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COMMERCE COMMISSION

DECISION NO. 304

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

TELARC LIMITED

and

STANDARDS NEW ZEALAND

- The Commission:** Alan Bollard (Chairman)
Peter Allport
Roger Taylor
- Summary of Proposal:** That Telarc Limited acquire the Management System Certification Division of Standards New Zealand.
- Determination:** Pursuant to s66(3)(a) of the Act, the Commission determines to give a clearance for the proposed acquisition.
- Date of Determination:** 31 July 1997

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MEMORANDUM

To: Alan Bollard
Peter Allport
Roger Taylor

From: John Preston
Jane Chilcott

Date: 29 July 1997

Subject: **Business Acquisition: Telarc Limited/Standards New Zealand**

Working Day 6: 29 July 1997

Working Day 10: 4 August 1997

[Confidential information is contained in square brackets]

THE PROPOSAL

- 1 On 21 July 1997, the Commission registered a notice from Telarc Limited ("Telarc Ltd") seeking clearance to acquire the Management System Certification Division of Standards New Zealand ("Standards New Zealand"). Both Telarc Ltd and Standards New Zealand are Government owned entities which report to the Minister of Commerce. The proposal does not involve the other activities of the two organisations.
- 2 It is noted that Telarc Ltd and Standards New Zealand are not to be treated as a single entity as "interconnected bodies corporate" for the purposes of the Commerce Act 1986 ("the Act"). Although the Act states that two bodies corporate are to be treated as interconnected where both are subsidiaries of the same body corporate, or both of them are interconnected with bodies corporate that are interconnected with each other, s(7A) provides that no body corporate shall be regarded as a subsidiary of the Crown.

THE PROCEDURES

- 3 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. As no extension has been agreed, a determination is required by 4 August 1997.
- 4 This report concludes that staff are satisfied that implementation of the proposal would not result, and would not be likely to result, in Telarc Ltd acquiring or strengthening a dominant position in a market, and recommends that in terms of s66(3)(a) of the Act, the Commission give clearance to the proposed acquisition.

THE PARTIES

Telarc Limited (“Telarc Ltd”)

- 5 Telarc Ltd, a trading arm of the Testing Laboratory Registration Council of New Zealand, is a certification body involved in the assessment and certification of quality management systems to ISO 9000 standards and environmental management systems to ISO 14000 standards.
- 6 The Testing Laboratory Registration Council is a “... user-funded statutory body responsible for ensuring technical standards are met in New Zealand’s industrial, scientific, commercial, regulatory, health care and administrative sectors.”¹ It was established under the Testing Laboratory Registration Act 1972, and also owns International Accreditation New Zealand Ltd which is involved in accreditation² and training services.
- 7 Prior to the establishment of Telarc Ltd and International Accreditation New Zealand on 1 July 1997 and the resulting separation of accreditation and certification functions, the Testing Laboratory Registration Council operated accreditation and certification services under the name Telarc New Zealand.

Standards New Zealand

- 8 Standards New Zealand is an unincorporated body established by The Standards Council. The Management System Certification Division of Standards New

Zealand, like Telarc Ltd, undertakes the assessment and certification of quality management systems to ISO 9000 standards and environmental management systems certification to ISO 14000 standards. Standards New Zealand is also New Zealand's representative in the International Organisation for Standardisation (ISO).

- 9 The Standards Council, which reports to the Minister of Commerce, was established under the Standards Act 1988³ to develop and promote the use of standards in New Zealand.
- 10 Standards New Zealand is also involved in product certification, using the product certification mark, the "S Mark". However, as the proposed acquisition only relates to the Management System Certification Division of Standards New Zealand, it is not proposed to look at product certification in any further detail.

THE MARKET

Background Information

- 11 Formal certification of quality management systems has developed in recent years as a result of an increased commitment to quality and efficiency. The internationally-recognised ISO 9000 series of quality management systems standards, developed by the ISO, has been widely adopted as the basis for quality management systems certification and is widely used by industry internationally.⁴ While the ISO 9000 series was initially of most interest in the manufacturing sector, it is now sought in a range of fields which include the legal profession, the hospitality industry and educational institutions. There has also been the recent development of the ISO 14000 series of environmental management system standards, and QS 9000 standards for the automotive industry.
- 12 Certification to these international standards is of importance in the international marketplace as a way for New Zealand businesses to demonstrate that they are committed to quality and the environment. It is also considered that such management systems play a role in enhancing productivity and competitiveness.
- 13 Certification is achieved after developing and implementing a quality management or environmental management system and having the system audited against the appropriate standard. It is the act of certifying that a duly identified process or system conforms with a specific standard. For example, Carter Holt Harvey's tissue mill at Kawarau gained accredited certification under ISO 14000 in September

1996. It is also noted that it is the fourth organisation in New Zealand to be so certified.⁵

- 14 Both Telarc Ltd and Standards New Zealand are members of the Joint Accreditation System of Australia and New Zealand (“JAS-ANZ”). JAS-ANZ, based in Canberra, was formally established by the New Zealand and Australian Governments in 1991. Its primary role is to accredit organisations which conduct management systems certification programmes in Australia and New Zealand.⁶ The need for an accreditation system to recognise the competence of certifying bodies was highlighted with the increased demand for quality management system certification over the last decade, and increased competition between certification bodies.
- 15 Accreditation provides customers of certification services with assurances about the competence and integrity of the certification body in question. It is the formal recognition by a recognised body, of the competence of another body to provide a specified service or operation. As such, it has become increasingly expected that certification bodies will be accredited, although accreditation is not mandatory.⁷
- 16 Accreditation programmes also provide the basis for extending industry confidence internationally. That is, the development of national systems of accreditation operating to similar principles opens up the opportunity for mutual recognition agreements (“MRAs”) between accreditation bodies world-wide.⁸

Market Definition

- 17 Telarc Ltd and Standards New Zealand are both JAS-ANZ accredited certification bodies involved in the assessment and certification of quality management systems and environmental management systems in New Zealand to ISO 9000, QS 9000, and ISO 14000 standards. It is also noted that Telarc Ltd also offers “Q-base”, a certification programme for small to medium enterprises. However, the “Q-base” programme does not have JAS-ANZ accreditation, and we do not consider that it falls within the relevant market.
- 18 All market participants contacted by Commission staff confirmed that they compete in the market for the provision of quality management system certification services by accredited certification bodies.

- 19 Telarc Ltd submits that the relevant market is that for system certification for ISO 9000 and QS 9000 quality management systems standards and ISO 14000 environmental management system standards. While this is a relatively narrow market definition, we propose to adopt it for the purposes of this report.

Conclusion on market definition

- 20 We conclude that the relevant market is that for system certification for ISO 9000 and QS 9000 quality management systems standards and ISO 14000 environmental management system standards in New Zealand.

ASSESSMENT OF DOMINANCE IN THE MARKET FOR THE PROVISION OF MANAGEMENT SYSTEMS CERTIFICATION SERVICES IN NEW ZEALAND

- 21 Section 66(3) of the Act, when read in conjunction with s47(1) of the Act, requires the Commission to give clearance to a proposed acquisition if it is satisfied that the proposed acquisition would not result, or would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

- 22 Section 3(8) of the Act states that a person is in a “dominant position” if:

... a person as a supplier or an acquirer of goods or services either alone or together with any interconnected body corporate is 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 ... regard shall be had to-

- (a) The share of the market, the technical knowledge, the access to materials or capital of that person ... :
- (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.

Current Competition

23 The applicant submits that there are ten JAS-ANZ accredited organisations with clients in New Zealand, providing certification to the relevant ISO series of standards:

- Bureau Veritas Quality International (“BVQI”)
- Det Norske Veritas (“DNV”)
- International Certifications Ltd (“ICL”)
- KPMG Quality Certification (International) Ltd (“KPMG QCI”)
- Lloyd’s Register Quality Assurance Ltd (“LRQA”)
- NATA Certification Services International Pty Ltd (“NCSI”), operating from Australia
- SGS International Certification Services Pty Ltd (“SGS ICS”)
- Standards Australia Quality Assurance Services (“SAQAS”)
- Standards New Zealand
- Telarc Ltd

Market Shares

24 The applicant provided market share figures calculated on the number of registered clients⁹ each certification body has, from a total number of registered clients of 2272. On the basis of those calculations, Telarc Ltd estimates that, following the proposed acquisition, the combined entity would have a market share of approximately 62%.

25 A number of market participants did not consider that market shares based on registered client numbers was the most accurate way to calculate market shares. It was considered that annual revenue would be a more accurate measure of existing competitors’ market shares. However, all market participants contacted agreed that the market shares provided by the applicant were reasonably accurate, as they were based on independent market survey information. An independent market surveyor, “Fact Finders Business Information Services”, collects and analyses market data from each accredited certification body operating in New Zealand on a regular basis. As such, all market participants have a reasonably accurate picture of the market in which they compete and their current position within that market.

26 From market share information provided by the applicant and other market participants, market shares for existing competitors are estimated as follows:

Supplier	Estimated Market Share
Telarc Ltd	46.7%
Standards New Zealand	14.6% ¹⁰

Combined entity	61.3%
SGS ICS	11.5%
KPMG QCI	9.7%
BVQI	7.6% ¹¹
SAQAS	5.1%
ICL	3.6%
LRQA	0.7%
NCSI	0.3%
DNV	0.1%
TOTALS	100%

27 In the Commission's view¹², 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.

28 The estimated market share for the combined entity does not fall within one of the above "safe harbours", with the combined entity having a post-acquisition market share of just over 60% and the next largest competitor having a market share of 11.5%. However, market shares are insufficient in themselves to establish whether a dominant position would exist in a market. The Commission considers a range of additional factors before reaching a conclusion as to the acquisition or strengthening of a dominant position in any market, such as the constraint from the threat of market entry, and barriers to entry.

Constraints from Market Entry or Expansion

29 A number of market participants considered that the proposed acquisition would constrain their ability to compete in the relevant market, and could result in one or two of the smaller international players pulling out of the New Zealand market. It was also stated that both Telarc Ltd and Standards New Zealand benefit from a distinct commercial advantage over other commercial providers of certification services as a result of their "government entity status".¹³ Despite this perceived advantage, it is noted that these market participants have set up in competition in the

market, eroding the market shares of the two largest market participants. For example, BVQI noted that [

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30 Concern was also expressed by a number of market participants about the erroneous, yet widely-held belief that Telarc Ltd (or Telarc New Zealand as it was previously) is “the certification body” in New Zealand. It was considered that, as a result of the proposed acquisition, this myth would be perpetuated as Telarc Ltd would be substantially larger than any of its competitors.

31 The Chief Executive for SGS ICS, Richard Bradley, was of the opinion that [

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32 However, it is noted that there is little ‘customer switching’ between certification bodies. The Sales Manager for SGS ICS, Craig Muir, stated that while a client can change from one certification body to another, it is a “rare occurrence”.

33 Telarc Ltd also submits that there are many overseas suppliers of management systems certification services who could choose to establish a presence in New Zealand. To illustrate, there are currently 19 JAS-ANZ accredited certification bodies, and hundreds of other accredited certification bodies around the world.¹⁴

34 Staff conclude that the proposed acquisition would not prevent existing market participants from expanding their own services, or overseas organisations from entering the New Zealand market.

Barriers to Entry

35 The applicant submits that there are no onerous entry barriers to the market for the provision of management systems certification services by accredited certification bodies. As such, the possibility of de novo entry into the relevant market serves as a constraint on the existing market participants and would continue to constrain the combined entity.

36 One entry barrier identified by market participants was that of gaining JAS-ANZ

accreditation, which was considered by most market participants to be a costly and time-consuming process. As stated earlier, JAS-ANZ is recognised by the Australian and New Zealand governments as being the accreditation body for organisations involved in the certification of quality and environmental management systems.

37 An organisation applying for accreditation to JAS-ANZ is required to pay an application fee of \$A2,000. Once accredited, a certification body is then required to pay for the regular auditing services provided by JAS-ANZ, the current charge for which is \$A800 per day. There is also an annual registration charge made up of a number of different components¹⁵ :

- an accreditation component of \$A10,000 per annum;
- a certification component of \$A5,000 per annum; and
- a registration component of \$A70 per certificate issued by the certification body.

38 The time taken from application to accreditation varies between organisations depending on “how mature” the organisation is, its current systems and documentation. The auditor for JAS-ANZ, Stephen Keeling, estimated that the average time taken from application to accreditation would be approximately 36 weeks. However, he noted that some organisations have taken over 90 weeks to become accredited.

39 Other relevant costs for any new entrant into the market would include those incurred in establishing a client base and good reputation. For example, Certifications Manager for KPMG QCI, Ian Hendra, noted that it cost the company approximately [] to set up in business.

CONCLUSION

40 As a result of the proposed acquisition, the combined entity would have a market share of around 62%, and would face competition from a number of existing competitors including SGS ICS Pty Ltd with a market share of approximately 12%.

41 Staff consider that the market for the provision of management systems certification services by accredited certification bodies is competitive and that the combined entity would be subject to constraints from existing competition and from the threat of market entry.

- 42 Therefore, it is concluded that the proposed acquisition, if implemented, would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the provision of management systems certification services by accredited certification bodies.

RECOMMENDATION

- 43 It is recommended that you give clearance to the proposal under s66(3)(a) of the Act.

Jane Chilcott
Investigator

John Preston
Chief Investigator

Jo Bransgrove
Manager

¹ New Zealand Official Yearbook 1997, p384.

² Accreditation involves assessing that testing, measurement and calibration laboratories are technically competent to carry out specific tests and activities.

³ The Standards Act 1988 consolidated and amended the law relating to standards, and repealed the Standards Act 1965.

⁴ Refer “Link Industry Globally”, The Report of the Committee of Inquiry into Australia’s Standards and Conformance Infrastructure, March 1995, p131.

⁵ Refer Carter Holt Harvey Annual Report, 1997, p24.

⁶ Above n4, p107.

⁷ Above n 4, p10.

⁸ Above n4, p107.

⁹ Standards Australia publishes a register, under contract to JAS-ANZ, that lists all clients certified by JAS-ANZ accredited bodies.

¹⁰ BVQI and SGS ICS stated that the market share for Standards New Zealand was over-stated. It was estimated that Standards New Zealand would have a market share of approximately 13%.

¹¹ BVQI estimated that it would have a slightly higher market share of 8.8%.

¹² Refer Commerce Commission’s Business Acquisition Guidelines, 1996, p17.

¹³ []

¹⁴ The applicant also submits that certification services can be provided from thousands of non-accredited bodies or consultants around the world.

¹⁵ There is a ‘cap’ on the fees paid by a certification body to JAS-ANZ of \$A50,000.