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COMMERCE COMMISSION

Decision No. 419

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

ARMOURGUARD SECURITY LIMITED

and

INACRO LIMITED

The Commission: MJ Belgrave
MN Berry
PR Rebstock

Summary of Application: The acquisition by Armourguard Security Limited of all of the shares in Inacro Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.

Date of Determination: 22 February 2001

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THE PROPOSAL

1. On 31 January 2001 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) seeking clearance by Armourguard Security Limited (Armourguard) to acquire all the shares in Inacro Limited (Inacro).

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension in time was sought by the Commission. Accordingly, a decision on the application was required by Thursday 22 February 2001.
3. The applicant sought confidentiality for specific information contained in the notice, and a confidentiality order was made in respect of this information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's determination is based on an investigation conducted by its staff and their subsequent advice to the Commission.

THE PARTIES

Armourguard Security Limited (Armourguard)

5. Armourguard is owned by Tyco Group SARL, a company incorporated in Luxembourg. Its ultimate parent company is Tyco International Limited, which is incorporated in Bermuda.

6. Armourguard provides a range of services in the security industry. Those relevant to the proposed acquisition are cash services, including cash distribution and repatriation for banks (cash processing), ATM replenishment and servicing, and cash transporting for commercial clients, and manned services, which include mobile patrols, site guards, and retail security.

7. Armourguard's turnover for the last financial year in each area was as follows:

    - Cash services – [ ]
    - Static guards – [ ]
    - Mobile patrols – [ ]
    - Retail Security – [ ].

8. Armourguard operates nationally and has 23 branches throughout New Zealand.

Inacro Limited (Inacro)

9. Inacro is owned by Group 4 Securitas International B.V. which is registered in the Netherlands and Group 4 Securitas Limited, an English company. Its ultimate parent company is Group 4 Falck A/S, a company registered in Denmark.

10. Inacro has two subsidiaries, Group 4 Security (NZ) Limited (Group 4), and Group 4 International Correction Services Limited, a non-trading company which will not be acquired by Armourguard in the proposed transaction.

11. Group 4 is involved in cash processing by means of the Cash Logistics consortium together with the ANZ and ASB banks, mobile patrols, site guards and retail security. Associated with its retail security business is a service called Civil Recovery which involves taking civil court action against shop lifters to recover the amount stolen.

12. Group 4 earned [ ] in the last financial year. Its budgeted earnings for the current year are [ ].

13. Group 4 operates nationally and has cash centres in Auckland, Rotorua, Wellington and Christchurch.

OTHER RELEVANT PARTIES

Chubb NZ Limited

14. Chubb NZ Limited (Chubb) is the other major firm in the security industry. It is owned by Chubb PLC UK.

15. Chubb's business covers many aspects of the security industry. Those relevant to this investigation are cash processing, ATM replenishment and servicing, cash transportation for commercial clients, static guards, and mobile patrols.

16. Its approximate annual turnover for each area is:

    - Cash transit – [ ]
    - ATMs – [ ]
    - Commercial – [ ]
    - Static guards – [ ]
    - Mobile patrols – [ ].

17. Chubb operates nationally and has 14 company owned branches, each of which has cash facilities, and 17 contractor owned branches throughout the country. It has major hub sites in Auckland, Wellington and Christchurch.

THE PROPOSED ACQUISITION

18. Armourguard intends to purchase all the shares in Inacro. In effect, it is Group 4's business that is being purchased.

19. Armourguard states that acquisition of Group 4's existing customers will allow Armourguard to compete more vigorously in the manned services and electronic services. It should be noted that Group 4 does not operate in electronic services and does insignificant business in the mobile patrols part of manned services.

20. Group 4 states that it is being sold because its parent company, as a result of being sold to Falck, wants to be in fewer but bigger economies.

INDUSTRY BACKGROUND

21. The security industry consists of many different services. Those relevant to this investigation are described below.

Cash Services

22. Three separate types of cash services are offered by security companies. Armourguard and Chubb are involved in all three but Group 4 is involved only in cash processing. The three types of service are as follows.

Cash Processing

23. Cash processing involves collecting cash from a bank, processing it (counting, and checking authenticity and quality) and taking it back to the bank when required, using it for ATM replenishment, or on-selling it to other banks or commercial customers. [1]

24. Banks are either cash positive, i.e. take in more cash than they pay out and therefore have cash to dispose of, or cash negative, paying out more cash than is deposited and therefore requiring more cash. If a security company carries out cash transit for a cash positive bank, it collects cash from it each day, holds it overnight and then needs to dispose of it as soon as possible. If cash is held for a bank for more than a day, the bank must pay the overnight rate of [ ] to the Reserve Bank. If a security company is contracted to a cash negative bank, it must acquire cash for that bank.

25. The cash status of the major banks is:

- BNZ - cash positive
- ANZ – cash negative

[1] Cash processing is referred to by Group 4 as Cash Logistics which is also the name of the consortium entered into by Group 4, ANZ and ASB.

- ASB – cash negative
- Westpac – cash positive in the North Island, cash negative in the South Island
- National Bank – neutral

26. Cash processing is carried out for the various banks as follows:

Security Firm	Bank
Armourguard	BNZ Westpac National Bank in Nth Isl.
Group 4 [2]	ASB ANZ
Chubb	National Bank in Sth Isl.

27. Because BNZ and Westpac are cash positive and ASB and ANZ are cash negative, cash is transferred from Armourguard to Chubb and Group 4. Armourguard charges Chubb [ ] and Group 4 [ ].

28. A company involved in cash processing must have a fleet of armoured vehicles and a cash centre in at least each of the three main centres if it is to operate nationally. A cash centre consists of secure premises outfitted with a vault, note counting machines of which at least one must also be able to check authenticity and quality, coin counting machines, security cameras, and administrative support systems.

ATM Replenishment and Servicing

29. Armourguard replenishes and services ATMs for ANZ and BNZ and provides after hour servicing of a number of ASB's ATMs. Chubb replenishes and services Westpac ATMs, all of ASB's off site ATMs and some of National Bank's. The National Bank services the remainder of its ATMs. Group 4 is not involved in this service.

Commercial Collections

30. This service involves collecting cash, e.g. the day's takings, from commercial clients, and either delivering it to the client's bank or taking it back to the cash centre where the client's account is credited. It may also involve making up and dropping off cash floats or payrolls.

31. Both Chubb and Armourguard are involved in cash collections. Group 4 is not.

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[2] In Cash Logistics consortium with ASB and ANZ.

Manned Services

Static Guards

32. This service involves the provision of guards for clients' sites and events. The applicant estimates this market as being worth $200 million, including the guarding carried out in-house by organizations. The guarding carried out by security companies is estimated as being worth $70 million.

33. This part of the security industry is very labour intensive with very little capital requirement. Guards need a security officer licence. The larger firms provide their guards with basic training though this is not required by law. There are also several organisations that provide security training.

Mobile Patrols

34. The applicant estimates this market as being worth $50 million. It includes all forms of patrolling premises and alarm response.

35. The only equipment required for the mobile patrol business is vans and some form of despatch centre. As with static guards, personnel require a security guard licence and the larger firms provide some form of training.

Retail Security

36. The majority of retail security involves plain clothed security personnel whose main objective is to apprehend shop lifters. It can also involve personnel being present in retail premises in uniform as a deterrent.

37. Group 4 also provides the Civil Recovery service which entails taking civil court action against shoplifters to obtain recompense for the amount stolen. The licence for Civil Recovery expires on [ ].

MARKET DEFINITION

Introduction

38. The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

39. Section 3(1A) of the Act provides that:

> ". . . the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them."

40. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[3] *Commerce Commission v Carter Holt Harvey Building Products Limited*,[4] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[5] A brief outline of the principles follows.

41. Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

42. A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the *"ssnip"* test), assuming that other terms of sale remain unchanged.

43. Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".

Relevant Markets

Product Markets

44. The applicant has suggested that the appropriate product and functional markets are cash services and manned services in the security industry. They have advised that within the industry, the three parts of manned services – guard services, retail security, and patrol services - are sometimes considered to be separate markets. However they state that whether manned services is one or three markets makes no difference to the impact of the proposed acquisition on competition.

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[3] (1991) 4 TCLR 473.
[4] Williams J, 18 April 2000, HC, yet to be reported.
[5] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

45. As explained above, there are three distinct parts to cash services – cash processing, ATM replenishment and servicing, and cash transit for commercial customers. None of these can substitute for each other from the demand side perspective as consumers' requirements are quite different. Furthermore there are no other substitutable services for any of the three. A security company would require a significant investment in facilities in order to switch from another cash service such as commercial cash transit to cash processing. Cash processing is therefore not substitutable from the supply side perspective. Cash services are therefore made up of three different markets.

46. The only cash service that Group 4 is involved in is cash processing and therefore there will be no aggregation in the other two markets as a result of the proposed acquisition.

47. Although on the face of it there is an argument for separate markets for the three types of manned services, the skills and capital costs required for static guards, mobile services and retail security are very similar and many security companies supply all three services. Accordingly, for the purpose of considering the impact on competition of the proposed acquisition, the appropriate market is a single manned services market.

48. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the relevant product dimensions of the market are:

- Cash distribution and repatriation (cash processing)
- Manned services.

Geographic Markets

49. The applicant has submitted that the markets for cash and manned services are regional, broadly corresponding with the major urban centres and rural areas of New Zealand.

50. Armourguard, Group 4 and their main competitor, Chubb, all operate throughout New Zealand in all the product dimensions referred to above. Cash processing contracts are generally national and this is preferred by the banks. The Commission therefore concludes that for the purpose of assessing competition implications of the proposed acquisition in cash processing, the relevant geographic market is national.

51. Several firms compete in manned services in each of the urban and provincial centres. If a hypothetical monopolist within an urban centre were to increase its prices for manned services by a "small yet significant and non-transitory increase in price" (the "ssnip" test)[6], a security company from outside that urban centre would not be able to economically supply the same service.

52. For the purpose of this competition analysis the Commission agrees with the applicant that the relevant geographic market for manned services is New Zealand's major urban centres and rural areas.

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[6] A ssnip is regarded as an increase of 5-10% over 12 months

Conclusion on Markets

53. The Commission concludes that the relevant markets are:

- The national market for the supply of cash processing services
- Regional markets for the supply of manned services

COMPETITION ANALYSIS

Introduction

54. The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of **dominance**.

The Dominance Test

Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
>
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

The test for dominance has been considered by the High Court. McGechan J stated:[7]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of

[7] Commerce Commission v Port Nelson Ltd (1995) 5 NZBLC 103,762 103,787 (HC).

competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

55. Both McGechan J and the Court of Appeal, which approved this test,[8] stated that a lower standard than "a high degree of market control" was unacceptable.[9] The Commission has acknowledged this test:[10]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction.
>
> "A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability." (p21)

56. The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not so satisfied, clearance must be declined. The dominance test is applied in the following section.

The National Market for the Supply of Cash Processing Services

Market Concentration

57. An examination of concentration in a market is often an indicator of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

58. The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
> the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

59. These safe harbours recognise that both absolute levels of market share and the distribution of market shares between the merged firm and its rivals are relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The guidelines further state that:

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[8] Commerce Commission v Port Nelson Ltd (1996) 5 NZBLC 104,142 104,161 (CA).
[9] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC).
and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA).
[10] Business Acquisition Guidelines, Section 7.

> "Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours."

60. Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through possible market entry, also typically need to be considered and assessed.

61. Armouguard has [ ] market share and Group 4 has [ ]. The proposed acquisition would therefore result in the merged entity having [ ] market share. Currently, Armourguard, Group 4 and Chubb are the only suppliers of cash processing in New Zealand. Chubb's market share is [ ]. These levels of market share are outside the Commission's safe harbour guidelines.

Constraint from Existing Competitors

62. The merged entity would face some competition from Chubb which currently provides cash processing for the National Bank in the South Island. Chubb has the necessary premises, equipment and vehicles throughout New Zealand. It is therefore in a position to tender for bank processing business if the opportunity arose.

63. Armourguard is currently carrying out cash processing for BNZ, Westpac and National Bank in the North Island. It does not have a contract with Westpac which states that [ ]. It states that the current informal agreement could be terminated on [ ] notice. The National Bank has an informal agreement with Armourguard which can be terminated on [ ] notice. The National Bank states that it would consider contracting with another company if the price and service were right. BNZ has a [ ] agreement with Armourguard but it can be terminated on [ ] notice. BNZ also states that it would consider dealing with another company if the price and service were right. There is no significant cost for the banks in switching security company.

64. The Cash Logistics consortium that ANZ and ASB entered with Group 4 has another [ ] years to run. ANZ and ASB have not yet fully assessed what effect a sale of Group 4 will have on Cash Logistics though ASB has [ ]. [ ]

65. Although it is not clear whether Chubb would be likely to obtain ANZ's and ASB's cash processing business in the near future, there are no real barriers to it tendering for and obtaining contracts with BNZ, Westpac and the National Bank. [ ]. Furthermore, a majority of the banks consider Chubb to be a major competitor of Armourguard's.

66. It is the Commission's view that the merged entity would face effective competition from an existing competitor.

Constraint from Potential Competitors / Countervailing Power of Purchasers

67. A business acquisition is unlikely to result in the acquisition or strengthening of dominance if there is a credible threat of market entry. Potential competition can act as a constraint on market power, and so an examination of the nature and extent of this constraint is part of the Commission's assessment of competition.

68. Entry conditions, including the nature and height of any entry barriers, must be considered before the threat of new entry, which might constrain the conduct of a merged entity, can be evaluated.

69. A new entrant to the cash processing market, in order to obtain a contract with one of the banks, would need to be able to operate nationally. They would therefore have to have a cash centre and a fleet of armoured vehicles in Auckland, Wellington and Christchurch. Each centre would have to be outfitted with at least one vault, coin and note counting machines, a suitable security system including cameras, and a computer system for controlling the business.

70. The cost of setting up a national cash processing business, depending on whether vehicles and premises are purchased or leased could range from $6 million to $13 million. Approximately 90% of this is sunk costs as the vaults are not transferrable and the equipment, other than the armoured vehicles, is not useable for other purposes. In addition there are insurance, (premiums are at least $300,000 each year), labour, and administrative costs.

71. Whether capital cost amounts to a significant entry barrier depends on whether a new entrant could obtain a contract of sufficient length to justify the cost. Even if the business of one bank was obtained, it would take several years to recoup the set-up costs. The Commission has been advised that Armagard and ASAP Security Services Ltd and Brinks Australia Pty Ltd, two security firms in Australia, are large enough to be able to enter the New Zealand market. However, market participants have also pointed out that the New Zealand market is small and may not be attractive to such large companies.

72. The purchasers of cash processing services, the banks, have a high degree of countervailing power. Some of the banks have stated that if they were dissatisfied with the prices and services of a security company, they could switch to another security company. [ ].

    ASB and ANZ have not yet fully assessed their positions if Group 4 is acquired. A representative of the Reserve Bank has pointed out that it is the banks that control the cash processing market, not the security companies.

73. A facet of the countervailing power of the banks is their ability to meet some of the costs that an entrant would otherwise bear. This is demonstrated by the consortium entered into by ANZ, ASB and Group 4 in which [ ]

74. This form of entry would remain possible if the merged entity attempted to exercise market power.

Conclusion on the National Market for Supply of Cash Processing Services

75. The proposed acquisition will result in Armourguard obtaining a [ ] market share which falls outside the Commission's safe harbour guidelines. However, the merged entity would be constrained by at least one competitor offering the same service. The merged entity would also be constrained by the banks' countervailing power.

76. The Commission therefore concludes that the combined entry is unlikely to acquire or strengthen a dominant position in the national market for supply of cash processing services.

Regional Markets for Supply of Manned Services

Market Concentration

77. Armourguard has a [ ] market share and Group 4 a [ ] market share. The proposed acquisition would therefore result in the merged entity having [ ] market share. The proposed acquisition therefore falls within the Commission's safe harbour guidelines. Furthermore, existing competition within the market would provide considerable restraint on the merged entity.

Conclusion on Regional Markets for Supply of Manned Services

78. The Commission concludes that the merged entity would not acquire or strengthen dominance in the regional markets for the supply of manned services.

OVERALL CONCLUSION

79. The Commission has considered the impact of the proposed acquisition in the following markets:

   - The national market for the supply of cash processing services

   - Regional markets for the supply of manned services.

80. Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that implementation of the proposed acquisition would not result or be likely to result in any person acquiring or strengthening a dominant position in any of the above markets.

DETERMINATION ON NOTICE OF CLEARANCE

81. Accordingly, pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Armourguard Security Limited of all the shares in Inacro Limited.

Dated this 22nd day of February 2001

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MJ Belgrave
Chair