [ ];[49]

    93.2 [ ] identified the main competitors as McGraw-Hill, Cengage, Pearson and Wiley;[50] and

    93.3 many of the course coordinators we spoke with receive visits from sales representatives from Cengage and McGraw-Hill (along with Pearson and Wiley) all competing for adoptions.[51]

94. We now consider whether the Proposed Acquisition is likely to result in a substantial lessening of competition in the relevant markets.

Market share analysis

95. To help us identify the relevant subject area markets where the Proposed Acquisition has the potential to raise competition concerns, we collected sales revenue data from the Applicants and a number of their rivals, including their two major rivals (Pearson and Wiley).[52]

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46 Commission interviews with [ ].

47 Commission interview with University Bookshop Canterbury (11 December 2019).

48 Response from the Applicants to a request for further information from the Commission (3 March 2020).

49 [ ]

50 [ ]).

51 For example, Commission interview with [ ].

52 The Applicants supplied us with net sales revenues (sales minus returns) by subject areas for all their titles that had sold over 10 units in New Zealand in the previous year.

96. This provided us with initial market share estimates for each of the subject areas. The data indicated that either McGraw-Hill or Cengage made significant net sales[53] (over 10 sales per title) in 22 subject areas, with overlap (i.e. they both made significant sales) in 16 subject areas.

97. To identify the subject areas that could give rise to competition concerns, we applied the concentration indicators in the Commission's Mergers and Acquisitions Guidelines to the market share estimates. [54]

98. As a result of this process, we identified potential concerns in seven subject areas:[55]

 98.1 management;

 98.2 marketing;

 98.3 finance;

 98.4 quantitative business;

 98.5 mathematics;

 98.6 foreign languages and literature; and

 98.7 physical education.

99. However, for the reasons explained above, we narrowed down the product markets in two subject areas. That is, Spanish language in the foreign languages and literature subject area and project management and operations management in the quantitative business subject area.

100. Tables 1-3 contain our market share estimates for the relevant seven subject areas for the 2016, 2017 and 2018 calendar years.[56] We were unable to collect more detailed market share estimates for each of the Spanish language, project management and operations management product markets. We therefore have used the wider subject areas in which those courses are included to indicate more broadly the market shares in the relevant markets.

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53 That is the revenue from the sale of a textbook less returns.

54 For a description of concentration indicators see the *Mergers and Acquisitions Guidelines* above n1 at [3.5-3.55] and Attachment D.

55 We initially identified six subject areas of potential concern in the Commission's Statement of Issues which was later increased to seven with the addition of Spanish language in the foreign languages and literature subject area.

56 These market shares are based on sales revenue data provided by the Applicants, their two major rivals (Pearson and Wiley) and some of the smaller publishers, although it is possible that there are publishers with sales in these subject areas that we were not able to collect revenue data from and are therefore not included in the tables. We also note that there may be categorisation differences between the publishers. As such we consider these market shares an approximation. Taylor & Francis were unable to disaggregate their revenue to the mapping of the relevant subject areas. As such, their market shares for these subjects are a band where the upper end represents a situation where all their 'business' revenue came from that particular subject.

101. We consider that the three-year period broadly aligns with the life cycle of each edition of a textbook and so may take into account any switching or any new adoptions by course coordinators. As such, while market shares can sometimes be misleading in markets where competition occurs for the market, in this case, we consider that subject area market shares over three years are likely to provide a useful starting point for the assessment of competition within a particular subject area, as it reflects the aggregate result of a number of competitions across different courses. This allows us to understand the identity of publishers that have been active in a subject area and their relative strengths.

102. We note that in several subject areas the estimated market shares have fluctuated significantly during the three-year period under review. This may indicate expansion by some suppliers which we discuss further in the entry/expansion section of these reasons.

Table 1: Estimated percentage market shares by sales revenue and relevant subject category for CY2018

Company	Management	Marketing	Finance	Mathematics	Quantitative business	Physical education	Foreign languages and literature
Cengage	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
McGraw Hill	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Pearson	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wiley	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Macmillan	NA	NA	[ ]	NA	NA	[ ]	NA
Taylor & Francis	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
OUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
CUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total Revenue	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**

Source: Applicants, Edify (on behalf of Pearson and OUP), Wiley, Macmillan, Taylor & Francis and CUP. Note: The market share estimates for foreign languages and literature are incomplete as they do not include many specialist language publishers which are active in this subject area.

Table 2: Estimated percentage market shares by sales revenue and relevant subject category for CY2017

Company	Management	Marketing	Finance	Mathematics	Quantitative business	Physical education	Foreign languages and literature
Cengage	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
McGraw Hill	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Pearson	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wiley	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Macmillan	NA	NA	[ ]	NA	NA	[ ]	NA
Taylor & Francis	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
OUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
CUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total Revenue	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**

Source: Applicants, Edify (on behalf of Pearson and OUP), Wiley, Macmillan, Taylor & Francis and CUP.

Table 3: Estimated percentage market shares by sales revenue and relevant subject category for CY2016

Company	Management	Marketing	Finance	Mathematics	Quantitative business	Physical education	Foreign languages and literature
Cengage	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
McGraw Hill	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Pearson	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Wiley	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Macmillan	NA	NA	[ ]	NA	NA	[ ]	NA
Taylor & Francis	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
OUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
CUP	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total Revenue	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**	**$ [ ]**

Source: Applicants, Edify (on behalf of Pearson and OUP), Wiley, Macmillan, Taylor & Francis and CUP.

Further assessment

103. We also considered whether there were other subject areas not captured by our market share analysis that could give rise to concerns.

104. We did not find any other subject areas where the Applicants appeared to compete particularly closely and therefore concluded that there were no subject areas other than the subject areas identified above in which competition concerns are likely to arise.

105. To assess whether there was likely to be a substantial lessening of competition in the relevant markets, we considered the closeness of competition between the Applicants and their remaining rivals by:

105.1 analysing [ ];

105.2 assessing the difference in the closeness of competition between the lower and upper level courses; and

105.3 considering the extent to which the Applicants compete closely with each other and their rival publishers in terms of offering overlapping titles for courses within the seven identified subject areas.

<u>Mathematics and physical education</u>

106. Based on the market share estimates the Proposed Acquisition is likely to result in only a small increase of market share in both of these subject area markets. Cengage had a market share of [ ]% and McGraw-Hill a market share of [ ]% in mathematics for CY 2018. In Physical Education, Cengage [ ] has a market share of [ ]%, while McGraw-Hill has a market share of [ ]% for CY 2018.

107. Our analysis of course overlaps within these subject area markets also indicates that the Applicants do not appear to compete closely in either of these markets. For mathematics, the parties only overlap in [ ] courses in which either party made significant sales, while for physical education there is [ ] between the Applicants. It is worth noting that the [ ]in which the parties overlap in mathematics is a catch-all category called “other”. The titles McGraw-Hill offer in this course are an introductory mathematics and statistics textbook, while Cengage offers calculus and applied mathematics textbooks. We do not consider that these textbooks would likely be competing with each other for adoptions.

108. In addition, there are other publishers competing closely. These include Pearson and Wiley in mathematics, while Pearson, Taylor & Francis and other publishers are competing in the supply of physical education textbooks.[57]

109. We therefore consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in either of the markets for the supply of HED textbooks and supporting learning materials to the mathematics or physical education subject areas.

Finance

110. The market share estimates show that Cengage has a market share of [ ]% while McGraw-Hill has a market share of [ ]%, so the Proposed Acquisition is likely result in an increase in market share (to [ ]%) for CY 2018. Pearson with an estimated market share of [ ]% and Wiley with [ ]% are likely to remain strong competitors in this subject area market.

111. The Applicants overlap in [ ] courses in which either party made significant sales, although Cengage recorded [ ] sales and revenues in these [ ] courses, suggesting that it does not impose a particularly strong competitive constraint on McGraw-Hill. Pearson, Wiley and other smaller publishers currently sell textbooks in both of these courses.

112. In addition, [ ].

113. We therefore consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in the national market for the supply of HED textbooks and supporting learning materials to the finance subject area.

Marketing

114. We estimate that the merged entity would hold a market share of around [ ]% for CY 2018 in this subject area market.

115. We considered whether the Applicants were competing closely with each other relative to the competitors that would remain post-acquisition. While the Applicants compete in only [ ] out of the [ ] courses in which either party made significant sales, they currently have the adoptions for first year undergraduate courses in the four major metropolitan universities.

116. Pearson is the next largest competitor with a market share of [ ]%, with the remaining shares split between Wiley, Taylor & Francis and CUP. [ ] also advised us that Pearson has a leading author (Phil Kotler) in overseas undergraduate marketing courses in a tightly contested subject area.[58]

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[57] This includes Human Kinetics Publishers, a specialist publisher in the physical education subject area whose products are distributed in New Zealand by Footprint Books.

[58] Commission interview with [ ].

117. Although the market share estimates indicate that Wiley has minimal sales in this subject, other evidence suggests that Wiley imposes a competitive constraint in this subject area market. While Wiley had a market share of [ ]% in 2016 and [ ]. Wiley has at least seven titles available for sale in New Zealand in marketing, covering both upper and lower level courses.

118. In addition to Wiley, CUP, OUP, and to a lesser extent Macmillan and Taylor & Francis, all have a presence in this subject area, with CUP having at least one textbook for sale in New Zealand, OUP having at least four including one undergraduate offering[59] and Macmillan having at least three textbooks. This suggests that they may impose a limited competitive constraint on the merged entity post-acquisition, focused on upper level courses as discussed previously.

119. With Pearson being both Cengage and McGraw-Hill's closest competitor, and a likely constraint from Wiley over and above that suggested by its estimated market share, we consider that there will be sufficient competition in marketing to ensure there is no reduction in the quality of textbooks or supporting learning material. This is further strengthened by the additional, albeit limited, constraint that smaller publishers will exert in this subject area.

120. For these reasons, we consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in the national market for the supply of HED textbooks and supporting learning materials to the marketing subject area.

<u>Management</u>

121. Based on estimates, the merged entity would account for an estimated market share of around [ ]% in CY 2018 in this subject area. Pearson appears to be the next largest competitor with a [ ]% share, followed by Wiley with a [ ] share. In addition, [ ][60] identified Pearson as a strong competitor in this subject area.

122. Also, we note that Wiley has titles in this subject area and has secured the adoption of one of its titles in the Management 101 undergraduate course at the Victoria University of Wellington.[61]

123. [ ].

124. This suggests that the merged entity would continue to face strong constraints in this subject area post-acquisition. We therefore consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in the national market for the supply of HED textbooks and supporting learning materials to the management subject area.

59 Ibid.

60 Ibid.

61 See https://www.wgtn.ac.nz/courses/mgmt/101/2020/offering?crn=8508

Spanish language

125. The estimated market shares information we collected indicated that the merged entity would likely have a high market share in the wider foreign languages and literature subject area and face limited competition from other publishers in that subject area.

126. However, we found that the market share estimates for this subject area were incomplete and did not accurately reflect the extent of competition between the Applicants and their rival publishers. In particular, the estimates did not include the market share estimates of other specialist language publishers.

127. We note that the Applicants appear to compete closely for adoptions in relation to Spanish language courses. For instance, both parties offer titles in lower level Spanish courses, which have been adopted by two New Zealand universities.[62] The Applicants also compete with several other publishers of Spanish language textbooks. These competing suppliers of Spanish textbooks are Difusion Centro de Publicacacion y Publicaciones de Idiomas (Difusion), Edelsa and Vista Higher Learning, all three of which have offerings adopted by New Zealand Universities.[63]

128. We therefore consider that the merged entity would continue to be constrained by several competitors post-acquisition.

129. For these reasons, we consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in the national market for the supply of HED Spanish language textbooks and supporting learning materials.

Project management and operations management

130. The estimated market share information we collected indicated that the merged entity would likely have a relatively high market share in the wider quantitative business subject area. However, we placed limited weight on this information as we considered that the estimates may not accurately reflect the state of competition in the courses in which the Applicants overlap.

131. The Applicants overlap in two courses in this subject area (operations management and project management). Our analysis shows that there are at least 15 other titles from Pearson, Wiley and smaller publishers available in New Zealand in both of these courses. We therefore consider that the merged entity would continue to be constrained by a number of competitors post-acquisition.

132. For these reasons, we consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition in the national markets for the supply of HED textbooks and supporting learning materials separately for project management and operations management courses.

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[62] Cengage has adoptions at Waikato University and Cengage has adoptions at Otago University.

[63] Difusion currently has adoptions at Victoria University of Wellington, Edelsa has adoptions at Auckland University and Vista has adoptions at the University of Canterbury.

Conclusion on existing competition

133. We conclude that existing competition would likely be sufficient to prevent a substantial lessening of competition in all the above relevant markets.

Entry/Expansion

134. As noted, the Applicants submitted that there are "no material barriers to expansion into new subject areas."[64] Additionally, the parties provided examples from the vocational publishing sector in Australia to illustrate the ease of such expansion.[65] These include Skin Deep Learning, Didasko and IBSA.[66]

135. In determining whether entry or expansion is likely to prevent a substantial lessening of competition we assess whether such entry or expansion is likely, sufficient in extent and timely.[67] In this case we consider that the most likely form of expansion or entry into the relevant markets would be from publishers, including smaller publishers, expanding into new subject areas or enhancing their offering to compete for lower level courses.

136. We found evidence that there are likely to be some barriers that may hinder that expansion or entry in a likely, sufficient and timely fashion and so prevent a substantial lessening of competition in any of the affected markets. For example:

136.1 the need to invest in additional resources such as course specific resources (e.g., slides, inter-active quizzes and student performance tools), which is likely to incur sunk costs, to compete for lower level titles,[68] potentially including delivery platforms, and to expand into a broader range of subject areas, in which the commercial returns may be more uncertain;[69]

136.2 the tendency for course coordinators to be sticky and not switch to other textbooks regularly,[70] limiting the ability for new entrants to quickly recoup investments in new courses;[71]

136.3 access to a pool of highly regarded authors is necessary, but can be difficult if the publisher has no previous experience or reputation in the relevant subject area;[72] and

136.4 establishing a reputation in a new subject area can be a lengthy process.[73]

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64 The Applicants' response to the Commission's Statement of Issues (20 February2020) at [5.2-5.6].
65 Ibid at [5.7].
66 Ibid.
67 *Mergers and Acquisitions Guidelines* above n1 at [3.96-3.10].
68 Commission interview with [ ].
69 For example, Commission interview with [ ].
70 For example, Commission interview with [ ](20 November 2020).
71 For example, Commission interview with [ ].
72 For example, Commission interviews with [ ] and [ ].
73 Ibid.

137. However, we note that there are a few examples of other publishers being able to win an adoption for some courses, and examples of suppliers moving into new subject areas. This indicates that there may be some scope for expansion from rival publishers, and if so, this may provide further constraint on the merged entity.

138. However, we have not found it necessary to reach a conclusion on the likelihood, sufficiency or timeliness of entry or expansion in this case given our conclusions that existing competition is sufficient to constrain the merged entity in all the above relevant markets.

Constraint from countervailing power

139. A merged firm's ability to increase prices profitably may be constrained by the ability of certain customers to exert substantial influence on negotiations.[74]

140. The Applicants submitted that they are constrained by downstream customers bypassing educational publishers and obtaining content through alternative channels, including white space (eg, purchasing second-hand books) and openly licensed and freely available educational materials.

141. We agree with the Applicants that students are bypassing the purchase of new textbooks and obtaining educational products from alternative sources.

142. We consider that white space may provide some constraint on pricing by the merged entity and OER (or self-supply by course coordinators of course materials) may provide some constraint on quality. However, we have found no evidence to show these factors are likely to sufficiently constrain course coordinators from adopting a publisher's textbook.

143. For these reasons, we do not consider that either white space or OER are likely to provide a meaningful constraint to prevent a substantial lessening of competition in the relevant markets.

Conclusion on unilateral effects

144. For the reasons set out above, we consider that the Proposed Acquisition is unlikely to substantially lessen competition for the wholesale supply of HED textbooks and supporting materials in any of the relevant markets due to unilateral effects.

Competition analysis - coordinated effects

145. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase in the relevant market. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way. This

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[74] *Mergers and Acquisitions Guidelines* above n1 at [3.113].

could take the form of coordination on pricing or other non-price attributes, or of customer allocation across suppliers.

146. We assess whether:

146.1 a market is vulnerable to coordination; and

146.2 the merger changes the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

The Applicants' submissions

147. The Applicants submitted that the Proposed Acquisition will not increase the likelihood of coordination due to range of factors, including:[75]

147.1 there are a variety of different models of operation such that costs are likely to vary greatly between each market participant;

147.2 pricing can be complex;

147.3 demand for books varies through the revision cycle;

147.4 generally, educational products are highly differentiated products which are rarely direct substitutes for one another; and

147.5 the existing players in the industry are subject to a high degree of competitive constraint, including low barriers to entry and general disruption.

Our assessment of coordinated effects

148. We consider that the market for the supply of HED textbooks and supporting materials is unlikely to be vulnerable to coordination. We agree that:

148.1 textbooks are heterogenous and differentiated products in relation to both the textbooks themselves, and the services offered alongside them;

148.2 different textbook publishers have different models of operation; and

148.3 while demand for textbooks is broadly cyclical, we consider that opportunities to compete for adoptions are somewhat variable and unpredictable.

149. Further we consider that:

149.1 there are many HED textbook publishers with a range of different offerings (noting that a number of smaller publishers have a fairly low presence in New Zealand);

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[75] Application at [184]-[191].

149.2 competition for adoptions is strong between publishers because each adoption is profitable only for the adopted publisher. Stickiness by course coordinators reduces the number of opportunities to compete for adoptions and accordingly makes the incentive to win an adoption higher. Further, there is competition between sales representatives who are paid on commission.[76] These factors decrease the sustainability of any coordination by incentivising cheating. In particular, [ ] showed that sales representatives from each publisher were actively competing for adoptions; and

149.3 innovation exists in the form of producing new textbooks and ancillary services.

150. However, we do consider that the winning of adoptions is transparent, and publishers, via their sales representatives, have the opportunity to interact with each other.

151. Overall, we consider this market is not likely to be vulnerable to coordination.

152. We have also considered whether the Proposed Acquisition will make coordination more likely, complete or sustainable.

153. The aggregation of market share by the merged entity and the reduction in the number of suppliers could make coordination more likely. However, we note that the market shares of the remaining suppliers will be asymmetric, with the merged entity now the market leader and Pearson and Wiley second and third respectively. Given the factors outlined above, we do not consider these factors sufficient to make the market vulnerable to coordination, nor substantially lessen competition.

154. Given these factors, we consider that the Proposed Acquisition is unlikely to lead to a substantial lessening of competition through coordinated effects.

Overall conclusion

155. We are therefore satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

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76 The Applicants' response to the Commission's Statement of Issues at [7.4].

Determination on Notice of Clearance

156. Pursuant to section 66(3)(a) of the Act, the Commerce Commission determines to give clearance to Cengage and McGraw-Hill merging their global publishing businesses into a new, yet to be incorporated entity.

Dated this 14th day of April 2020

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Anna Rawlings
Chair

Attachment A: list of overlapping subject areas considered by the Commission

1. Management
2. Psychology
3. Marketing
4. Accounting
5. Finance
6. Economics
7. Education
8. Mathematics
9. Biological sciences
10. Engineering
11. Quantitative business
12. Physics
13. Foreign languages and literature
14. Chemistry
15. Health and related professions
16. Business
17. Nursing
18. Physical education
19. Computer science
20. Food science
21. Environmental science
22. Geology