

## MYOB/RECKON ACCOUNTANTS GROUP LETTER OF ISSUES

### 1. Introduction

- 1.1 This document sets out the response of MYOB and Reckon to the Commerce Commission's (NZCC's) Letter of Issues (LOI) in relation to the proposed acquisition by MYOB Group Limited (MYOB) of the Accountants Group of Reckon Limited (Reckon) (Proposed Transaction).
- 1.2 The NZCC's focus is whether the Proposed Transaction may give MYOB the incentive and ability to raise prices to medium to large accounting firms and a sub-set of accounting firms that do not consider cloud-based accounting software to be a viable alternative. As part of this assessment, the NZCC is considering whether MYOB may be able to price discriminate between different accounting firms.
- 1.3 For the reasons set out below, there is strong evidence that MYOB will not have the incentive or ability to raise prices to any customer or sub-set of customers post-merger, and will not do so.

### 2. Executive Summary

- 2.1 The effects of the Proposed Transaction must be assessed against a likely counterfactual. To this end, there is no prospect whatsoever that Reckon will move its APS suite to the cloud. As [REDACTED], and it has stated (as a listed company), it simply does not have the resources (nor the time) to do this. As a result, its constraint on the market will decline. Indeed, it is already declining, as evidenced by [REDACTED].
- 2.2 As to the relevant markets:
  - (a) the evidence reveals that the compliance software requirements (i.e. client accounting and tax) are the same for all firms. Accountants in large firms perform the same compliance tasks for their clients as those in small firms. This is because the outputs of compliance software – client accounts and tax returns – need to comply with accounting and tax regulations. The requirements of these regulations do not differ by firm size;
  - (b) accounting firms can and do mix and match the compliance and business software of different providers. This is borne out the by the fact that [REDACTED] and by industry survey data<sup>1</sup> that shows a significant number of accounting firms use software from multiple different providers; and
  - (c) the evidence suggests that there is a single market for accounting software, regardless of the platform i.e. desktop or cloud. There is no functionality that desktop software has that cloud software cannot offer. If anything the opposite is true, given that cloud-based solutions can more efficiently integrate with third party providers via APIs. This is evidenced by the [REDACTED]. While there may be the odd practice that does not consider a cloud-based provider to be an option, MYOB [REDACTED] and they may be less likely to switch at all (including between MYOB and Reckon).
- 2.3 In any event, regardless of the market definition adopted, MYOB will not be able to profitably increase prices,<sup>2</sup> or decrease quality, to any group of accounting firms.
- 2.4 First, MYOB [REDACTED]<sup>3</sup>:

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<sup>1</sup> Wolters Kluwer, *The Good, the Bad and the Ugly: Insights, Trends and Benchmarking for the NZ Accounting Profession* (2015) (GBU Report), p.15.

<sup>2</sup> In this response, references to MYOB not having an ability to increase prices are references to price increases not justified by any quality improvements.

<sup>3</sup> The MYOB document referred to in the LOI at [30] [REDACTED].

(a) [REDACTED]

(b) [REDACTED]

2.5 [REDACTED].

2.6 Second, Xero and CCH are strong competitors across all customer segments.

(a) For the supply of both compliance and business software to medium to large accounting firms,<sup>4</sup> the switching data indicates that:

(i) [REDACTED]<sup>5</sup>; and

(ii) [REDACTED];

(b) For users of desktop software, again, there is vastly more switching:

(i) [REDACTED]; and

(ii) [REDACTED],

indicating that cloud providers impose a significant constraint on desktop pricing.

2.7 Third, accounting firms have countervailing power that would allow them to resist, or render unprofitable, any attempt to increase prices.

(a) In light of the demonstrated constraint imposed by CCH and Xero, accounting firms can credibly threaten to switch all of their accounting software modules away from MYOB;

(b) Firms could also switch, or threaten to switch, one or more modules. It is common for firms to 'mix and match' modules from different software providers, and so they could switch, or threaten to switch, one or more compliance modules to CCH or Xero to discipline price increases. [REDACTED].

(i) [REDACTED].

(ii) [REDACTED].

(iii) As the NZCC's market enquiries confirm, accounting firms have a broader range of choices for business software,<sup>6</sup> and so switching, or threatening to switch, away from any of these modules would be a particularly effective course of action.

(c) Even a switch, or a threat to switch, of a small number of users (licences) within a firm to a competitor would constrain an attempt to increase prices. For example, if MYOB increased the price of client accounting to a Reckon accounting firm post-merger, [REDACTED].

2.8 Fourth, increasing prices to Reckon accounting firms would be contrary to the rationale for the Proposed Transaction, and would put at risk revenues in the much larger SME software market.

(a) A key stated rationale for the Proposed Transaction is the opportunity for MYOB to access a greater number of SMEs in the referral channel, which is a key source of new SME

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<sup>4</sup> A medium to large accounting firm is defined as a firm with greater than 30 accountants, as used by the NZCC to partition the market in its RFIs of 25 January 2018 to MYOB and Reckon.

<sup>5</sup> Clearance Application, Table 5, which shows MYOB's top 10 largest monthly accounting firm losses between January 2016 and September 2017. Between October 2017 and January 2016, MYOB has identified [REDACTED].

<sup>6</sup> LOI at [15].

business for MYOB.<sup>7</sup> The value of potential revenues from SMEs far outweighs the annual maintenance value (**AMV**) of subscription revenues received from accounting firms. This is because, **[REDACTED]**. The downside of a firm switching away would be an order of magnitude greater than the upside of a price rise of even 5% on accounting software.

(b) This is borne out in **[REDACTED]**.

2.9 In light of the above, there is no realistic prospect that the Proposed Transaction will give MYOB the ability or incentive to increase prices, for any accountant software products, to any sub-set of customers.

### 3. **Potential markets that the NZCC is considering**

3.1 The NZCC is considering whether the markets should be defined as follows:<sup>8</sup>

- a) medium to large accounting practices distinct from small practices;
- b) accounting compliance modules versus business modules; and
- c) desktop software versus cloud-based software for certain groups of customers.

3.2 The NZCC considers that the extent to which suppliers are able to price discriminate between different types of customers is relevant to this analysis.<sup>9</sup>

### 4. **No separate market for medium to large accounting practices**

4.1 The NZCC states that it has received mixed views from market participants on whether medium to large accounting firms have separate requirements from smaller accounting firms, specifically in relation to “different levels of management sign-off” and “greater reporting ability”. Subsequent to the LOI, the NZCC advised that some concerns had been raised regarding the ability of CCH and Xero software to perform the compliance work of “families of companies” i.e. company groups with multiple related entities.<sup>10</sup>

4.2 There is no basis on which to define markets by size of accounting practice. This is because:

- (a) compliance software functionality requirements are the same for all sizes of firms; and
- (b) all providers of accounting software can and do supply all sizes of accounting firms, with the exception of specialist software to very large firms, where in-house solutions and specialist providers’ solutions are used.

*Compliance software functionality requirements are the same for all sizes of firms*

4.3 The compliance software requirements for accounting firms are the same regardless of firm size. Accountants use compliance software to ensure that their clients comply with the relevant accounting and tax regulations. Specifically:

- (a) client accounting modules are used to ensure that a person’s or company’s accounts are prepared in the prescribed form; and

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<sup>7</sup> See MYOB 2017 Investor Presentation Day presentation, p.17-18.

<sup>8</sup> LOI at [11].

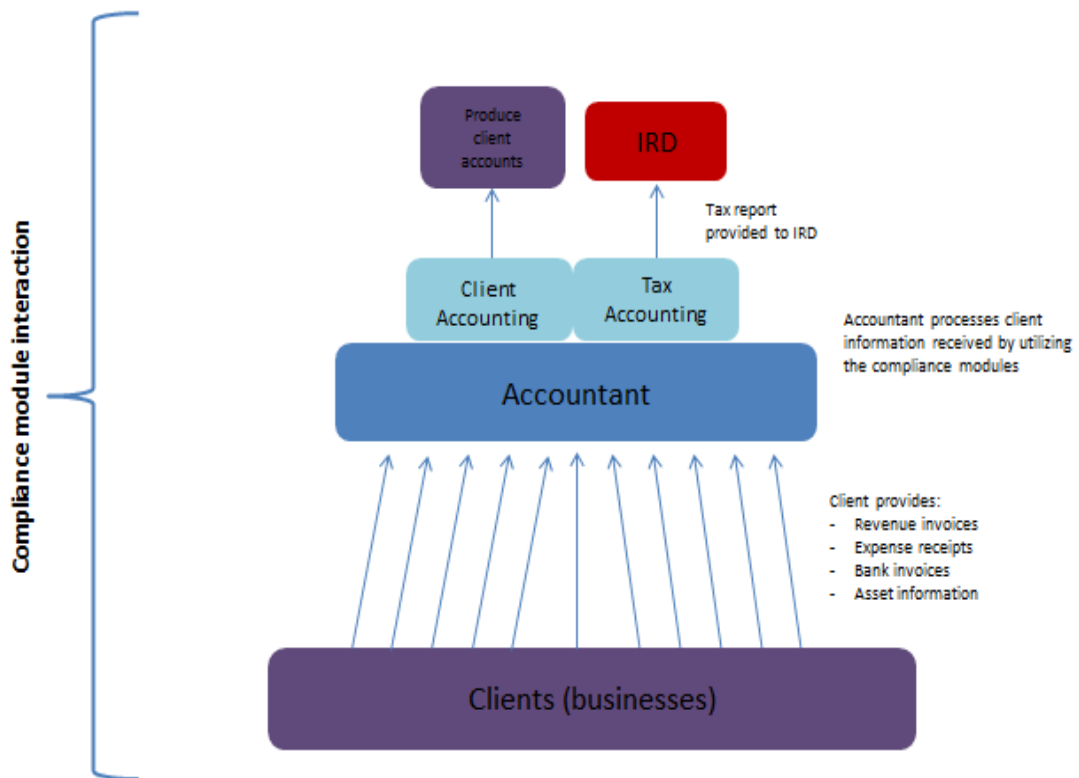
<sup>9</sup> LOI at [13].

<sup>10</sup> Phone call between NZCC and Bell Gully (27 February 2018).

- (b) tax modules are used to ensure that a person's or company's taxes are prepared in the prescribed form and in accordance with the IRD's requirements, and that the required information is provided.

4.4 In small firms, there may be as few as only one or two accountants. Each accountant will have their own clients, which may be individuals or companies of various sizes. In larger firms, there will be a larger numbers of accountants and a larger number of clients.

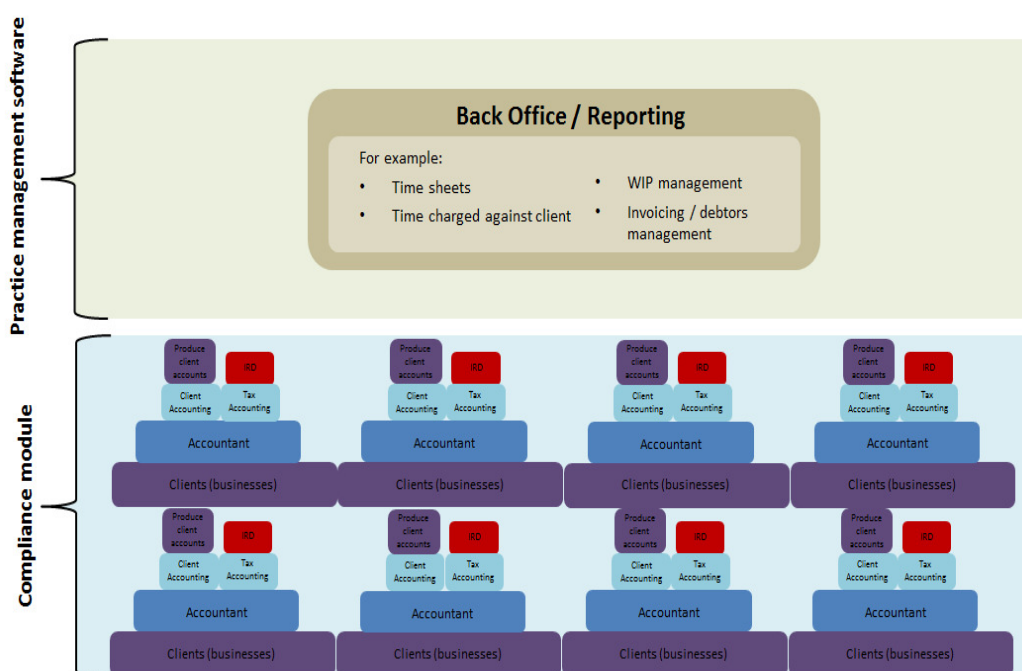
**Diagram 1 – compliance module functionality – sole practitioner**



4.5 However, the work carried out by accountants for their clients is the same regardless of whether they work in large or small firms: the accountant will prepare the accounts of their clients (which may be individuals, companies, trusts etc. of various sizes and complexity) and prepare their tax returns for lodgement. The output of these processes is mandated by accounting and tax rules. In the case of tax, the output must be in a prescribed format in order to be accepted by the IRD. As such, compliance modules are scalable: larger firms simply purchase more licences than smaller ones.

4.6 The below diagram shows functionality of compliance and practice management software in a medium to large firm. As can be seen, practice management software is concerned with the management of the accounting firm, and not the delivery of compliance services to individual SMEs.

**Diagram 2 – compliance/business module functionality – all firm sizes**



4.7 As regards the NZCC’s concern about management sign-off, this functionality is very basic: it simply records the stages of the review process and notifies managers, as required, when their input is needed. It is separate from the actual compliance work of compiling accounts and preparing returns and does not access a client’s financial or tax data.

- (a) For MYOB, the layered sign-off functionality is simply an additional column (or columns, depending on the number of reviewers required) in a table.<sup>11</sup> This could easily be (and is for smaller firms) achieved by using spreadsheets.
- (b) Similarly, for Reckon, this functionality (which sits within the practice management module) is also simple, providing for additional fields to be added for different reviewers at differing levels of seniority.
- (c) Both CCH and Xero have this functionality. For example, CCH states that its tax module “lets you easily manage and view all aspects of the return life-cycle. Move returns through Draft, Completed, Approved, Signed, Filed, Assessed and Archived. Security permissions ensure only approved users can e-file and no unauthorised changes are made”.<sup>12</sup>

4.8 As regards the concern around “greater reporting”, again, there is very limited additional reporting provided by MYOB’s and Reckon’s compliance products that is not required to comply with accounting or tax rules. Rather, the vast majority of reporting functionality is found in practice management modules.

- (a) For MYOB, the additional reporting features in the client accounting module allow accountants to customise the look of accounts by e.g. adding a company logo, changing fonts or colours. It also offers a set of workpapers (calculations underlying an accounting treatment).

<sup>11</sup> Workflow management technically sits in a separate, very basic, ‘framework’ module that operates in the background. This module is supplied by MYOB with all business and practice management modules, regardless of the size of accounting firm and no matter how few licences are acquired. It also contains other basic information such as client contact details and security (e.g. document access permissions). No substantive client data sits within the framework.

<sup>12</sup> <https://www.cchfirm.co.nz/support-my-accounting-clients/tax/>.

- (b) Reckon's workpaper functionality does not sit in the client accounting module. Rather, accounting firms use workpapers from other suppliers (or their own), and Reckon's software manages the process.

4.9 This is functionality that both CCH's and Xero's products contain.

- (a) CCH states that its client accounting module: "includes a comprehensive suite of master reports, designed and maintained on your behalf. You'll enjoy professional and compliant reports with none of the time-consuming formatting hassles. Master reports can be tailored to include your logo, images, font preferences and much more...";<sup>13</sup>
- (b) Similarly, Xero states about its Workpapers (client accounting) module that "[i]n addition to the suite of preformatted workpapers, you can create your own to suit your practice's compliance and financial reporting needs covering any period up to 366 days".<sup>14</sup>

4.10 Moreover, to the extent that an accountant desires any additional functionality to assist it in performing compliance work, this can be sourced from additional providers (or developed internally). For example, the majority of accountants still prefer to use Excel for workpapers and there are also third party workpaper providers.<sup>15</sup> CCH promotes its interoperability with Excel as a feature of its client accounting product:

*"When you use Client Accounting, you can stay happily in your long lasting love affair with Excel, thanks to a powerful interface which smoothly exports and re-uploads data between ledger and workpaper. The ease with which you can create and customise workpapers within Excel gives you phenomenal flexibility."<sup>16</sup>*

4.11 Finally, the NZCC has indicated that some market participants have raised concerns that only MYOB and Reckon offer software that can cater to accounting firms that need to prepare client accounts and tax returns for large corporate entities with multiple subsidiaries. However, neither MYOB nor Reckon (nor Xero or CCH) have the functionality to perform the compliance work of complex corporates or multinational companies.

4.12 The solutions used by the accounting firms that cater to large corporates (e.g. the 'Big 4' accounting firms) are either bespoke solutions developed in-house by these accounting firms, or provided by specialist software providers e.g. TaxLab.

4.13 While, technically, MYOB, Reckon, Xero and CCH could be used to construct the reports and lodge the tax returns for each of the individual companies of such entities, they do not have the functionality to perform the underlying calculations, and so would simply be used to generate the final accounts/tax return.

*Groupings of customers by MYOB and Reckon not reflective of differing requirements*

4.14 The NZCC notes that MYOB recognises **[REDACTED]** different customer groupings, and Reckon three, based on the number of users in an accounting practice.<sup>17</sup> However, **[REDACTED]**.

(a) **[REDACTED]**.

(b) Reckon **[REDACTED]**. Further, and as discussed in detail below, since the date of the cited document (2015), Xero and CCH both now compete in each of the 'groupings' cited by the NZCC.

<sup>13</sup> <https://www.cchfirm.co.nz/support-my-accounting-clients/client-accounting/>.

<sup>14</sup> <https://www.xero.com/nz/features-and-tools/practice-tools/workpapers/>.

<sup>15</sup> Third party providers include Hayes Knight, Caseware, Audit Assistant and Chartered Accountants Australia and New Zealand.

<sup>16</sup> <https://www.cchfirm.co.nz/support-my-accounting-clients/client-accounting/>.

<sup>17</sup> LOI at [20].

## 5. Compliance and business modules

- 5.1 The NZCC's preliminary view is that competitive conditions for the supply of compliance modules on the one hand, and business modules, on the other, appear to be "materially different", in particular because there are a broader range of providers for business modules, including generic software providers, than there is for compliance software.<sup>18</sup> This is consistent with MYOB's experience, which is that accounting firms have a broad range of practice management providers to choose from, including generic providers such as SAP and Oracle.
- 5.2 The NZCC is also considering the extent to which the business and compliance modules from separate providers can be integrated with one another, given that some accounting practices have advised that they cannot 'mix and match' modules from different providers because it involves data duplication, which can cause inconsistencies and result in inconsistent data across systems.

*Integration between compliance and business modules is not necessary*

- 5.3 There is only limited integration between the practice management and compliance modules of MYOB and Reckon. This is because practice management software relates to the running of an accounting practice, whereas compliance software helps accountants provide services to clients. It is not necessary for accountants to have access to detailed client data when running their practice, just as it is not necessary for firm performance to be accessed in the compliance modules.
- 5.4 To the extent that data does need to be shared between compliance and practice management modules, this is limited to very high level information such as client contact details, name of the responsible accountant etc.

*Data can be shared between modules without "integration"*

- 5.5 In terms of mixing and matching compliance modules from different suppliers, this does not necessarily require manually re-keying data as suggested by the NZCC's market enquiries. Rather, data can be shared via exporting to file types such as .CSV, .TXT and .MYE, which can then be exported into another application. It is in a software company's best interests that it offers an import/export routine, so that its product can be used by as many clients as possible.
- 5.6 Indeed, CCH's website states that:<sup>19</sup>

### ***"Compatible across all platforms***

*The days of having your hands tied by software compatibility are long gone. Getting all the information you need into Client Accounting couldn't be more simple and smooth. Just select a .CSV source file and you can quickly bring in data from any number of sources. You can also bring your client data in from Xero and there are dedicated imports for BankLink and MYOB Business products... you (and your clients) will love it."*

- 5.7 As discussed in detail below, evidence of accounting firm behaviour and previous market research is that accounting firms do pick and mix different modules from different software suppliers.

## 6. Desktop and cloud-based software are in the same market

- 6.1 The NZCC is considering the extent to which desktop customers would be unwilling to switch to cloud software in response to a price increase or quality decrease. It cites the below as factors as being relevant to this assessment:

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<sup>18</sup> LOI at [15] and [17].

<sup>19</sup> <https://www.cchfirm.co.nz/support-my-accounting-clients/client-accounting/>.

- (a) market feedback is that accounting firms that have recently switched between desktop products are unlikely to switch in the short to medium term;
  - (b) accounting firms that consider re-training costs to be high are unlikely to switch in the short to medium term; and
  - (c) MYOB [REDACTED]; and
  - (d) switching costs are high.
- 6.2 It considers that moving from cloud-based products appears to be more “realistic” alternative for firms with “younger managers, that are coming to the end of a desktop product contract, and are smaller and more agile”.<sup>20</sup>
- 6.3 MYOB does not consider that the above factors form a basis for defining a separate market for desktop products.

*The functionality of cloud and desktop products is the same*

- 6.4 There is no substantive difference between the functionality of cloud and desktop products from a functional point of view, particularly for compliance software where the work product required is dictated by external requirements and is therefore the same across providers.
- 6.5 That said, the efficiencies of cloud computing make software that is cloud-hosted superior to desktop based software. For example, APIs make it easier for software from different providers to interact, resulting in more efficient workflows.

*Switching costs are not high*

- 6.6 The NZCC’s enquiries have revealed comments that switching costs are high. It refers to an internal MYOB document from June 2015 referring to [REDACTED]. However this document, which is nearly three years old, [REDACTED].
- 6.7 In any event, since June 2015 the cost, risk and time involved with switching have reduced significantly. Indeed, switching costs are the same (or lower) when switching from desktop to cloud, than from desktop to desktop. In particular:
- (a) desktop software needs to be physically installed on each user’s device, while cloud software does not;
  - (b) cloud computing involves no servers being located on a client’s premises, resulting in fewer maintenance costs and freeing up office space; and
  - (c) the efficiencies achieved from switching to a cloud-based provider (e.g. better interoperability with third party modules via APIs) are likely to off-set any short term costs of switching.
- 6.8 Both CCH and Xero have software dedicated to transferring client data from other systems. Xero provides a free comprehensive data conversion service that facilitates the movement of accounting practices from MYOB’s desktop products to Xero’s cloud-based solution.<sup>21</sup> CCH promotes ease of switching as one of its key selling points, promising that “converting to CCH iFirm is a seamless experience”.<sup>22</sup>

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<sup>20</sup> LOI at [24].

<sup>21</sup> Xero, ‘Moving from MYOB and Reckon to Xero made easy’, available at: <https://www.xero.com/au/partner-programs/partners/convert/>.

<sup>22</sup> <https://www.cchifirm.co.nz/>.



- 6.9 Finally, the evidence of increased switching away from Reckon and MYOB to cloud providers Xero and CCH is clear evidence that switching costs are not high. We discuss this further below.

*Accounting firms that have recently switched*

- 6.10 It is understandable that an accounting firm has recently switched software providers is less likely to want to switch in the short to medium term. However, this is not a phenomenon unique to accounting software, and does not support the proposition that desktop software is in a separate market from cloud software.
- 6.11 In addition, to the extent that the above is true, then the Proposed Transaction will not increase the ability of MYOB/Reckon to impose a price increase on such firms. If a firm has recently switched from Reckon to MYOB (or vice versa) and is unlikely to switch in response to a price increase in the short to medium term, then MYOB (and Reckon) could already profitably impose a price increase (that is not justified by quality improvements) on these firms.

*Re-training costs not a barrier to switching*

- 6.12 Re-training costs could be a factor in defining a separate market for desktop software if these differed significantly between desktop and cloud software. However, this is not the case. The software of different providers, whether cloud or desktop based, are different. They each have their own user interface and functionality, and they each require training for accountants to get up to speed. There are no additional costs associated with re-training using cloud software.
- 6.13 In any event, where an accounting firm considers that re-training costs are high and will not switch in the short to medium term for this reason then, again, the Proposed Merger does not increase the ability of MYOB (or Reckon) to impose a price increase on these customers (nor does it increase its ability to identify these firms).

*Managers that are unwilling to switch and a perception that data is not safe in the cloud*

- 6.14 Historically there have been some views that the cloud is not as secure as desktop. However, these concerns have now largely been addressed, as evidenced by:
- (a) the success of Xero and CCH (neither of which offer a desktop solution in New Zealand), together with cloud players like Intuit and Sage in e.g. the US, UK and Australia;
  - (b) the urgency with which MYOB is moving to the cloud, and the fact that **[REDACTED]**; and
  - (c) Reckon's decision to sell its Accountants Group because it is unable to move this product into the cloud, meaning it considers that it will not be a viable business in the future.
- 6.15 If there were significant and widespread concerns about the security of cloud software, MYOB, Xero, CCH, Sage, Intuit and others around the world would not be spending hundreds of millions of dollars on rolling out cloud offerings.
- 6.16 To the extent that there are some accountants that still harbour concerns about the security of the cloud vis-à-vis desktop-based products (which still carry their own security risks e.g. hacking of individual devices, server outages etc), the parties expect that this would be a very small number of individuals.

**7. Theories of harm that the NZCC is investigating**

- 7.1 The NZCC is investigating whether the Proposed Transaction would give MYOB the incentive and ability to profitably increase prices or decrease quality to:
- (a) medium to large accounting firms; and/or

- (b) accounting practices that would not be willing to switch to a cloud provider.
- 7.2 The LOI says that “these concerns have been raised because the merging parties may have the ability to identify and price discriminate between groups of customers...if the merged entity was able to identify and price discriminate between customers for which the merging parties are currently their main options, and there are few or no other options, the merger could result in higher prices or reduced quality for those customers”.<sup>23</sup>
- 7.3 In any event, the Proposed Transaction will not result in a substantial lessening of competition (**SLC**) in any market, however defined.
- 7.4 As discussed in **Appendix A**, MYOB considers that any likely counterfactual must accept that Reckon will not migrate APS to the cloud, and that its competitive constraint will continue to decline. Again, however, MYOB does not consider that this makes a difference to the analysis; the Proposed Transaction will not SLC even if compared with the status quo.
- 7.5 MYOB will not have the incentive or ability to increase prices to these discrete customer groupings because:
- (a) **[REDACTED]**; and
- (b) **[REDACTED]**, it will have no ability to raise prices to them.
8. **[REDACTED]**.
- 8.1 **[REDACTED]**.
- 8.2 The NZCC cites a single piece of evidence in support of its current view that MYOB may be able to identify groups of customers and price discriminate against them: a MYOB strategy paper that refers to **[REDACTED]**.<sup>24</sup> However, this document is not evidence that MYOB can predict which accounting firms are likely to be susceptible to a price increase.
- (a) **[REDACTED]**.
- (b) **[REDACTED]**.
- (c) **[REDACTED]**.
- 8.3 **[REDACTED]**.
9. **No ability to increase prices to accounting software supplied to medium to large practices**
- 9.1 The NZCC is considering whether MYOB may have the incentive and ability to unilaterally raise the price of compliance software to medium to large accounting practices. This section sets out why the Proposed Transaction would not give MYOB the incentive or ability to do this, principally because:
- (a) it will continue to face strong competition from CCH and Xero post-merger;
- (b) accounting firms have countervailing power and a number of strategies available to them to defeat an attempted price increase; and
- (c) raising prices would be contrary to the rationale for the deal and would jeopardise revenues in the market for supplying accounting software to SMEs.

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<sup>23</sup> LOI at [30].

<sup>24</sup> LOI at [30], citing MYOB Board Strategy Offsite presentation (4 October 2017), p.138.

*Xero and CCH are strong competitors for accounting firms of all sizes*

- 9.2 The NZCC cites a MYOB 16 November 2016 strategy offsite presentation (**[REDACTED]**), that shows **[REDACTED]**, as part of its discussion on why it considers APS may be the only alternative for medium to large accounting practices. However, switching behaviour since **[REDACTED]** clearly shows that Xero and CCH compete for practices of this size.
- 9.3 As submitted in the Application, **[REDACTED]**.<sup>25</sup>
- 9.4 **[REDACTED]**.
- 9.5 Reckon has also previously provided the NZCC with data showing its wins and losses in 2015, 2016 and 2017. **[REDACTED]**.
- 9.6 Set out in the table below are medium to large accounting firms **[REDACTED]**.

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<sup>25</sup> Application seeking clearance at Table 5. **[REDACTED]**.

**PUBLIC VERSION**

**Table 1 - Reckon medium to large accounting firm losses (2016-2018)**

Name	Year	Number of users (accountants)	Modules switched away from Reckon			Lost to
			Client accounting	Tax	Practice management	
[REDACTED]						

**PUBLIC VERSION**

9.7 [REDACTED].

9.8 [REDACTED].

9.9 The above is clear evidence that Reckon and MYOB currently face strong competition from cloud providers for the supply of both compliance and business software to medium to large accounting firms, and MYOB will continue to be constrained post-merger. Indeed, this competition will only intensify post-merger, as the offerings of CCH and Xero continue to improve.

*Accounting practices have countervailing power*

9.10 In addition to the strong constraint imposed by CCH and Xero, accounting firms would also be able to impose a constraint on any attempt by MYOB to increase prices post-merger. Accounting firms could do this by:

- (a) switching, or threatening to switch, discrete modules away from MYOB; and/or
- (b) switching, or threatening to switch, some compliance software licences away from MYOB.

9.11 This is because accounting firms can, and do, 'mix and match' software from multiple providers. The 2015 GBU Report demonstrated that even in 2014, 30% of accounting firms used the software of more than one provider.<sup>26</sup> Based on the data set out in the tables above, this is likely to have increased significantly since this time.

9.12 Table 3, below, sets out the number of MYOB and Reckon licences used by their accounting firm clients for client accounting, tax and practice management. As can be seen, [REDACTED]. [REDACTED]. This indicates that a significant number of accounting firm customers of both parties 'mix and match' the modules of different providers.

**Table 2 - MYOB and Reckon licence numbers**

	<b>Client Accounting</b>	<b>Tax</b>	<b>Practice management</b>
<b>MYOB AE</b>	[REDACTED]	[REDACTED]	[REDACTED]
<b>Reckon</b>	[REDACTED]	[REDACTED]	[REDACTED]

[REDACTED]

9.13 This data is consistent with survey data across the accounting industry as a whole. Thus, were MYOB to attempt to increase prices post-merger in, for example, compliance modules, a firm could respond by switching a business module away from MYOB (practice management or another module). As the NZCC recognises,<sup>27</sup> accounting firms have multiple options for business software, and so switching, or threatening to switch, would be a credible response.

9.14 As can be seen by looking at [REDACTED]. Thus, accounting firms have a significant ability to discipline Reckon (and MYOB post-merger).

9.15 Similarly, a firm could switch some of its accountants over to Xero or CCH compliance modules, decreasing the number of licences acquired from MYOB. Many accounting firms already use more than one client accounting module (this is evidenced by the 2015 GBU Report, previously provided to the NZCC, which shows that accounting firms use, on average, 1.5 accounting modules).

<sup>26</sup> GBU Report, p.15.

<sup>27</sup> LOI at [15].

9.16 Switching to Xero is likely to be particularly simple, given that medium to large firms will very likely have enough SME clients that use Xero such that they can effectively use Xero's client accounting product for free,<sup>28</sup> and so 'switching' would be very low cost.

9.17 [REDACTED].

9.18 [REDACTED].

*Raising prices would be contrary to the rationale for the Proposed Transaction*

9.19 In addition to the significant constraint that will be imposed by Xero and CCH, and the countervailing power of accounting firms, MYOB is not incentivised to increase prices post-merger [REDACTED].<sup>29</sup>

9.20 A significant rationale for the Proposed Transaction is to acquire Reckon's accounting customer book in order to improve MYOB's ability to increase sales to SME customers via accountant referrals. As set out in the 2015 Information Memorandum for the sale of Reckon Accountants Group, accountants often play the "gatekeeper" role and hold significant influence over the software choice of their clients.<sup>30</sup>

9.21 MYOB estimates that the addressable SME market is worth approximately [REDACTED]<sup>31</sup> the market for accounting software and its analysis is that accountants are **nine times** more likely to refer the accounting software they use themselves to SMEs.<sup>32</sup>

9.22 Accordingly, MYOB is incentivised to maintain and grow the number of accounting firms clients in order to improve its penetration of the significant larger SME market. Imposing supra-competitive prices on Reckon customers, who MYOB hopes will recommend its software to their clients, is very likely to alienate these accounting firms and drive them to switch to CCH or Xero. This would run completely counter to the deal rationale, [REDACTED].

9.23 If MYOB was to attempt to impose a price increase on medium to large accounting practices, [REDACTED].

9.24 To illustrate [REDACTED].

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<sup>28</sup> As set out in the Application at [13.8], Xero offers a number of incentives to accountants and accounting practice to use Xero HQ through Xero's partner program. All Xero partners are eligible to receive Xero HQ for free to manage their practice's client portfolio. Accounting practices that are bronze-level partners are also eligible to receive the Xero tax module for free. Silver-level and above partners are eligible to receive the Xero Practice Manager and Xero Workpapers modules for free.

<sup>29</sup> [REDACTED].

<sup>30</sup> Information Memorandum for the sale of Reckon Accountants Group (September 2015), p.10. See also MYOB 2017 Investor Presentation Day presentation, at 17.

<sup>31</sup> Estimate based on NZ Statistics data on the number of businesses in New Zealand. Assumes that the 372,429 businesses with 0 employees (i.e. sole traders) could pay on average [REDACTED] and the 140,199 business with between 1 and 19 employees could pay [REDACTED]. Businesses above 20 employees, of which there are 15,543 are classified as too large to be SME users and hence not included.

<sup>32</sup> See MYOB 2017 Investor Presentation Day presentation, p.18.

### Scenario – a 5% price increase imposed on a medium to large accounting firm

R-Firm has 30 accountants and each accountant has [REDACTED] SME clients.<sup>33</sup> All accountants at R-Firm use Reckon's tax software and R-Firm pays the average price per user, for a firm of its size, for Reckon's tax module: [REDACTED] per year.<sup>34</sup>

The average revenue per user of MYOB SME software is [REDACTED].<sup>35</sup>

Accordingly, for R-Firm:

- AMV for tax software is 30 \* [REDACTED]
- Potential SME referrals is 30 \* [REDACTED]
- Potential SME AMV is [REDACTED]

MYOB subsequently imposes a price increase of 5% on Reckon's tax module.<sup>36</sup> This amounts to increased AMV revenue of [REDACTED] per annum from this firm. However, if R-Firm switches away from MYOB in response to the price increase, the likelihood that MYOB will sell its SME software to R-Firm's SME clients (potential sales of [REDACTED]) drops sharply given that R-Firm will be nine times less likely to recommend MYOB to its SME clients (and probably even less likely, given that it has just had a negative experience with MYOB).

Indeed, even if only one accountant at R-Firm was to switch its tax software to a competitor, the price increase would result in MYOB losing [REDACTED] of direct revenue as well as putting at risk over [REDACTED] of SME AMV revenue opportunity.

9.25 Accordingly, it is not surprising that [REDACTED].

### 10. No ability or incentive to impose a price increase on a sub-set of desktop customers

10.1 The NZCC is considering whether MYOB would have the incentive and ability to increase prices to accounting firms that would not be willing to switch to cloud providers i.e. CCH and Xero in response to a price increase. As discussed above, the evidence strongly suggests that there is no separate market for desktop software as distinct from cloud-based software.

10.2 As discussed above, there is significant evidence of switching from desktop-based software to cloud-based software. Indeed, [REDACTED]. Cloud providers therefore clearly constrain desktop providers.

10.3 To the extent that the NZCC is concerned that there may be a sub-set of accounting firms that may be vulnerable to a price increase because they have a preference for desktop-based software vis-à-vis cloud-based software (because e.g. they have just switched, they have concerns about security or they consider switching costs to be high), as set out above, [REDACTED].

10.4 [REDACTED] these accounting firms would be able to use the strategies described in the countervailing power section, above e.g. they could switch (or threaten to switch) a single licence

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<sup>33</sup> [REDACTED].

<sup>34</sup> Calculated based on the average revenue derived from accounting firms with over 30 accountants that use Reckon tax software, based on data in 'NZCC 29<sup>th</sup> Jan 2018 requests.xlsx' provided by Reckon in response to the NZCC's second RFI. Reckon's average revenue per licence from accounting firms with more than 30 users is approximately [REDACTED] from client accounting and [REDACTED] per annum from practice management. The potential upside from increasing the price of those modules is therefore even less than in the example above.

<sup>35</sup> MYOB has two SME products: DIY (Do It Yourself) and DIFM (Do It For Me). The annual cost of DIY is [REDACTED] per annum, while DIFM is [REDACTED] per annum. The average is [REDACTED]. To the extent that accountants using Reckon software have more DIY than DIFM clients (i.e. more large SMEs than small ones), this is likely to be a conservative estimate.

<sup>36</sup> For the purposes of this example, [REDACTED].

at very little cost to 'experiment' with the cloud. This threat would be credible, even if the firm has doubts that it will follow through.

- 10.5 Finally, as set out above, raising prices or lowering quality to these accountants also runs counter to deal rationale, and **[REDACTED]**.



## APPENDIX A – COUNTERFACTUAL

### 11. The competitive constraint provided by Reckon will decline in the counterfactual

- 11.1 The NZCC's current view is that the counterfactual is the "status quo, where MYOB and Reckon continue to independently provide desktop products". It is still considering "the extent to which MYOB and Reckon would transition their desktop products to the cloud without the proposed merger"<sup>37</sup>
- 11.2 The evidence provided to date, and supplemented below, shows that, while MYOB will continue to re-build its AE and AO suites for use in the cloud over time, Reckon does not have the capital nor the time to re-build APS in the cloud environment. There is therefore no "likely" counterfactual in which APS will ever move to the cloud.

#### *MYOB*

- 11.3 Absent the Proposed Transaction MYOB will continue to operate its Accounting Practice segment and will pursue opportunities to grow. However, consistent with its 'Connected Practice' strategy, MYOB will continue to transition its software for accountants to the cloud.
- 11.4 **[REDACTED]**.
- 11.5 **[REDACTED]**.

#### *Reckon*

- 11.6 There is no realistic prospect that Reckon will move its APS product to the cloud without the Proposed Transaction; Reckon simply does not have the resources, nor the time, to re-build APS as a full cloud solution.
- 11.7 Reckon's APS suite of 15 modules was built for use in the desktop environment at a time when cloud computing had not been contemplated, **[REDACTED]**.
- 11.8 **[REDACTED]**.
- 11.9 Reckon simply cannot afford to spend such time and money across the APS suite of 15 modules. Reckon's EBIDTA earned from APS in Australia and New Zealand combined for FY17 was approximately **[REDACTED]**. **[REDACTED]**.
- 11.10 Similarly, **[REDACTED]**.<sup>3839</sup>
- 11.11 **[REDACTED]**.
- 11.12 Therefore, in the face of competition from players such as Xero and CCH (which have far deeper pockets and spend far more than Reckon on product development), and also Sage and Intuit in Australia **[REDACTED]**, Reckon simply does not have the capital or time to 'catch up' to these players. Thus, it has decided to sell its Accountants Group business.
- 11.13 Reckon's public statements to the market, and the market's assessment of Reckon's future and of the Proposed Transaction, is confirmation of the above. For example:

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<sup>37</sup> LOI at [27].

<sup>38</sup> **[REDACTED]**.

<sup>39</sup> **[REDACTED]**.

- (a) At the time of the deal, Reckon's CEO, Clive Rabie, stated that "as time went by we realised we needed to move to the cloud and the cost of building out the technology, or investment, **which quite honestly we didn't have**",<sup>40</sup> and
- (b) Market analyst Morningstar commented that "the transaction is logical for Reckon, as its practice management software is yet to be migrated to the cloud, **an exercise that would likely be too costly and complicated for Reckon to undertake alone**. The uncertainty around the software's future would likely have eventually caused client losses, meaning Reckon had little choice but to sell the business".<sup>41</sup>

(emphasis added)

11.14 The appropriate counterfactual, therefore, is that Reckon will maintain its existing level of functionality in its compliance modules and will update them to ensure compliance with accounting and tax regulations. It will also look to add 'cloudy bits' to its business modules (which is a sub-optimal solution compared with full cloud functionality), [REDACTED].

11.15 Under this scenario, APS will become increasingly less attractive to accounting firms, as its product stagnates and the quality of rivals' products increases. [REDACTED], and the accounting firms that it already has (approximately [REDACTED] in New Zealand).

11.16 Indeed, Reckon's declining constraint on the market is already being felt, [REDACTED]. [REDACTED].

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<sup>40</sup> Australian Financial review, *MYOB buys Reckon's accounting group for \$180 million*, 16 November 2017.

<sup>41</sup> Morningstar, *Reckon Gets a Good Price for Practice Management; FVE Increased to AUD 1.46*, 16 November 2017, p.2.

**Table 3 - Reckon wins, losses and net customer numbers (2015-2017)**

<b>Year</b>	<b>Wins</b>	<b>Losses</b>	<b>Net customers</b>
2015	[REDACTED]	[REDACTED]	[REDACTED]
2016	[REDACTED]	[REDACTED]	[REDACTED]
2017	[REDACTED]	[REDACTED]	[REDACTED]

## APPENDIX B – POTENTIAL COMPETITION

### 12. Potential competition

- 12.1 The NZCC is considering whether entry (either desktop or cloud) would constrain any exercise of market power by the merged entity following the merger. Its understanding is that compliance modules are designed specifically for New Zealand regulatory requirements, and that software providers in other countries would therefore need to rebuild their software to enter the New Zealand market.<sup>42</sup>
- 12.2 However, entry into the New Zealand market would be relatively straight forward for an existing provider in another jurisdiction (especially for providers in Australia, given the similarities between Australia's and New Zealand's tax and accounting regimes). Tax and client accounting software modules would need to be re-configured somewhat (but not entirely re-written), however this would not be particularly onerous for the provider.
- 12.3 For business modules, entry is entirely feasible; no modifications are required for use in New Zealand. This is evidenced by the large number of international firms that already offer practice management and document management software to firms in New Zealand.
- 12.4 Given these low barriers to entry, MYOB maintains that there are multiple competitors operating in other jurisdictions, including Australia, that could quickly and easily establish a presence in New Zealand in response to incentives.
- 12.5 In addition to the above, **[REDACTED]** TaxLab, which provides tax software specifically for large accounting firms and corporates, including the Big 4, is well-placed to enter the tax software market in the near future. TaxLab was founded by former Deloitte accountants and is used by Big 4 firms.
- 12.6 **[REDACTED]**.
- 12.7 TaxLab's software has been built to file tax returns on IRD's new technology platform called Gateway Services. In April 2019 income tax returns will be accepted by IRD through Gateway Services. **[REDACTED]**.

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<sup>42</sup> LOI at [40].