

## CAPITA/IBS MERGER INQUIRY

### Summary of hearing with Northgate held on 29 January 2009

#### Background

1. Northgate told us that the revenues and benefits (R&B) market was relatively stable, without a lot of new activity. Northgate noted that some new sales opportunities had arisen as a result of the creation of unitary authorities. Legislative changes drove some additional sales to the installed base of customers, but these sales tended to be made by existing suppliers. Northgate did not consider that there would be any dramatic changes to this picture over the next five years or so. Even where significant changes were being discussed (such as a move away from council tax in Scotland), these changes would be likely to take some time to come to fruition.
2. Northgate estimated that there would be about six tender opportunities a year for R&B software, and that its own experience (consistent with the CC's analysis of data from SOCITM) was that customers seemed to re-tender around every eight or nine years approximately.
3. Northgate considered that there were likely to be more opportunities in the social housing (SH) market than in the R&B market for new software sales, which would be driven by such things as mergers between social landlords. Northgate anticipated between 10 and 20 SH tender opportunities a year over the next few years.
4. According to Northgate, there had been a small downward trend in activity in both the R&B and SH markets, over recent years, as a result of customers' efficiency drives. Although the SH market was more active than the R&B market, it was also more resource-intensive to service and less open to legislative change providing opportunities for additional sales to existing customers.

#### Market definition

5. Northgate said that it would be difficult but not impossible for a supplier of software to smaller social landlords or local authorities to begin to supply larger customers. This was a result of both the operational challenges of serving larger customers, and the need to build a perception among larger customers that the supplier was capable of dealing with their requirements. However, if there was a radical change, (for example a significant legislative change), new entrants would have a greater opportunity to enter the market. [✂]
6. According to Northgate, whilst IBS had historically provided its R&B software to small-to-medium sized local authorities, it had in recent years been selling to large local authorities as well and IBS's software was therefore obviously capable of serving these larger customers.
7. Northgate considered that whilst there are merits in looking at market shares in terms of more recently awarded tenders, it would be slightly more meaningful to look at market shares in terms of the overall installed software base. This is because customers tend to stay with suppliers for a long period of time (and possibly beyond their initial contract period) and so Northgate tends to look at revenues on the basis of both new sales and income from existing customers.

8. In Northgate's view, there was no trend among local authorities to integrate their revenues and benefits teams, to obtain efficiencies such as the use of a single integrated IT system. Northgate explained that, although this had sometimes been attempted, it tended not to last because different teams had different requirements and the pace of change required was different for each team. Northgate noted that local authorities tended to be relinquishing social housing responsibilities to other organizations and this further undermined the case for integrated R&B and SH systems.
9. According to Northgate, it would be possible for a non-UK company to supply R&B software to the UK market, but it would have to be a large company with an established reputation in other similar markets. The software itself could be written outside the UK.

### **Rationale for the transaction**

10. Northgate told us that, in the SH market, it viewed its and [REDACTED] products as the top products, with [REDACTED] product in the number three position. On the R&B side, [REDACTED] all products had very similar functionality. [REDACTED]

### **The counterfactual**

11. Northgate considered that IBS's profit warning prior to its sale simply confirmed that there were challenges in the market and that rates of new installations were slowing, rather than indicating that IBS was going out of business. The need for IBS to change its business model as its customer base matured may have driven the sale.
12. One of the main attractions for it in purchasing Anite was its complementary products such as Anite's social care and document management products, as Northgate already had a strong presence in R&B and housing. The acquisition was largely product driven, but it did give Northgate access to customers as well (although Northgate was in many cases selling other products to these customers already).
13. [REDACTED] Northgate's decision to purchase Anite was not related to or provoked by the Capita-IBS merger, and Northgate's acquisition was well advanced when it learnt of the Capita-IBS merger.

### **Barriers to entry/expansion**

14. Northgate told us that significant technological or legislative changes requiring large-scale re-writes of R&B software would create opportunities for new suppliers to enter the market. However, for smaller changes, the incumbent suppliers would still enjoy an advantage over new entrants. Any such large or small changes would also be an opportunity for Northgate to expand.
15. Northgate noted that some potential new entrants to the R&B market already sold software to local authorities and therefore had established reputations that could be extended into R&B software. When council tax was first introduced, there was entry into the market by large software suppliers with established reputations in the supply of other types of software.
16. The size of the R&B application, the length of time incumbents had been established and the need for knowledge of local government processes and contacts would be barriers to entry, but these were not insurmountable. Knowledge of local government

processes could be obtained, for example, by recruiting suitable staff from local authorities.

17. Northgate also highlighted the level of upfront investment needed to enter the market [REDACTED], and the time required [REDACTED] as further barriers to entry. However, this would not be such a problem, in a scenario where the Government announced a long change that would take effect in the future, ie 18 months. Everyone would be in the same position then.
18. Northgate told us that, whilst it might be possible for a new supplier to enter the R&B market by supplying only one module at a time, this would be difficult and unlikely. This was in the main because there were limited numbers of customers that purchased their R&B core modules on a module-by-module basis.
19. Northgate did not consider that the underlying database technology used by a supplier significantly affected local authority decisions about which R&B software to use. Northgate noted that, despite some tenders specifically stating that a council had an Oracle strategy (Northgate's has an Oracle-based system), it did not necessarily win such tenders because the council was simply making a top-level strategic statement, not announcing an intention only to purchase Oracle-based systems.
20. Northgate said that, whilst it was aware of some examples of local authorities and software suppliers working together to establish the software supplier in other markets in the past, it did not know of any examples in the R&B market. Local authorities would be likely to take the view that sponsoring new software development was not core business for them.
21. Northgate explained that it had a portfolio of different products, [REDACTED] it had a policy of continuously improving those products [REDACTED]. [REDACTED]

## **Buyer power**

22. Northgate said that customers had become more sophisticated in recent years in terms of understanding the whole lifecycle costs of software, rather than focusing on the upfront capital expenditure component of the price as they may have done in the past. The majority of bids in which Northgate participated were carried out under European procurement regulations.
23. [REDACTED]
24. Northgate explained that bidding in tender processes involved expending considerable resources without any guarantee of success and Northgate took this into account when considering which tenders to pursue.
25. Customers purchasing a quantity of other Northgate software and products sometimes asked for reduced prices [REDACTED].
26. [REDACTED]
27. Customers would, however, take into account the risk associated with changing supplier, given the business-critical nature of the R&B software for local authorities. Customers were also concerned about their performance indicators that they had to report to other parts of Government. Any change in software supplier would be likely to result (even if only initially) in a drop in apparent performance until teething problems were resolved. Northgate noted that poor performance against such

indicators was unlikely to be solely or mainly due to the software used, given that each software supplier had customers performing both well and poorly against these indicators. Northgate has very good evidence to show that authorities which use our software perform far better than those of our competitors.

28. Northgate told us that price was very important in tender negotiations [REDACTED]. Typically, a shortlist of two or three bidders would be drawn up from the list of all bidders, then a preferred bidder would be chosen. Whilst pricing could change after that stage, care had to be taken not to invalidate the preferred supplier decision. Therefore it was a bidder's original pricing decision which was key.
29. According to Northgate, profitability changed during the lifecycle of its relationship with a customer. [REDACTED]
30. Northgate told us that that local authorities did communicate with each other about their R&B software (including name of supplier, pricing and satisfaction levels), for example via professional associations and geographic groupings of local authorities within a region.

### **Competition between IBS and Capita (and other competitors) pre-merger**

31. Northgate considered IBS and Capita to be strong competitors in R&B pre-merger, with Northgate, IBS and Capita likely bidders for every tender. IBS had been more successful at winning business than Capita as the market matured. IBS was growing but Northgate and Capita had the greater market shares. [REDACTED]
32. [REDACTED]
33. Northgate told us that Civica was no longer a serious contender in the R&B market, and that Civica had not been actively bidding. However, Civica was bigger in SH. Although 3i's investment made it possible that Civica might re-emerge as a stronger competitor in R&B, the recent economic downturn made this less likely.
34. Northgate told us that Orchard is a sound competitor in the SH market, although it noted that Orchard is limited by being in the SH market only. Aareon is a reasonably strong mid-range competitor, Orchard is also strong in the mid-range and is starting to challenge for larger business. There are lots of smaller suppliers for small SH organizations, and there are six or seven competitors at the top end. In Northgate's opinion, Civica was also a strong competitor in SH.
35. According to Northgate, the R&B market could sustain three competitors although it could decline to a point where it could only sustain two players.
36. Northgate considered that innovation was required in both the R&B and SH markets to stay competitive. Northgate noted that there was more scope for innovation in the core SH modules than in the core R&B modules, where all competitors tended to have the same functionality. Therefore, in the R&B market, Northgate tried to innovate outside the core modules.

### **Effects of the merger**

37. Northgate did not consider that a merged Capita/IBS could dominate the R&B or SH markets, although it would be a very competent competitor to Northgate.

38. Whilst Northgate noted that some large local authorities such as [redacted] might outsource IT procurement and management in their entirety, some such partnerships had proven to be unsustainable. Outsourcing companies had found it difficult to recoup large initial investments. In future, Northgate expected smaller-scale partnerships covering certain areas rather than comprehensive outsourcing.

### **Coordinated effects**

39. Northgate explained that it obtained information about the market in a number of ways. It spoke with customers, professional associations, attended industry events and it sought informal feedback from potential customers and it made its own judgements.
40. Northgate's sales executives were keen to bid for every opportunity, [redacted].
41. Northgate told us that [redacted] it would be at a disadvantage bidding for shared services arrangements where it was not the incumbent supplier for at least one of the partners. [redacted]