ISSN 1178-2560
Decision Series
Project no. 11.04/PRJ0044173

Public version

Determination

Juice Technologies Pty Limited and APT Business Solutions Limited [2020] NZCC 1

The Commission:	Sue Begg Dr Jill Walker Dr Derek Johnston
Summary of application:	An application from Juice Technologies Pty Limited seeking clearance to acquire 100% of the shares in APT Business Solutions Limited.
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:	4 March 2020

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

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The Proposed Acquisition

1. On 16 December 2019, the Commission registered an application (the Application) from Juice Technologies Pty Limited (Juice Technologies) seeking clearance to acquire 100% of the shares in APT Business Solutions Limited (APT) (the Proposed Acquisition).

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.

3. Our decision on the Proposed Acquisition was made prior to the announcement of a nationwide lockdown as a result of the COVID-19 pandemic and the resulting period of national emergency. The reasons in this Determination reflect the views of the Commission at the date on which the decision to grant clearance was made, being 4 March 2020.

Our framework

4. 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

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

6. 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]

7. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the 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

8. 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]

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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].

Some courts have used the word ‘material’ to describe a lessening of competition that is substantial.[5]

9. 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]

10. 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]

11. 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

12. 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

13. 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.[11]

Relevant parties to the Proposed Acquisition

The merging parties

14. Juice Technologies is active in New Zealand through its wholly owned subsidiary, Infocare Systems Limited (Infocare) and supplies Student Management System (SMS) software to the New Zealand childcare industry. Infocare has been active in the supply of SMS since 2003. We refer to the applicant as Infocare from this point on.

15. APT is a privately held company which also supplies SMS software to the New Zealand childcare industry and was one of the first SMS providers in New Zealand when it entered in the early 1990s.

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[5] Ibid at [129].
[6] *Mergers and Acquisitions Guidelines* above n 1 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).
[11] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [98].

Other relevant parties

16. In addition to the merging parties, we set out below several other parties that are relevant to the Proposed Acquisition.

Other SMS software suppliers

17. Superior Admin Limited (Discover) entered as a supplier of SMS software in 2017. It is now one of the three largest SMS software suppliers to childcare providers in New Zealand, along with Infocare and APT.[12] We understand that Discover offers cloud-based technology with a more modern user interface than the merging parties.[13] As discussed below, since its entry, Discover has expanded significantly in the supply of SMS software to early childhood education (ECE) providers.

18. The Application also lists the following SMS software suppliers which Infocare submitted are likely to further constrain the merged entity:[14]

    18.1 Aimy Limited (Aimy Plus), which supplies SMS to out of school care and recreation (OSCAR) providers;

    18.2 Mace IT Services (Juniorlogs), which in the past has focused largely on playcentres [ ];[15]

    18.3 Porse In-Home Childcare (NZ) Limited (Porse), which is a home-based care provider that has developed its own SMS software which it uses for its own home-based care services; and

    18.4 First Base, which Infocare submitted has been operating for 20 years, but which has no online presence and which market participants indicated now has a minimal presence as an SMS supplier.

19. We discuss these suppliers further in the Competition Assessment section of this Determination.

20. [ ].[16]

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12 On the basis on revenue figures and market share estimates provided in the Application at Tables 1-10, and on feedback from industry participants.

13 Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

14 Application at [61].

15 We understand that playcentres operate as a single SMS customer, with all playcentres using the same SMS. [ ]

16 Commerce Commission interview with [ ].

The Ministry of Education

21. The Ministry oversees, regulates, and administers funding to childcare providers in New Zealand. The Ministry places requirements on suppliers of SMS software to childcare providers relating to information collection, funding and other administrative matters. These requirements are discussed further in the Industry Background and Competition Assessment sections of this Determination.

Customers

22. Infocare and APT supply SMS software to ECE providers. These customers range in size from single-centre providers to large conglomerates comprising many ECE centres throughout New Zealand.

23. Best Start Educare Limited (Best Start) is [ ][17] It is New Zealand's largest provider of ECE, with approximately 260 centres nationwide.[18] [ ][19]

24. Evolve Education Group Limited (Evolve) is [ ][20] and is New Zealand's second largest ECE provider, with approximately 120 centres nationwide.[21] [ ][22]

Rationale for the Proposed Acquisition

25. Infocare proposes to acquire 100% of the shares of APT for [ ], conditional on Commerce Commission clearance. The Proposed Acquisition would result in overlap in the supply of SMS software in New Zealand.

26. Infocare submitted that, since both APT and Infocare began operating, there have been significant developments in the industry.[23] It submitted that these developments have resulted in their respective software becoming out of date when compared with more modern offerings, such as Discover, which are cloud-based, highly functional and superior in appearance.[24]

27. Infocare submitted that significant investment is needed to update its technology in order to provide stable and effective software for its customers, and that it would be challenging to undertake this investment without the merger.[25] Infocare considers

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17 [ ]
18 https://best-start.org/about-us.
19 Commerce Commission interview with Best Start, 29 January 2020.
20 [ ]
21 https://www.evolveeducation.co.nz/our-centres/
22 Commerce Commission interview with Evolve, 28 January 2020.
23 Application at [8].
24 Application at [7]-[11].
25 Application at [13]-[14].

that the Proposed Acquisition would result in a larger customer base to justify the capital costs of the required upgrades.[26]

Industry background

28. SMS software is designed to assist with the administrative aspects of running a childcare centre. The core functionality of SMS software for childcare providers includes:

    28.1 recording all child enrolment details, attendance details and demographics;

    28.2 storing staff/teacher information, staff rosters and worked hours;

    28.3 invoicing and receipting; and

    28.4 documenting fundraising projects and recording donations.

29. In addition, childcare providers use SMS software to collate and provide up to date statistical information to the Ministry for funding and policy purposes.

30. In 2013, the Ministry introduced a new information collection system called the Early Learning Information (ELI) system. The change introduced new, expanded requirements for information supplied to the Ministry by ECE providers and required that SMS suppliers gain approval from the Ministry and integrate with the ELI system.[27] The exception to this requirement is OSCAR providers, which can use SMS software that is not Ministry-approved.

31. The Ministry also offers a free online portal, ELI Web, which allows centres to provide information manually (i.e. without using SMS software). We understand that this is only feasible for very small childcare centres and that almost all childcare providers use third party SMS software.[28]

How the Proposed Acquisition could substantially lessen competition

32. We have considered whether the Proposed Acquisition would be likely to substantially lessen competition as a result of unilateral effects or coordinated effects.[29]

    32.1 Unilateral effects arise when a firm acquires a current or potential competitor that would otherwise provide a competitive constraint, allowing the merged entity to profitably raise prices or reduce quality to its customers.

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26 Application at [14].

27 Commerce Commission interview with the Ministry of Education, 4 February 2020.

28 For example, Infocare estimates that [ ] of ECE centres use ELI Web – Application at Table 1.

29 We do not consider that vertical and/or conglomerate effects are likely, since the Proposed Acquisition would not result in vertical integration and neither party appears to supply any must-have products or services that are not available elsewhere.

32.2 Coordinated effects arise when a merger or acquisition increases the potential for the merged firm and some or all of its remaining competitors to coordinate their behaviour and collectively exercise market power to increase prices or reduce quality.[30]

Market definition

33. Market definition is a tool that helps identify and assess the close competitive constraints that a 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.

34. We define markets in the way that best isolates the key competition issues that arise from a merger.[31] In many cases we may not need to precisely define the boundaries of a market. What matters is that we consider all competitive constraints. For that reason, we also consider products and services which fall outside the market but still impose a competitive constraint on the merged entity.

Applicant's view of the relevant markets

35. Infocare submitted that the relevant market for our consideration of the Proposed Acquisition is the national market for the provision of SMS to childcare providers.[32] However, in the Application, Infocare also identified four different categories of childcare providers that use SMS, being:[33]

35.1 education and care centres, which are all-day centres catering for children aged 0-5;

35.2 kindergartens;

35.3 home-based care providers; and

35.4 OSCAR providers, which include school holiday programmes and before/after school care.

36. Infocare submitted that SMS suppliers to childcare providers typically supply SMS to multiple customer types.[34] It submitted that the requirements for SMS do not vary across the above categories, meaning the software is the same regardless of customer type.[35] However, Infocare also submitted that the functionality customers

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30 See for example Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2013) at 27-28.
31 *Mergers and Acquisitions Guidelines*, above n 1, at [3.10]-[3.12].
32 Application at [30].
33 Application at [31].
34 Application at [36].
35 Application at [36].

require from SMS is different at other education levels (for example, for secondary and tertiary education providers).[36]

Our view of the relevant markets

37. For the purpose of our competition analysis, we have defined the relevant market as the national market for the supply of SMS software for education and care centres, kindergartens, and home-based care providers (the pre-school SMS market).

38. We set out our reasons for arriving at this relevant market below.

Product dimension

39. Infocare and APT supply SMS software to ECE providers, which includes providers of education and care centres, kindergartens, and home-based care. Infocare and APT also supply SMS software to OSCAR providers. We considered whether it may be appropriate to also include other education sectors, such as primary schools, secondary schools, and/or tertiary education providers, in the relevant market, as these sectors also utilise SMS.

40. Infocare submitted that SMS software is used in all levels of the education sector and that suppliers who target one education sector could readily switch or expand to target others.[37]

41. However, the requirements for SMS software for the childcare sector appear to be materially different to those in other education sectors. This suggests there is limited scope for both supply-side and demand-side substitution between the products supplied to the different sectors.

42. For example, there are unique requirements for Ministry approval and ELI integration of pre-school SMS products that do not apply to other education sectors.[38] This is primarily due to the funding structure that exists for ECE providers,[39] which is administered through the Ministry and necessitates consistent, accurate supply of information.[40] Consequently, there is significant investment required by firms wishing to supply pre-school SMS products, detailed further below.

43. It follows that SMS suppliers to non-childcare sectors are limited in their ability to supply their products to ECE providers and, as such, these other sectors are likely to

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36 Application at [36] and [38].

37 Application at [38].

38 As discussed, the Ministry requires that SMS software for ECE providers is integrated with its ELI system. We understand this can take over a year to achieve, due to the software development and testing that is often required - Commerce Commission interview with the Ministry of Education, 4 February 2020.

39 The New Zealand government fully funds ECE for up to six hours per day and 20 hours per week for all children between three and six years of age. This funding model is unique to ECE and is administered by the Ministry – see https://www.education.govt.nz/early-childhood/funding-and-data/20-hours-ece-for-ece-services.

40 Commerce Commission interview with the Ministry of Education, 4 February 2020.

fall outside the relevant market. Below, we consider whether it is necessary to further narrow the market to certain types of childcare providers.

<u>Separate market for pre-school SMS software</u>

44. As with SMS suppliers for other educational sectors, SMS suppliers that have developed a product for OSCAR customers cannot readily supply that SMS software to pre-school childcare customers. This is because care for school aged children does not involve the same Ministry approval and integration requirements that apply to pre-school care, and meeting the Ministry's requirements for pre-school SMS products requires significant additional investment.[41] That is, there is no substitutability from the supply of OSCAR SMS products to the supply of pre-school SMS products.[42]

45. From a demand perspective, because of these different requirements, a pre-school education provider is unlikely to switch to an SMS product that targets OSCAR providers if faced with a small but significant increase in price (SSNIP) from its existing SMS supplier.[43]

46. Therefore, we consider that the relevant market is limited to SMS software for pre-school childcare providers, and that SMS software for OSCAR providers falls outside the relevant market.

47. The Proposed Acquisition would result in a low level of aggregation in the supply of SMS software to OSCAR providers.[44] Therefore, we do not consider the Proposed Acquisition is likely to raise competition concerns in the supply of SMS software to OSCAR providers.

Customer dimension

48. We considered whether it may be appropriate to adopt separate customer markets for different-sized ECE providers. It appears that there are some notable differences in competition between SMS suppliers for large customers with over five centres on the one hand, and smaller customers comprising five or less centres on the other. For example:

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41 This is reflected in evidence from [ ] – Commerce Commission interview with [ ].

42 Conversely, pre-school SMS suppliers may be able to relatively easily provide OSCAR SMS products. Consequently, any supply-side substitutability is likely to only go one way, ie, from pre-school SMS products to OSCAR SMS product, but not both ways.

43 *Mergers and Acquisitions Guidelines*, above n 1, at [3.15]-[3.24].

44 The merged entity would have an estimated share of [ ]% in the supply of SMS software to OSCAR providers. In addition, there is significant existing competition from Aimy Plus (with an estimated OSCAR share of [ ]%) – Application at Table 9.

48.1 large customers comprising five or more childcare centres appear more able to negotiate bespoke pricing and functionality due to their elevated value to SMS suppliers;[45] and

48.2 large customers may be more sticky than smaller customers due to the additional requirements in switching multiple centres to a new SMS, and an increased level of integration between the SMS software and other business systems such as accounting, payroll, and other third party applications.[46]

49. While this might suggest separate customer markets, given the merged entity would have significant market share and would likely face the same competitive constraints in relation to both sets of customers, we have not defined separate customer markets.

Geographic dimension

50. New Zealand SMS software suppliers operate nationwide. As discussed, SMS suppliers to New Zealand pre-school childcare providers need to be approved by the Ministry and integrated with its ELI system. Given these New Zealand-specific requirements, overseas SMS suppliers are unlikely to be adequate substitutes. Therefore, the geographic scope of the pre-school SMS market is national.

Conclusion on market definition

51. For the above reasons, in our competition assessment below, we consider whether the Proposed Acquisition would be likely to give rise to a substantial lessening of competition in the national market for the supply of SMS software for education and care centres, kindergartens, and home-based care (the pre-school SMS market).

With and without scenarios

52. 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).[47]

Scenario with the Proposed Acquisition

53. With the Proposed Acquisition, Infocare would acquire the business and assets of APT. Infocare submitted that, if the Proposed Acquisition proceeds, it would seek to develop a single back end system to support both Infocare and APT, which would remain two separate but improved front end platforms.[48] Infocare estimates that

45 Commerce Commission interview with [ ].
46 Commerce Commission interview with [ ].
47 *Mergers and Acquisitions Guidelines*, above n 1, at [2.29].
48 Application at [46].

these technology upgrades would take approximately 12 – 18 months and require capital expenditure of approximately $2 – 3 million.[49]

54. Infocare submitted that the time required to build the new back end platform and improve the front-end products would likely lead to customers continuing to switch away to its competitors.[50]

Scenario without the Proposed Acquisition

55. Infocare submitted that without the Proposed Acquisition, APT and Infocare would remain separate entities and that both firms would continue to lose market share to new software suppliers.[51] Infocare also submitted that one of the new SMS platforms would likely acquire APT and switch APT's customers onto that new platform.[52]

56. We consider that without the Proposed Acquisition, there are two potential ownership scenarios for APT:

56.1 acquisition by a third party; or

56.2 APT continues as a standalone entity.

57. Under either of these scenarios, APT and Infocare would remain competing suppliers in the pre-school SMS market.

Third party purchase of APT

58. [ ][53]

59. [

59.1

59.2

59.3]

49 Application [15]-[16] and [46].
50 Application at [50].
51 Application at [56].
52 Application at [56].
53 Commerce Commission interview with [ ].

60. We therefore consider that absent the Proposed Acquisition, there is a real chance that APT would be sold to a third party. We consider that a third-party purchaser would likely either switch APT's customers to its existing platform (in the case of an existing SMS supplier [ ]), or upgrade APT's software as necessary to remain competitive in the market.[54]

APT standalone

61. [ ][55]

62. We consider that if APT was to continue as a standalone business absent the Proposed Acquisition, it may continue to lose market share to both Discover and other recent [ ] entrants, such that its competitive significance would be diminished.

Conclusion on the without scenario

63. We consider that without the Proposed Acquisition by Infocare, there are two real chance scenarios: that a third party would purchase APT, and that APT would remain a standalone entity. We do not consider it necessary to determine which of these is likely to be more competitive because it does not affect our competition analysis.

Competition assessment - Unilateral effects

64. To test whether the Proposed Acquisition would be likely to result in a substantial lessening of competition due to unilateral effects, we have considered:

    64.1 the extent to which Infocare and APT constrain each other competitively and whether the extent of any constraint is likely to change absent the Proposed Acquisition;

    64.2 whether there are other competitors in the market that would be likely to constrain the merged entity;

    64.3 whether potential entry or expansion by other suppliers of pre-school SMS services would likely act as a constraint on the merged entity, taking into account barriers to entry and expansion; and

    64.4 whether pre-school SMS software customers are likely to have sufficient countervailing power to constrain the merged entity's ability to raise prices.

Competition between APT and Infocare

65. Table 1 sets out the estimated market shares of the merged entity, and other participants in the market, based on revenue estimates provided in the Application.

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[54] We note that if, absent the Proposed Acquisition, another existing supplier [ ] sought to acquire APT, that transaction would also need to satisfy section 47 of the Act in relation to any possible impact on competition.

[55] Commerce Commission interview with [ ].

Table 1: Estimated market shares of preschool SMS suppliers in 2019

Party	Market share %[56]
Infocare	[ ]
APT	[ ]
Merged entity	[ ]
Discover	[ ]
Others	[ ]
Total	**100**

Source: Application at Tables 1-10

66. Table 1 shows that post-acquisition, the merged entity would have a market share of [ ]% of the pre-school SMS market. Discover would be the second-largest player with [ ]% and other small SMS suppliers accounting for the balance.

67. Industry participants we interviewed agreed that competition between Infocare and APT has been, and remains, limited. Prior to the entry of Discover in 2017, pre-school SMS customers were held by Infocare and APT in roughly equal shares and the two firms did not compete aggressively against each other for customers.[57]

68. It does not appear that either supplier implemented significant competitive strategies such as software development, marketing campaigns, or price competition.[58] Infocare stated that [ ][59] [ ].[60]

69. Competitors and customers told us that competition on price is not a major factor in the pre-school SMS market because the cost of SMS software represents a small proportion of the overall costs of a childcare provider, meaning that customers are unlikely to switch for the sole reason of attaining a lower price.[61] We understand

56 Application at Tables 1-10. These figures exclude OSCAR from the relevant market. In the Application, Discover's estimated aggregated market share across all segments including OSCAR is [ ]%.
57 Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].
58 Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].
59 Commerce Commission interview with Infocare, 16 January 2020.
60 Commerce Commission interview with [ ].
61 For example, Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

that in the past, customer churn between Infocare and APT only occurred when circumstances demanded; for example, when a childcare centre was acquired and moved to the software used by the acquiring firm.[62]

70. We do not consider that either Infocare or APT is likely to provide materially more constraint on each other absent the Proposed Acquisition.

70.1 Infocare submitted that its current customer base is insufficient to justify the investment in new technology and software development.[63]

70.2 [ ][64]

71. We therefore consider that while Infocare and APT are similar in size and have similar products, they are not providing a material competitive constraint on each other, nor are they likely to provide increased constraint in the future absent capital investment. Rather, we consider that any material competitive constraint is being provided by other competitors and the threat of entry. These constraints are discussed below.

Constraint from existing competitors

72. Infocare submitted that recent entrants to the SMS market, particularly Discover, have secured significant market share at the expense of Infocare and APT.[65] Infocare considers that this is because these entrants operate with more modern technology and provide better experiences and features for customers.[66]

73. While the Proposed Acquisition would mean a reduction in the number of competitors in the market, we consider that remaining competing suppliers of SMS (in particular, Discover) would continue to provide material constraint on the merged entity.

Constraint provided by Discover

74. Infocare submitted that Discover's entry in 2017, and subsequent success in acquiring customers, has been a key competitive challenge to both Infocare and APT and that Discover would constrain the merged entity.[67]

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62 Commerce Commission interview with [ ].
63 Commerce Commission interview with Infocare, 16 January 2020.
64 Commerce Commission interview with [ ].
65 Application at [74]-[75].
66 Application at [72]-[75].
67 Application at [62] and [75].

75. Discover's entry appears to have changed the competitive landscape of the pre-school SMS market by introducing competitive constraint to both Infocare and APT. Discover has been successful in securing customers at the expense of both incumbents and has built a significant market share in a short period of time, gaining an estimated [ ]% in a period of just over two years.

76. Industry participants told us that Discover's success is due to:

76.1 its product offering a more intuitive user interface, which includes smoother operability that is easier to learn;[68]

76.2 the superior functionality of the product, such as an ability to interface with a customer's website to streamline client onboarding[69] and business metrics functions, which assists in management and benchmarking;[70] and

76.3 an aggressive strategy from Discover to marketing its product and securing customers from its competitors.[71]

77. For example, [ ] noted that apart from a promotional evening in 2019, it had not been offered a demonstration of the Infocare system since 2015.[72] This was contrasted with Discover, which has had two meetings with [ ] in the previous six months.[73]

78. Customers consistently indicated that they had considered switching to Discover (or were already using Discover), supporting the view that Discover has provided material recent constraint on Infocare and APT.[74]

79. None of the customers we spoke to expressed concerns about the likely impact of the Proposed Acquisition. For example, [ ] expressed the view that the Proposed Acquisition would involve two inferior products coming together, and it would likely be more of an issue if Infocare or APT sought to acquire Discover, since Discover is the strongest alternative option to the merging parties.[75] [ ] and [ ] both

68 Commerce Commission interview with Discover, 22 January 2020; Commerce Commission interview with [ ].

69 Commerce Commission interview with [ ].

70 Commerce Commission interview with [ ].

71 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

72 Commerce Commission interview with [ ].

73 [ ] - Commerce Commission interview with [ ].

74 For example, Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

75 Commerce Commission interview with [ ].

noted that the Proposed Acquisition may give Infocare and APT an opportunity to improve their products to bring them more in line with Discover.[76]

80. In addition, the merging parties' internal documents indicate that they each view Discover, rather than each other, as their most significant competitor.[77]

81. We consider that Discover is currently constraining Infocare and APT and that this constraint is likely to continue, with Discover well-placed to continue expanding post-acquisition. We discuss the conditions for entry and expansion below at paragraph 85.

Constraint provided by other SMS suppliers

82. We do not consider that other SMS providers such as Aimy Plus, Porse, and First Base, are currently providing any material constraint on Infocare and APT. We therefore consider they are unlikely to materially constrain the merged entity.

82.1 As noted above, Aimy Plus supplies SMS software to OSCAR providers and [ ][78]

82.2 The SMS used by Porse is solely an in-house system and is not provided commercially.[79] [ ]

82.3 Based on [ ][80] [ ] we understand that First Base no longer has a material presence in the market.

83. Similarly, our view is that Juniorlogs is not currently constraining the merging parties, given [ ]. However, we consider that Juniorlogs is more likely than the suppliers listed above to expand and constrain the merged entity, since it is already a Ministry-approved SMS supplier [ ]. We discuss this further below in the Entry and Expansion section.

84. In summary:

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76 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

77 For example, [ ] - Application at Appendix 3.

78 Commerce Commission interview with [ ].

79 Commerce Commission interview with Porse, 28 January 2020. Porse accounts for an estimated [ ]% of an estimated [ ] in total sales to home-based care customers, with an estimated [ ]% of these sales accounted for by the merging parties - Application at Table 8.

80 [ ]

84.1 we do not consider that Infocare and APT are providing a significant degree of constraint on each other at present or that the Proposed Acquisition would remove an aggressive competitor from the market;

84.2 we consider that Discover is providing significant competitive constraint on both Infocare and APT through offering a superior product and aggressively targeting the customers of both merging parties;

84.3 constraint from Discover would continue to exist post-acquisition; and

84.4 other existing suppliers are not currently constraining the merging parties.

Entry and expansion

85. We set out below our assessment of the conditions of entry and expansion in the pre-school SMS market, and whether timely and sufficient entry is likely to constrain the merged entity. This is referred to as the LET test.[81]

86. We consider that the conditions of entry into the pre-school SMS market are not so onerous as to prevent sufficient and timely entry or expansion. In addition, we consider that such entry and expansion [ ] is likely to further constrain the merged entity.

Conditions of entry and expansion

87. We consider that successful entry and expansion in the pre-school SMS market requires overcoming barriers relating to:

87.1 the Ministry's process for approving new SMS suppliers and integrating their software with the Ministry's ELI database; and

87.2 the apparent reluctance of some customers to switch providers.

Ministry process

88. As noted, all SMS products (except for OSCAR, which is outside the relevant market) must be approved by the Ministry and integrated with its ELI system. Applications for approval are accepted once a year and there are no application fees.[82] Upon application, the SMS software must already be developed with its intended functionality and must be capable of supporting:[83]

88.1 both centre-based and home-based ECE providers;

88.2 both sessional and all-day ECE providers;

88.3 a minimum of 50 services; and

81 *Mergers and Acquisitions Guidelines* above n 1 at [3.93-3.106].
82 Commerce Commission interview with the Ministry of Education, 4 February 2020.
83 Application at [29].

88.4 the funding and regulatory requirements of ECE providers.

89. After the application window closes, the Ministry works with applicants to assist them in integrating with its ELI system. This can require further investment in product development by the SMS supplier. In total, the testing, approval, and integration process can take over a year.[84]

90. In addition, the Ministry frequently requires changes and updates to approved SMS software which must be approved by the Ministry. The SMS suppliers that we interviewed generally considered meeting the Ministry requirements to be time-consuming and resource intensive.[85]

91. We also received feedback that meeting the integration requirements to gain Ministry approval can be difficult.[86] However, the entry of suppliers such as Discover and Juniorlogs demonstrates that new entry is not prevented by the Ministry approval process.

Customer switching

92. Evidence suggests that the customers of SMS software suppliers – childcare centres and home-based care providers – do not readily switch from one SMS supplier to another. Customers and SMS suppliers that we spoke to stated that this is based on:[87]

92.1 a reluctance on behalf of customers to move away from the SMS that they know and that works for them;

92.2 the perceived inconvenience of switching to a new system, which would entail costs such as staff training and data migration; and

92.3 the fact that customers in general do not appear to be overly price sensitive.

Significance of barriers

93. Despite the existence of the barriers discussed above, we do not consider them to be insurmountable, and evidence suggests they are unlikely to prevent timely entry or expansion.

94. For example, Discover and Juniorlogs are already Ministry-approved and integrated with the Ministry's ELI system, and

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[84] Commerce Commission interview with the Ministry of Education, 4 February 2020; Commerce Commission interview with [ ].

[85] For example, see [ ] submission to the Commerce Commission, 29 January 2020, at [3a].

[86] For example, Commerce Commission interview with [ ].

[87] For example, Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview with [ ]; Commerce Commission interview [ ]; Commerce Commission interview with [ ].

[ ][88]
[ ][89]

95. In addition, we consider that suppliers can reduce customers' perceived costs of switching SMS suppliers. For example, if a supplier can demonstrate the ease of switching or relieve some of the inconvenience by providing onboarding assistance and/or training, we consider customers are likely to be more willing to switch. The suppliers listed above confirmed the importance of working closely with customers in this regard.[90]

96. Feedback from customers indicates that while the cost of SMS software is not significant or determinative, there are considerable potential benefits to be gained from improved SMS functionality. For example, [ ] noted that if an alternative system was able to reduce some of the tasks that it currently performs manually, that would be attractive.[91] Similarly, [ ] told us that price is one factor, but it is outweighed by the track record and benefits offered by the software.[92] This suggests that SMS suppliers are likely able to encourage customers to switch through more efficient or cost-saving functionality and by assertive marketing and demonstration of the benefits offered by the software and the provider (as Discover has done).

97. As noted, Discover has had some success in this regard by offering improved functionality such as more efficient client onboarding and business metrics.[93] [ ][94]

98. We note that customer contracts are generally month to month or short term.[95] It does not appear that customers are typically locked into long term contracts that would prevent them from switching between SMS suppliers. The short-term nature of customer contracts also lessens the risk to a customer in switching to an alternative provider or new entrant.

Likelihood of entry

99. We consider that entry and/or expansion by suppliers in the pre-school SMS market is likely to occur despite the potential barriers to entry discussed above.

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88 Commerce Commission interview with [ ].
89 Commerce Commission interview with [ ].
90 Commerce Commission interview with Discover, 22 January 2020; Commerce Commission interview with Juniorlogs, 15 January 2020; Commerce Commission interview with [ ].
91 Commerce Commission interview with [ ].
92 Commerce Commission interview with [ ].
93 Above at paragraph 76.
94 Commerce Commission interview with [ ].
95 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

99.1 Discover is a recent example of a competitor that has managed to enter and acquire customers relatively quickly. As noted above, Discover has obtained an estimated [ ]% share of the pre-school SMS market since it entered in 2017.

99.2 [ ][96] [ ]

99.3 While Juniorlogs' [ ], it is Ministry-approved and is [ ].[97] Juniorlogs told us that [ ][98]

100. We have estimated that sustainable profitable entry may be achieved with a relatively moderate market share. [ ].[99] [ ] provided a similar estimate of the cost of developing its SMS product.[100]

101. Based on these costs, we estimate that a new entrant may be able to recover all costs and return a profit by obtaining something in the order of 10% to 15% share of customers over a period of between two to five years. As noted, Discover has secured [ ] in two years since entering.[101]

102. The evidence we have collected also does not suggest that the Proposed Acquisition is likely to raise barriers to entry in the pre-school SMS market. Rather, several industry participants indicated that it is possible that it could provide an opportunity for competing SMS suppliers by making Infocare's and APT's customers more open to switching providers.[102]

103. This is because the Proposed Acquisition would likely lead to some changes and disruption for Infocare and APT customers as a result of the likely product updates and/or migration onto a new platform. Given customer stickiness is in part due to an aversion to change, such disruption could cause some long-term customers from APT and/or Infocare to consider other supply options.

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96 [ ] – Commerce Commission interview with [ ].

97 Commerce Commission interview with Juniorlogs, 15 January 2020.

98 Commerce Commission interview with Juniorlogs, 15 January 2020.

99 Commerce Commission interview with [ ].

100 Commerce Commission interview with [ ].

101 [ ] - Commerce Commission interview with [ ].

102 Commerce Commission interview with [ ]; Commerce Commission interview with [ ].

104. While barriers to entry and expansion do appear to be present, we do not consider they are insurmountable. On balance our view is that the likelihood of entry by new competitors [ ] and expansion by existing competitors (such as Discover and Juniorlogs) is likely to be sufficient in extent and timely enough to constrain the merged entity and prevent a substantial lessening of competition.

Countervailing power

105. As noted, larger customers comprising multiple childcare centres appear to have a higher degree of negotiating power compared to smaller customers. However, we do not consider that this typically extends to the ability to exercise countervailing power by, for example, sponsoring new entry or self-supplying SMS software.[103]

106. In addition, smaller customers of five centres or less appear to be price-takers and SMS suppliers can and do price discriminate between customers of different sizes. Therefore, any additional negotiating ability possessed by larger customers is unlikely to constrain the merged entity across the entire market.

107. Therefore, we do not consider that pre-school SMS software customers are likely to have sufficient countervailing power to constrain the merged entity.

Conclusion on unilateral effects

108. Based on the assessment above:

108.1 Infocare and APT do not appear to be providing significant competitive constraint on each other;

108.2 the merged entity would likely continue to be constrained by competition from the well-established SMS software supplier, Discover; and

108.3 the scope for entry and/or expansion by competing SMS suppliers is likely to further constrain the merged entity.

109. Therefore, we do not consider the Proposed Acquisition would be likely to substantially lessen competition in the pre-school SMS market due to unilateral effects.

Competition assessment - Coordinated effects

110. To test whether a merger or acquisition would be likely to result in a substantial lessening of competition due to coordinated effects, we assess:[104]

110.1 whether the relevant market is vulnerable to coordination; and

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103 *Mergers and Acquisitions Guidelines*, above n 1, at [3.116].
104 *Mergers and Acquisitions Guidelines*, above n 1, at [3.89].

110.2 whether the merger or acquisition would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

Vulnerability of the market to coordination

111. We consider that prior to the entry of Discover, Infocare and APT established a relatively static duopoly in which they had approximately equal shares of the pre-school SMS market and did not compete aggressively for each other's customers.[105]

112. Prior to Discover's entry, it appears the market was characterised by several features conducive to coordinated conduct, including:[106]

112.1 a small number of competitors and an absence of a particularly vigorous competitor or strong competition from outside Infocare and APT;

112.2 firms of similar size and cost structures; and

112.3 little innovation, stable demand and a lack of supply shocks/volatility (since the Ministry introduced the ELI system and associated new requirements in 2013, total market demand appears to have been relatively stable).[107]

113. We consider that these factors, combined with the lack of aggressive competition (on both price and quality) between Infocare and APT prior to Discover's entry, indicate that the market may have been vulnerable to coordination.

Impact of the Proposed Acquisition on coordination

114. The Proposed Acquisition would lead to a high degree of concentration, with just two SMS suppliers (the merged entity and Discover) supplying over [ ]% of customers in the pre-school SMS market,[108] and other recent or future entrants yet to establish a significant foothold.

115. Given the apparent advantages to some customers of Discover's SMS product, we consider it likely that Discover would continue to gain market share at the expense of the merged entity, at least until the merged entity undertakes the product development it has outlined in the Application.[109] However, if the market were to remain with a high level of concentration, over time Discover and the merged entity may find it more profitable not to compete aggressively, as appears to have occurred

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105 Above n [67]-[68].

106 *Mergers and Acquisitions Guidelines* above n 1 at [3.89].

107 For example, the total number of licensed ECE services increased from 4255 in 2013 to 4653 in 2019, reflecting a modest but steady increase in demand – Ministry of Education Early Childhood Education Census, 2013 – 2014.

108 Based on revenue estimates provided in the Application – see Table 1.

109 Application at [15]-[17]; Commerce Commission interview with Infocare, 16 January 2020; Commerce Commission interview with [ ]; Commerce Commission interview with [ ].
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previously when the market had only two suppliers. Such an outcome may enable Discover and the merged entity to avoid costly marketing activity, aggressive pricing offers, and/or investments in product development that would otherwise improve quality for customers.

116. The relevant question then becomes whether [ ] or any other existing suppliers and/or potential entrants would enter/expand successfully and maintain an effective presence in the market to disrupt any potential coordinated outcome. On balance, we consider that this is likely to be the case. As discussed above in the section on entry and expansion, our view is that entry conditions, along with the current positioning of recent [ ] entrants, would likely allow those entrants to expand and constrain the merged entity. As has already been the case with Discover, we would also expect entry and/or expansion to involve increased innovation in the form of enhanced SMS functionality. We consider this is likely to disrupt any potential coordination.

117. Therefore, we do not consider that the likelihood of coordinated outcomes is materially different either with or without the Proposed Acquisition.

Conclusion on coordinated effects

118. Based on the assessment above, we do not consider that the Proposed Acquisition would be likely to substantially lessen competition in the pre-school SMS market due to coordinated effects.

Overall conclusion

119. For the above reasons, we are satisfied that 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.

Determination on notice of clearance

120. We are 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.

121. Pursuant to section 66(3)(a) of the Act, the Commerce Commission determines to give clearance to Juice Technologies Pty Limited to acquire up to 100% of the shares in APT Business Solutions Limited.

Dated this 4th day of March 2020

Sue Begg
Deputy Chair