



COMMERCE COMMISSION

Decision No. 632

Determination pursuant to the Commerce Act 1986 in the matter of an application for a merger transaction between

Provenco Group Limited

and

Cadmus Technology Limited

- The Commission:** Paula Rebstock
Peter JM Taylor
Gowan Pickering
- Summary of Application:** Merger transaction whereby Cadmus and Provenco will amalgamate
- 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:** 5 February 2008

CONTENTS

EXECUTIVE SUMMARY	i
THE PROPOSAL	1
INDUSTRY BACKGROUND	1
Industry Participants	1
EFTPOS Technology	2
MARKET DEFINITION	2
FACTUAL AND COUNTERFACTUAL	3
COMPETITION ANALYSIS	3
The Wholesale Standalone Market	3
The Wholesale Integrated Market.....	5
The Standalone Reselling Markets and Integrated Reselling Markets	6
OVERALL CONCLUSION.....	8
DETERMINATION ON NOTICE OF CLEARANCE.....	9
APPENDIX ONE: STATUTORY FRAMEWORK	10

EXECUTIVE SUMMARY

- E1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 21 November 2007. The notice sought clearance for the merger of Cadmus Technology Limited (Cadmus) and Provenco Group Limited (Provenco).
- E2. For the purpose of this clearance application, the Commission concludes that the relevant markets are those for:
- the national market for the wholesale supply of standalone EFTPOS technology and services (the ‘*wholesale standalone market*’);
 - the national market for the wholesale supply of integrated EFTPOS technology and services (the ‘*wholesale integrated market*’);
 - various regional markets for the resale supply of standalone EFTPOS technology and services (the ‘*standalone reselling market*’); and
 - various regional markets for the resale supply of integrated EFTPOS technology and services (the ‘*integrated reselling market*’).
- E3. The Commission considers that the likely counterfactual scenario would be that, Cadmus and Provenco would continue to be active in each of the relevant markets []].
- E4. The Commission concludes that, in the wholesale standalone market and in the wholesale integrated market, there is unlikely to be a substantial lessening of competition. In each of those markets, the Commission found that, in the factual, the combined entity is likely to face a combination of constraints from existing and potential competitors, as well as from some customers with countervailing power.
- E5. The Commission found that post-acquisition, there would continue to be several resellers in both the standalone and integrated reselling markets. In the factual, merchants would continue to have a number of resellers to choose from. The Commission concludes that there is unlikely to be a substantial lessening of competition in any of the reselling markets.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 21 November 2007. The notice sought clearance for the merger of Cadmus Technology Limited (Cadmus) and Provenco Group Limited (Provenco).
2. The issue for the Commerce Commission (the Commission) is whether 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. The Commission has cleared the application as it is satisfied that the merger will not have, or would not be likely to have, the effect of substantially lessening competition in a number of markets for the supply of EFTPOS technology and services.
3. In considering a clearance application the Commission compares two situations: one with the merger proceeding (the factual), and one without the merger (the counterfactual). The impact of the merger on competition is then viewed as the prospective difference in the extent of competition in a market between these two situations.

INDUSTRY BACKGROUND

Industry Participants

4. Electronic Fund Transfer at Point Of Sale (EFTPOS) is a method of electronic payment using credit and debit cards to purchase goods and services. The industry participants involved in the supply of EFTPOS transactions is as follows:
 - **Manufacturers of EFTPOS terminals:** Cadmus is the only manufacturer based in New Zealand. All other manufacturers are based overseas with their products imported via distributors. The main brands represented in New Zealand are Cadmus, VeriFone, Ingenico and Hypercom. Other brands of EFTPOS terminals are Keycorp and Quest;
 - **Importers/distributors of terminals:** These companies import EFTPOS terminals from manufacturers and distribute in New Zealand. For example, Provenco imports Keycorp terminals and is also the exclusive distributor of Hypercom terminals in New Zealand. Importers/distributors either wholesale EFTPOS systems to resellers, or in some cases, supply directly to large 'corporate' customers, such as supermarkets, large nationwide department stores, or oil companies;
 - **Resellers:** Resellers are dealers who purchase products from distributors and on supply directly to merchants or local resellers. Cadmus and Provenco are also resellers as they sell their own product directly;
 - **Merchants:** Merchants that use EFTPOS technology as a payment method vary from supermarkets and restaurants, to taxis and dairies; and
 - **Payment system operators (Switches):** There are two companies that operate the payment systems that route the electronic transaction from the EFTPOS terminal to the customers' and the merchants' banks. They are EFTPOS New Zealand (ENZ), which is owned by ANZ and Electronic Transaction Services

Limited (ETSL). For security purposes, EFTPOS terminals need to be certified by either of the two switches.

5. **Cadmus** is principally engaged in the manufacturing, distribution and reselling of EFTPOS technology and services. **Provenco** is active in the importation, distribution and reselling of EFTPOS technology and services.

EFTPOS Technology

6. The Commission found that there are three types of EFTPOS technology presently available in New Zealand:
 - **Standalone systems:** EFTPOS terminals that sit independently of merchants' point-of-sale (POS) and require merchants to key-in the transaction manually. These systems are typically hardware focussed, relatively simple to install, and are usually used for example by dairies and cafes that have one POS (single-lane merchants);
 - **Integrated systems:** These systems are integrated with the POS, meaning there is two-way communication between the EFTPOS system and the POS. Such systems are software-based (the software application sits within the POS), and tend to be used by large, multilane merchants, such as department stores, supermarkets and petrol stations; and
 - **Interfaced systems:** These are partially-integrated in the sense that there is one-way communication between the POS and the EFTPOS keypad. Such systems offer some, but not all, of the advantages of the integrated systems.

MARKET DEFINITION

7. In considering this application the Commission needed to identify the relevant markets in which competition would be impacted by this proposed merger. Based on the different types of EFTPOS technology outlined above, at least two distinct product markets have been defined — one encompassing standalone technology and the other encompassing integrated and interfaced technology (referred to as integrated technology). In order to assess the functional dimensions, the Commission assessed the supply chain highlighted in the industry background. Consequently, two functional dimensions of the market have been defined, one as the wholesale supply and the other the reseller level. The Commission also considered the geographic boundaries of the market. It took the view that competition occurs nationally at the wholesale level, and regionally at the reseller level.
8. The Commission concluded that the markets relevant to the application are:
 - the national market for the wholesale supply of standalone EFTPOS technology and services (the '*wholesale standalone market*');
 - the national market for the wholesale supply of integrated EFTPOS technology and services (the '*wholesale integrated market*');
 - various regional markets for the resale supply of standalone EFTPOS technology and services (the '*standalone reselling market*'); and

- various regional markets for the resale supply of integrated EFTPOS technology and services (the ‘*integrated reselling market*’).

FACTUAL AND COUNTERFACTUAL

9. When assessing the competitive impacts of a merger, the Commission assesses the likely situation with the merger (the factual) with the likely situation without the merger (the counterfactual).
10. Under the factual, Cadmus and Provenco would continue to be active in the relevant markets and Provenco’s exclusive contract with Hypercom []. Cadmus submitted that []. In the factual, there would continue to be other suppliers in each of the relevant markets.
11. The Commission considers it likely that []
12. In the counterfactual, []
13. The Commission considers that in the counterfactual, Cadmus and Provenco would continue to be active in each of the relevant markets [].

COMPETITION ANALYSIS

The Wholesale Standalone Market

14. In the wholesale standalone market, the combined entity would have a market share of approximately []. However, the Commission found that, post-acquisition, there would be two other existing competitors in this market, Skyzer and Tech Trans, both of whom supply established global brands of EFTPOS terminals. Skyzer is the most recent entrant. While it has been active in Australia since 2003 it entered New Zealand in 2007. Due to it distributing the recognised Ingenico brand the Commission believes that Skyzer provides a competitive constraint in this market and is likely to continue to do so in the future.
15. Tech Trans’ [] Post-acquisition, the Commission considers that Tech Trans would continue to provide a competitive constraint.

Table 1: Market shares by value of the wholesale supply of standalone EFTPOS technology and services

Company	2004/05 \$000s	2005/06 \$000s	2006/07 \$000s	2004/05 %	2005/06 %	2006/07 %
Cadmus	[]	[]	[]	[]	[]	[]
Provenco	[]	[]	[]	[]	[]	[]
Combined entity	[]	[]	[]	[]	[]	[]
Tech Trans	[]	[]	[]	[]	[]	[]
Skyzer*	-	-	[]	-	-	[]
Total	[]	[]	[]	100%	100%	100%

Source: Commission estimates

Note: *Skyzer entered the New Zealand market in 2007. Sales refer to Jul 07-Dec 07. All others sales figures refer to Jul-Jun financial year.

16. The Commission considers that the main barriers to entry into this market are: obtaining access to EFTPOS technology; obtaining New Zealand software certification from the payment system operators ETSL or ENZ; establishing a distribution channel and obtaining staff to provide maintenance and technical support services to customers.
17. Most industry participants highlighted software certification as the most difficult barrier, with costs estimated to be in the region of \$20,000-\$30,000 and lengthy turnaround times from ETSL. However, the Commission considers that these barriers do not appear to be insurmountable as evidenced by Skyzer's recent entry. The Commission has also identified [] potential entrants [].
18. []
19. []
20. The majority of customers in the wholesale standalone market are independent resellers. The smaller resellers, which are active on a regional level, are unlikely to have much countervailing power.
21. The larger dealers, which operate on a national level, are likely to provide some constraint, as they purchase large volumes. While some of these dealers expressed concerns about the size of the combined entity and that it may refuse access to its products, some of these dealers have already begun accessing products from Skyzer, as a way of reducing their reliance on Cadmus and Provenco products.

22. Further, the Commission found that [] in order to get better discounts.
23. The Commission concludes that, in the wholesale standalone market, there is unlikely to be a substantial lessening of competition, as the combined entity is likely to face a combination of constraints from existing and potential competitors, and large customers.

The Wholesale Integrated Market

24. Provenco currently competes in the wholesale integrated market with its product Syncro Plus. While Cadmus has traditionally focused on the standalone market, some industry participants said that Cadmus was developing an integrated product. The Commission found that []].
25. The Commission considers that in the counterfactual []]. The Commission has taken a conservative approach and, in the counterfactual, treated Cadmus as a near entrant in the integrated market for the purposes of its analysis.
26. Compared to the counterfactual, where Cadmus and Provenco [], in the factual, the combined entity would have a well established integrated product (Syncro Plus) []].
27. As shown, in the table below, post-acquisition, the combined entity would be constrained by three existing competitors in this market. These are Tech Trans, Direct Payments Solutions (DPS) and Quest. All three sell established brands of EFTPOS terminals. In particular, DPS is seen by industry participants as a dynamic company and the Commission considers it likely that its presence in this market would grow.

Table 2: Market shares by value in the Wholesale Integrated Market

Company	2006/07 \$000s	2006/07
Cadmus	[]	[]
Provenco	[]	[]
Combined Entity	[]	[]
Tech Trans	[]	[]
Direct Payment Solutions	[]	[]
Quest	[]	[]
Total	[]	100%

Source: Commission estimates

28. The barriers to entry in the wholesale integrated market are likely to be greater than those in the wholesale standalone market. The Commission found that the main barrier is likely to be software development, which involves access to technical staff. It is estimated that the development cycle for software for an integrated solution is approximately one year and costs approximately \$250,000-\$400,000. However, it is not necessary for the distributor to always provide software development services themselves; there are a number of merchants [] who have developed their own software.
29. While barriers to de novo entry appear to be high, the Commission has found that entry is possible and likely from companies active in providing EFTPOS solutions.
30. The Commission has found [] potential entrants in the wholesale integrated market. []
31. The majority of customers in the wholesale supply of integrated products are large retail chains. These customers are likely to have a degree of countervailing power as they are likely to have a number of supply options that they could use as a credible threat against the combined entity. For example, []
32. The Commission concludes that, post acquisition, [], there is unlikely to be a substantial lessening of competition in this market, as there are likely to be constraints from existing competitors, potential competitors and some countervailing power from buyers.

The Standalone Reselling Markets and Integrated Reselling Markets

33. The Commission considers that the same competition considerations, particularly conditions of entry, would apply across all the relevant regional markets identified. Therefore, as a working assumption for the purposes of analysing this particular

Application, the Commission conducted a generic competition analysis for a representative region, and applied this across all possible regional resale markets.

34. The Commission found that accurate information on the number of resellers does not exist as no industry statistics are collected. The Applicant estimated that there are between 60 and 80 resellers, while some industry participants have estimated there to be approximately 20 to 30 dealers. The large number of resellers in these markets contributed towards the difficulties in estimating reliable market shares.
35. The Commission found that there are some large national resellers active in the supply of standalone EFTPOS technology. Examples are Eftpos New Zealand (ENZ), Nationwide Eftpos Technology, SmartPay, Eftpos 2 Go, Viaduct and Eftpos Specialists. Some of these suppliers have a single outlet from which they distribute nationally, while others operate a franchise network. In addition, the Commission found that there are a large number of smaller regional dealers across New Zealand. Some of these local resellers specialise in EFTPOS technology and others also supply other electronics products.
36. Overall, the Commission found that post-acquisition, there would continue to be several resellers in both the standalone and integrated markets. In the factual, merchants would continue to have a number of resellers to choose from and the Commission found that merchants were less concerned about branding and more concerned with product functionality.
37. The Commission found there to be more resellers of standalone EFTPOS technology than integrated technology, as the majority of local dealers tend to supply small businesses that require only basic solutions. However, dealers of standalone EFTPOS technology could easily expand into selling integrated technology and there are some that currently sell both e.g. Viaduct and ENZ. There are similarities in the activity of reselling standalone and integrated technology and all that is required is access to a product and access to a different type of customer.
38. The Commission also found that it would not be difficult for resellers in a particular region to expand. It would also not be difficult for a new entrant to enter a particular region. Access to a product, a distribution outlet, sales staff and the ability to provide basic product support is necessary to compete in these markets. [

]. As concluded in the wholesale markets, post acquisition, there would continue to be sufficient choice of wholesalers that resellers can source from, making entry into the reselling markets relatively straightforward.

39. Some resellers raised concerns with their ability to compete with the combined entity in the reselling markets, as they would be sourcing products from them and competing with its retail arm for sales to merchants. In particular, dealers expressed concerns with regards to gaining access to products or to proprietary software which would enable them to provide value-added services like loyalty programmes and mobile phone top ups. However, the Commission found that post-acquisition,

there would be three alternative wholesalers that customers could switch to. As mentioned above, these are Tech Trans, Direct Payments Solutions (DPS) and Quest. Further, the Commission found that there are no barriers to resellers switching wholesalers.

OVERALL CONCLUSION

40. The Commission is satisfied that the proposed merger will not have, nor would be likely to have, the effect of substantially lessening competition in:
- the wholesale standalone market;
 - the wholesale integrated market;
 - the standalone reselling markets; or
 - the integrated reselling markets.

DETERMINATION ON NOTICE OF CLEARANCE

41. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed merger of Cadmus Technology Limited and Provenco Group Limited.

Dated this 5th day of February 2008

Paula Rebstock
Chair
Commerce Commission

APPENDIX ONE: STATUTORY FRAMEWORK

1. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal would not be likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.¹
2. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.²
3. In determining whether there is a change along the spectrum which is significant, the Commission must identify a real lessening of competition that is not more than nominal and not minimal.³ Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.
4. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
5. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

¹ *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-721.

² *Air New Zealand & Qantas Airways Limited v Commerce Commission* (2004) 11 TCLR 347, Para 42.

³ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.