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Statement of Preliminary Issues

MYOB Group Limited and Reckon Limited

14 December 2017

Introduction

1. On 29 November 2017, the Commerce Commission registered an application (the Application) from MYOB Group Limited (MYOB) to acquire the Accountants Group business of Reckon Limited (Reckon).[1]

2. The Commission will give clearance if it is satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties who wish to make a submission do so by **12 January 2018**.

The parties[3]

5. MYOB is a public limited company incorporated in Australia and is listed on the Australian Securities Exchange. MYOB provides software solutions to businesses and accounting practices in New Zealand and Australia. MYOB operates in New Zealand through three divisions, namely Accounting Practices, SME, and Enterprise.

6. Reckon is also a limited liability company listed on the Australian Securities Exchange. Reckon provides software solutions to accounting practices and professional service firms, as well as to SMEs. In New Zealand, Reckon organises its operations into two groups, namely Business Group and Practice Management Group. In New Zealand, the Practice Management Group comprises the Accountants Group and provides accounting, tax, and other software to accounting practices under the Reckon APS brand.

7. Both parties are suppliers of software solutions to New Zealand accounting practices: MYOB via its Accounting Practice Division and Reckon via its Accountants Group.

1 A Public version of the application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.
2 The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.
3 The Application at [2-3].

Reckon's Business Group, which provides accounting software to businesses, is not part of the acquisition.

Our framework

8. Our approach to analysing the competition effects of the proposed merger are based on the principles set out in our Merger and Acquisition Guidelines.[4] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

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

10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial sense.[6]

11. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening of competition is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:

    11.1 constraint from existing competitors – the extent to which current competitors compete and the degree they would expand their sales if prices increase;

    11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    11.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Preliminary issues

12. We will investigate whether the proposed merger would be likely to substantially lessen competition in the relevant markets by looking at the unilateral and coordinated effects that might result from the merger. The questions that we will be focusing on are:

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4 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

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

6 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

12.1 unilateral effects: would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?

12.2 coordinated effects: would the merger increase the potential for the merged entity and all, or some, of its remaining competitors to coordinate their behaviour and collectively exercise market power?

Market definition

13. The Applicant submits that the relevant market is the national supply of practice software to accountants and accounting practices.[7]

14. The Applicant submits that, within this market, there are two software categories:

14.1 business modules, comprising practice management[8] and document management[9] functionality; and

14.2 compliance modules, comprising tax[10] and client accounting functionality.[11]

15. We will test whether different sized accounting practices have different needs and therefore whether separate customer markets are justified. In this respect, we note that MYOB offers different packages to large and small practices. We will also consider whether any customers have a strong reliance on the software that the merging parties supply, and whether the merged entity would be able to price discriminate against such customers.

16. We will test the degree to which cloud based software competes with desktop based software in order to understand whether those products should be in the same or separate markets. Both MYOB and Reckon predominately offer a desktop software solution, whereas Xero Limited (Xero) and CCH New Zealand Limited (CCH) offer a cloud based solution.[12]

Without the merger

17. The Applicant submits that the relevant without-the-merger scenario is: [13]

17.1 MYOB would continue to operate in the Accounting Practice segment and would pursue growth options as they arise.

17.2 Reckon would continue to offer its desktop suite and attempt to add online components, however over time it would lose customers to competitors.

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7 The Application at [12.1].

8 Practice Management includes timesheet, billing and collection, customer relationship management and resource planning functionality.

9 Document management includes filing and searching functionality.

10 Tax functionality enables the calculation, compliance, and lodgement of tax and tax returns.

11 Client accounting includes functionality that allows accountants to validate client accounts and compile and lodge statutory reports.

12 The Application at [9.2].

13 The Application at [16].

18. We will test what is likely to occur in the relevant markets absent the merger.

Unilateral effects: would the merged entity be able to raise prices on its own?

19. The Applicant submits that the proposed merger will not substantially lessen competition in a market for the national supply of practice software to accountants and accounting practices.

20. Where two suppliers compete in the same market, a merger between the two would remove a competitor that would otherwise act as a competitive constraint, potentially allowing the merged entity to raise prices or lessen quality.

21. MYOB and Reckon are current competitors in the supply of software solutions to New Zealand accounting practices. However, the Applicant submits that Reckon imposes a declining constraint, as it has not been able to meet the challenges that cloud platforms pose and is unlikely to do so in the future.[14]

22. The Applicant also submits that the merged entity would continue to face strong competition from cloud competitors and large international software companies, including in particular Xero and CCH (iFirm).[15] It says that the merged entity would face additional competitive constraint from generic software and solutions suppliers, particularly in relation to practice management and document management software supplied to accounting firms.[16]

23. The Applicant submits that there are low barriers to switching for accounting practices because:[17]

    23.1 accounting software providers have software dedicated to converting accounting practices' data from other systems which facilitates the movement of accounting practices between competitors; and

    23.2 accounting practices use on average 1.5 software solutions, therefore a significant number of practices already have an existing relationship with an alternative provider.

24. The Applicant submits that there are low barriers to entry and expansion in New Zealand and there is a real threat of entry.[18]

    24.1 Entry into New Zealand would be relatively easy for an existing provider in another jurisdiction. The Applicant submits that given the similarities between Australia's and New Zealand's tax and accounting regimes, entry from Australian software providers would not be onerous.[19]

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[14] The Application at [18.2].
[15] The Application at [19.1].
[16] The Application at [20.1].
[17] The Application at [21].
[18] The Application at [22].
[19] The Application at [22.2].

24.2 There are multiple competitors operating in other jurisdictions, including three firms operating in Australia that do not currently offer software to New Zealand accounting practices, namely Thomson Reuters, Sage, and Intuit.[20]

25. MYOB estimates that new entry would be feasible within a year.[21]

26. The Applicant submits that customers are able to exercise countervailing power. Large accounting firms have demonstrated an ability to build their own solutions, integrated with in-house systems.[22] We note the Applicant does not make the same claim in respect of smaller accounting practices.

27. We will test:

27.1 the closeness of competition between the merging parties;

27.2 whether other providers offer New Zealand accounting practices accounting software that is a good alternative to those supplied by the merging parties;

27.3 how easily rival software providers could enter and expand in New Zealand;

27.4 the ability and willingness of accounting firms to switch between software providers, particularly in respect of switching between desktop and cloud based solutions;

27.5 the constraint posed by generic software and solutions suppliers (eg, SAP, Microsoft, Google Drive, and iManage); and

27.6 whether accounting practices would be able to impose any countervailing power.

Coordinated effects: would the merged entity be able to coordinate with rivals to raise prices?

28. The Applicant submits that the merger will not give rise to coordinated effects because:[23]

28.1 the acquisition would not remove a particularly aggressive competitor as Reckon's model has been surpassed by cloud based solutions and Reckon has no plans to invest in a pure cloud solution of its own; and

28.2 the market is characterised by innovation and is rapidly evolving.

29. 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. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated

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20 The Application at [22.5].
21 Ibid.
22 The Application at [23.1].
23 The Application at [24.1].

effects require some or all of the firms in the market to be acting in a coordinated way.[24]

30. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the merger would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable. Some factors we will consider are:

30.1 whether the characteristics of the product or service makes coordination likely, for example when:

30.1.1 the products are homogeneous;

30.1.2 there is little innovation and stable demand;

30.1.3 firms can easily observe each other's prices; and

30.1.4 there is repeated interaction.

30.2 whether the merger would leave any markets with only a few rivals or eliminate a vigorous competitor;

30.3 whether the firms in the market are similar (for example, in size and cost structure) such that they would have similar incentives to coordinate;

30.4 whether interactions between suppliers enhance the potential for coordination; and

30.5 whether the threat of entry or the countervailing power of customers or suppliers would disrupt any attempts to coordinate.

Next steps in our investigation

31. The Commission is currently scheduled to make a decision on whether or not to give clearance to the merger by **Friday 16 February 2018.** However, this date may change as our investigation progresses.[25] In particular, if we need to test and consider the issues identified further, the decision date is likely to extend.

32. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

33. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "MYOB/Reckon" in the subject line of your email, or by mail to

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24 Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.84].

25 The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.

The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **Friday 12 January 2018**.

34. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

35. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.