COMPETITION COMMISSION

FRANCISCO PARTNERS LP AND G INTERNATIONAL INC MERGER INQUIRY

Provisional findings report

Published: 14 July 2005

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

Provisional findings report

Francisco Partners LP and G International Inc merger inquiry

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Summary

The reference

1. On 22 March 2005, the Office of Fair Trading (OFT) referred the completed acquisition of G International, Inc. (G International) from International Business Machines Corporation (IBM) by Francisco Partners LP (FP) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). We are required to publish our final report by 5 September 2005.

Electronic data interchange and the companies

2. Electronic data interchange (EDI) is an electronic tool which was developed in the 1980s to provide a more efficient exchange of business information between trading partners. EDI refers to a specific means of formatting (a message content standard) and transmitting data. Intermediaries, called value-added networks (VANs), were created in the 1980s to facilitate the EDI process. They allowed each customer to adopt its own communication protocol, yet allowed multiple trading partners to communicate electronically using a VAN as an intermediary.

3. An EDI VAN combines a physical communications and computing infrastructure with data management processes that enable the handling and transmitting of messages that relate to business information flows.

4. FP is an investment firm which looks to invest in technology companies facing strategic challenges as a result of changing industry circumstances. FP purchased Global eXchange Services, Inc. (GXS)[1] from General Electric Company (GE) in 2002. GXS is a global provider of EDI products and services. In November 2004, FP

[1]In this context, GXS refers to the specific named entity. Subsequently, and as defined in the glossary, GXS refers to either Global eXchange Services, Inc. or to Global eXchange Services, Inc and its subsidiary companies, as the context requires.

acquired IBM's EDI service business, G International, through its wholly owned subsidiary, Redux Acquisition Holdings LLC (Redux).

The merger and the relevant merger situation

5. As a result of the transaction, FP and G International have ceased to be distinct. FP's UK share of supply of EDI VAN services through its UK subsidiary Global eXchange Services Limited (GXS Ltd) was substantially greater than 25 per cent. This share has increased following the acquisition of G International. The share of supply test set out in section 23(4) of the Act is satisfied. We therefore conclude that a relevant merger situation has been created.

Market definition

6. We analysed which services were technically feasible and economically viable substitutes for traditional EDI VANs. We found that traditional EDI VANs accessed using the internet and more modern internet VANs were very similar in nature to traditional EDI VANs, and that these were part of the relevant product market as substitution between them was technically feasible and economically viable.

7. We found that the use of a direct internet trading relationship using point-to-point internet EDI based on technologies such as Applicability Statement 2 (AS2) has some different technical characteristics from EDI VANs. Whilst this solution, insofar as it requires an 'always on' internet connection, may be unsuitable for some customers, it appears to be a technically feasible and economically viable substitute for a significant proportion of EDI VAN users. We found that point-to-point internet EDI was part of the relevant product market.

8. Another EDI variant is known as web EDI. In this case the interface used by one trading partner is a web page, but the other trading partner can process the

transaction automatically, similarly to other EDI systems. This we also found to be part of the relevant product market.

9. We considered the geographic market for EDI products and services. We observed significant and sustained price differences between the UK and the USA. Price comparisons with Europe were inconclusive; GXS charged the same list prices for certain elements of its ICS VAN service in Europe as in the UK, but for other elements UK prices are higher. Tradanet, GXS's EDI VAN service with the largest UK sales, operates on a different pricing structure and is not sold outside the UK.

10. The pre-eminence of the retail specific Tradacoms standard in the UK may act as a factor which distinguishes the UK as a separate geographic market. There are few providers in common in the different geographic areas. Taking account of the differences in prices, the fact that many European and US EDI VAN providers do not sell in the UK, and the UK-specific standards issue, we conclude that at present the relevant geographic market is the UK.

Assessment of the competitive effects of the merger

11. Overall we consider that before the merger there was only limited competition between IBM and GXS, both directly and via several EDI software providers that resell EDI VAN services in conjunction with their own software (resellers). This competition was generally for larger customers and appeared very modest for small customers, which tended to followed their trading partners' preferences. Direct competition for reseller business had largely been between IBM and British Telecommunications plc (BT). Whilst we saw some evidence in the UK of competition from the providers with a small market presence, such as EasyLink Services UK Ltd (Easylink), Sterling Commerce and Harbinger Commerce, this appeared limited and there was no evidence of these providers taking significant volumes of business,

even though they were sometimes used by larger direct customers as a threat in negotiations with GXS or IBM.

12. We concluded that we expect growth in point-to-point internet EDI. It was difficult to judge the speed and extent of the likely change and we did not expect rapid movement in the short term, but we did conclude that the possibility of switching would act as a constraint on GXS.

13. We noted that there had been no significant entry into the UK market in recent years. Evidence also indicated that expansion had been difficult in the UK market.

14. We assessed what would be likely to happen in the absence of the merger (the counterfactual). The IBM business was profitable and we expect that, in the absence of the merger, it would either have continued under IBM's ownership or would have been sold to a third party.

15. The pre-merger situation was characterized by the presence of one competitor with a very large market share (GXS), three with relatively small shares (IBM, EasyLink and BT) and several other participants with very low market shares. The merger removed the largest of the three relatively small participants.

16. It is clear that GXS had a very strong pre-merger market position. GXS's pricing may have been constrained to some degree by IBM.

17. We identified certain groups of customers that appeared to have viable alternatives. We considered that for each of these groups (large retailers, software providers to personal lines insurance brokers, and resellers) the existence of these alternatives would be sufficient to ensure that the loss of IBM as a competitor would not have a

substantial effect. Certain customers told us that they do not have viable alternatives and may face a reduction in choice as a result of the merger. However, these are also the customers for whom pre-merger competition appears to have been of limited significance.

18. We found that resellers will remain as active market participants after the merger and will have a choice of EDI VAN providers. Use of resellers will be a choice available to customers, including those that have not used resellers in the past.

19. In summary, we find that in those areas where IBM would have provided some competition most customers should have sufficient viable alternatives to resist any lessening of competition.

20. We also conclude that there is no evidence to suggest that the merger has increased the likelihood of coordinated effects where none existed prior to the merger.

Provisional findings

21. We have therefore provisionally concluded, with two members of the group dissenting, that the merger has not resulted, and may not be expected to result, in a substantial lessening of competition (SLC) within any market in the UK for goods or services.

Provisional findings

1. The reference

1.1 On 22 March 2005, the OFT referred the completed acquisition of G International by FP to the CC for investigation and report. The reference was made under section 22 of the Act. Our terms of reference are contained in Appendix A. We are required to publish our final report by 5 September 2005.

1.2 This document, together with the appendices, constitutes our provisional findings which we are required to notify to the main parties under the CC's *Rules of Procedure*.[2] Further information, including non-commercially sensitive versions of main-party and third-party written submissions, and details of a survey of EDI VAN customers conducted on behalf of the CC by ORC International (the customer survey), can be found on our web site.[3] We cross-refer to these documents where appropriate.

2. Electronic data interchange and the companies

Electronic data interchange

2.1 Businesses generate and process a large volume of documents, such as purchase orders, delivery information and invoices. These documents provide an information flow which is vital for the smooth operation of the supply chain.

2.2 A majority of the data in these documents is generated from computer applications. In many cases, where the documents are communicated by mail or fax, these documents are printed and copied before the information they contain is sent to the trading partner. The trading partner may in turn re-key this information into another computer application for further processing.

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[2] *Competition Commission: Rules of Procedure (CC1)*. Paragraph 10.3.
[3] www.competition-commission.org.uk.

2.3 The process can be slow, costly and error-prone, and the need for a faster, cheaper and more accurate solution for exchanging commercial data has been significant for many companies, especially those dealing with a large volume of transactions and a large number of trading partners (eg major retailers).

2.4 EDI is one of a number of electronic tools which were developed in the 1980s to provide a more efficient exchange of business information, that supports transactions between trading partners, using a specific means of formatting (a message content standard) and various ways of transmitting data.

2.5 In the UK, EDI standards were developed by the Article Number Association (ANA) (an association of businesses set up to facilitate standardization across the retail supply chain; and the forerunner of today's GS1 UK—the UK EDI association) in conjunction with relevant industry sectors. In 1982, the ANA launched the standard most widely used for trade in the UK retail, food and beverage sectors: Tradacoms. Since then the ANA and its successors have worked with their members and other organizations to implement the international, UN-backed standard called EDIFACT in the UK and today GS1 UK promotes the use of eXtensible Markup Language (XML).

2.6 Message content standards were the first building blocks of EDI systems and early systems relied on tape delivery or telecommunications lines—either leased lines or dial-up connections—for data transmission between trading partners. This approach, called point-to-point or direct connect EDI, was manageable when companies had a small number of trading partners. As trading communities grew, so did the complexity and cost of managing numerous direct connect EDI links.

2.7 Other industry sectors also adopted EDI in the 1980s, the most notable of which is the European automotive industry. Its data standards organization, the Organization

for Data Exchange by Tele Transmission in Europe (ODETTE) was first formed in London, with participation from national automotive organizations in France, Germany, Italy, Spain and Sweden, and is still very active today. In the context of our inquiry, we have not focused on the automotive sector, in which neither GXS nor G International has a significant presence.

2.8 VANs were introduced in the 1980s to facilitate EDI. VANs allowed users to connect to a single access point for the VAN using an appropriate message content and communications protocol, rather than support independent direct connections to each of their trading partners. Use of direct communications entailed significant complexity and expense, both because of physical telecommunications requirements and because of the different message content and communications protocols that were used.

2.9 EDI VANs can be likened to a postal service. A person places a message into envelopes, addresses them, and drops them into a post-box. The post office then sorts the envelopes and a postal worker delivers them to the intended addressee, or they are placed in a personal post office box for collection.

2.10 An EDI VAN combines a physical communications and computing infrastructure with data management processes that enable the handling and transmitting of messages that represent business transactions.

2.11 In the UK, the ANA selected ICL as its provider of the first third-party VAN called Tradanet, which was aimed at the retail industry. By the early 1990s, Tradanet was well established in the retail sector and other EDI VAN providers, including IBM, AT&T (see paragraph 5.7) and BT, had entered the market. General Electric Information Systems (now GXS) initially acquired a minority shareholding in ICL's

subsidiary International Network Services and eventually took full control of the company in 1993.

2.12 The role of EDI VAN providers remained broadly unchanged until the late 1990s, when the emerging use of internet technologies for EDI started to transform this industry.

2.13 There are several new approaches that have been developed exploiting internet technology:

- the internet can be used, instead of leased lines or dial-up connections, as a method of connecting to an EDI VAN;
- newer EDI VANs have been developed based on internet technology with potentially lower costs and additional functionality;
- point-to-point connection directly between trading partners can be carried out effectively and securely, avoiding the need for intermediation via a VAN; and
- web-based interfaces allow users to create messages online that can automatically be processed upon receipt.

These developments are described in more detail in our discussion of market definition, see paragraphs 4.8–4.14.

Francisco Partners LP

2.14 FP is a private equity firm based in the USA. It has approximately $2.5 billion of committed capital under management.

2.15 FP is organized as a Delaware limited partnership. Its General Partner is Francisco Partners GP LLC, a Delaware limited liability corporation. The partnership has approximately 400 limited partners, none of which owns more than 5 per cent of FP. The General Partner has 5.72 per cent of the capital commitment.

2.16 Target investments for FP are typically companies active in the communications, hardware, software or IT services sectors, or those active in other technology-related or technology-enabled markets.

2.17 FP is an investment firm which looks to invest in technology companies facing strategic challenges as a result of changing industry circumstances. FP told us that it is in these circumstances that it seeks 'to buy confusion at a discount and ultimately sell clarity at a premium'.[4] Its investments in GXS in 2002 and G International in 2004 were in line with its strategy.

GXS

2.18 GXS is a global provider of EDI products and services and has also been one of the leading providers for 20 years. Prior to FP's acquisition of G International, GXS was its only subsidiary company active in the supply of EDI.

2.19 In September 2002, GXS was recapitalized, which resulted in FP owning 90 per cent and GE owning 10 per cent of the stock in the company.

2.20 GXS provides EDI VAN and related services to approximately 30,000 customers worldwide. GXS had worldwide revenues in 2004 of $329 million, derived from transaction processing and software maintenance fees, software licensing fees, and fees from professional services provided in connection with EDI and similar systems to customers in over 25 countries. The data centres used to provide those services are located in Amsterdam in the Netherlands, Cleveland in Ohio, USA, and in Hong Kong. The company is headquartered in Gaithersburg, Maryland, USA.

[4]According to FP's Overview Submission, 12 April 2005.

2.21 Within Europe, GXS has wholly owned subsidiaries and offices in Belgium, France, Germany, Italy, the Netherlands and the UK. GXS Ltd, the wholly-owned UK subsidiary of GXS, is based in Sunbury-upon-Thames, Middlesex, as are the headquarters for the Europe, Middle East and Africa (EMEA) region. The revenues of GXS Ltd in 2004 were £29.2 million. GXS's Tradanet revenue in the same year, deriving from sales to around 3,000 customers, was approximately [✂]. Details of GXS's financial data is contained in Appendix B.

2.22 Within the UK, GXS Ltd supplies a number of different EDI VAN services: Tradanet, EDI*Express and Interchange Services (ICS). The majority of customers in the UK currently subscribe to the Tradanet service. There is a small number of EDI*Express UK customers and they are in the process of being migrated to ICS. ICS is a global EDI VAN service, which was launched in Europe in November 2004, shortly after its release in the USA. Whilst currently it has [✂] customers in the UK, all new customers will be placed on the ICS service. GXS told us that existing Tradanet and EDI*Express customers will be encouraged to upgrade to ICS.

G International

2.23 Prior to the acquisition by FP, the business owned by G International was part of the Global e-business Hosting Services Division of IBM.

2.24 In 2004, G International's worldwide customers numbered approximately 10,000 in total. Global G International revenues in 2004 were approximately $170 million. Within the UK, G International had approximately [✂] customers accounting for UK revenues of [✂] in 2004. Details of G International's financial data is contained in Appendix B.

3. The merger and the relevant merger situation

Outline of the merger situation

3.1 In October 2004, FP, through its wholly owned subsidiary, Redux, entered into an agreement with IBM to acquire G International.

3.2 The transaction was structured partly as a share deal and partly as an asset deal. The assets of IBM's EDI VAN service, which included customer contracts and computer hardware, were transferred to a specially-created company called G International in November 2004. Redux purchased the shares of this company for a total consideration of [✂]. At the time of the transaction, G International had [✂] of debt. In January 2005, GXS signed an agreement to acquire Redux and thus G International.

3.3 There were two other jurisdictions where regulatory clearance was required. In both jurisdictions the transaction was unconditionally cleared.

3.4 The consideration allocated to the legal entity set up to acquire the UK EDI trade and assets (which included approximately [✂] customer contracts, [✂] reseller contracts, some staff and some ancillary network hardware and peripherals mainly located in Warwick) was [✂].

3.5 The global deal structure in the UK involves G International outsourcing for a period of three years to IBM the provision of the technical infrastructure for the EDI VAN services provided to the transferred customers. Therefore for this period the acquired customers will continue to utilize the same AT&T network used prior to the merger, unless they move to one of GXS's EDI services.

Undertakings to the OFT

3.6 The OFT accepted interim undertakings on 22 February 2005 from FP and GXS Ltd to prevent GXS from integrating the G International EDI VAN service business in the UK with that of GXS in a manner which might prejudice any investigation of the merger by the CC.

Undertakings to the CC

3.7 When the merger was referred, the CC adopted these undertakings and considered whether any further changes were necessary to prevent pre-emptive action by the parties which might prejudice the reference or impede the application of effective remedies at the end of the inquiry. As a result, on 26 May 2005, the CC released the parties from the OFT undertakings and accepted replacement interim undertakings given by FP, GXS and GXS Ltd.[5]

The rationale for the merger

3.8 IBM's rationale for the sale of its EDI VAN service business, according to its strategic documents, was to divest this part of the business because of low growth prospects for the EDI VAN service, especially as customers were likely to move to newer, open-standard technologies. IBM considered that the EDI VAN service business was faced with declining revenue and a fixed cost structure, placing downward pressure on its margins.

3.9 IBM told us that if it did not sell the business, its plans were to implement additional cost reductions to improve profitability. [✂].

3.10 GXS told us that the transaction will give it the potential to redress some of the revenue pressures on the supply of EDI VAN services. In addition, GXS considered

[5]These undertakings can be viewed on the CC web site.

that there were opportunities for cost savings. GXS told us that the merger will not only broaden its presence in key global regions, particularly in the Asia Pacific region and South America, but will also give it the potential to create a leading provider of integrated business-to-business services between EDI and other back-office accounting and logistics systems.

Jurisdiction

3.11 Under section 22 of the Act, the CC is required to decide whether a relevant merger situation has been created. A relevant merger situation is created where two or more enterprises have ceased to be distinct and either the share of supply test or the turnover test specified in the Act is satisfied.

3.12 The acquisition of G International by FP in November 2004 has resulted in the enterprises carried on by, or under the control of, G International ceasing to be distinct from enterprises carried on by, or under the control of, FP within four months of the reference.

3.13 The relevant share of supply test in section 23(4) of the Act is met if FP increases its share of supply of products or services of any description in the UK to at least one-quarter as a result of the merger, or if it already supplies at least one-quarter and increases its share as a result of the merger.

3.14 We have made our own estimates of the shares of supply of EDI VAN service providers in the UK. These estimates are based on information provided for the latest financial year by the companies supplying those services. These estimates indicate that prior to the merger, GXS Ltd already supplied substantially more than 25 per cent of EDI VAN services in the UK and it has increased its share as a result of the

merger. The share of supply test is therefore met, and we do not have to consider whether the turnover test is met.

3.15 For the reasons set out in paragraphs 3.12–3.14, we conclude that there is a relevant merger situation within the meaning of the Act. This was not disputed by any party during the course of our inquiry.

4. Market definition

General considerations

4.1 As stated in the CC's *Guidelines on merger references (CC2)*, the definition of the relevant market (or markets) is a crucial element in deciding whether a merger would result in an SLC. There are usually two key dimensions to the definition of a market:

- the relevant *product* market; and
- the relevant *geographic* market.

The market boundaries are determined by substitutability, that is the extent to which customers can readily switch between substitute products, or suppliers can readily switch their facilities between the supply of alternative products.

4.2 The generally-accepted conceptual approach to market definition, used in many jurisdictions, is the hypothetical monopolist test. This test considers whether a certain product or set of products, which might constitute a market, could hypothetically be monopolized profitably. The test is most often formulated by considering the potential for a company to impose a small, but significant, non-transitory increase in price with profitable results. However, it is also possible to consider the test in terms of the impact of changes in other characteristics, such as a reduction in product quality or an increase in delivery times.

4.3 Historically, pricing structures for EDI communications services in the UK have been complicated and the structures varied between EDI service providers, between

products, and over time. Comparison of prices is therefore inherently difficult, and various customers have indicated to the CC that they have difficulty in comparing the prices of the various services.

4.4 However, the hypothetical monopolist concept remains a useful analytical framework and, within this framework, there is a variety of evidence which can help define the relevant product market. These include:

- inherent characteristics of the product affecting the substitutability of various alternatives;
- evidence of past behaviour in the market, such as substitution by customers between suppliers/products;
- barriers and costs for customers when considering switching between alternative products and/or suppliers;
- the existence of different categories of customers and price discrimination, which may narrow the extent of the relevant market; and
- views of customers and competitors.

The basic product: EDI VAN services

4.5 An EDI VAN is a 'store and retrieve' mailbox system, which manages the electronic transfer of information from one company to another. EDI messages are transmitted to the sending party's mailbox at the EDI VAN. The EDI VAN then places those messages in the mailbox of the receiving party, ready for collection.[6]

4.6 In addition to data transmission services, EDI VAN providers also provide other services, such as:

- **authentication:** verification of the identity of trading partners and of the authority of trading partners to interact with one another;

[6]In some cases messages are forwarded rather than collected—this is known as 'store and forward'.

- **security:** provision of a protective buffer between computer systems of trading partners, thereby minimising and controlling the points of contact; and
- **non-repudiation/audit tracking:** an EDI VAN can provide neutral, third-party audit trail information to enable trading partners to settle disputes.

4.7 Historically, users accessed EDI VANs mainly via leased line telecommunications connections.

Impact of the internet

4.8 One impact of the internet has been to allow trading partners to use the internet infrastructure for data transportation between their IT systems and those of their EDI VAN provider. This can provide lower telecommunications costs, but otherwise makes no significant difference to the overall service. We refer to this approach as 'EDI VANs accessed via the internet'.

4.9 A second impact of the internet has been to allow the development of 'internet EDI VANs'. These EDI VANs also provide for the exchange of electronic documents through a mailbox system, but make extensive use of internet technology, not only for transmission to and from the VAN but also for operating the VAN. Internet EDI VAN service providers also offer independent arbitration, archiving, and secure/timely delivery of data. More modern technology may offer a cost advantage over EDI VANs.

4.10 Another impact of the internet has been to allow providers to extend their reach to new, typically smaller, trading partners which had not previously invested in EDI, by offering access through a web page. Under this model, known as 'web EDI', the main trading partner sets up a web site for its smaller partners to use. When the smaller partner creates a transaction on the web site, it can be automatically processed by the larger one as though it was an EDI message. Web EDI requires manual input by

the smaller partner; it is therefore appropriate only if the smaller partner has a small volume of transactions.

4.11 Internet technology has allowed the development of direct, point-to-point communication between trading partners; we refer to this as point-to-point internet EDI. A variety of standards have been developed that allow direct inter-firm messaging to take place via the internet without the need for an intermediary, whilst still providing high levels of security.

4.12 One of these standards is known as AS2. A high profile example of the adoption of point-to-point internet EDI is the use of AS2 by Wal-Mart, including its subsidiary Asda in the UK. AS2 has been adopted by Asda for its transactions with its largest suppliers, accounting for the majority of the retailer's business.

4.13 Asda is currently in the process of implementing AS2 with its suppliers. This initiative commenced in November 2004 and at the time of this report was well advanced. Asda has provided support to enable suppliers to acquire approved AS2 software and has provided a software user licence to assist its suppliers with this move. Asda has also provided another service, similar to web EDI, for those much smaller suppliers for whom AS2 is not suitable; these customers represent less than [✂] of Asda's business. We were not in a position to make an overall assessment of this initiative. Evidence from other major retailers did not suggest that they would be making such a move within the next one or two years; however, one major supplier of Asda told us that it was very pleased with Asda's move and that it had achieved significant savings in EDI costs.

4.14 GXS told us that web-based marketplaces (e-marketplaces) began to emerge at the same time as internet EDI communications services and that they are based on the

same model. GXS told us that e-marketplaces bring together dispersed trading partners and provide software tools and protocols that enable the traders to do business electronically. E-marketplaces are discussed further in paragraph 4.20.

Substitution

4.15 We considered whether these various types of service were technically feasible and economically viable substitutes for traditional EDI VANs.

4.16 We found that traditional EDI VANs accessed via the internet had essentially the same characteristics as traditional EDI VANs accessed via other means such as leased lines, and that substitution was therefore technically feasible and economically viable.

4.17 We found that internet EDI VANs provided a very similar service to traditional EDI VAN services, potentially at a significantly lower cost, and that substitution was therefore technically feasible and economically viable.

4.18 We found that web EDI provides an alternative which is suitable for certain trading relationships, typically those where one trading partner is much smaller than the other. Web EDI is normally only available to the smaller partner if the larger one arranges provision. In these cases web EDI is a technically feasible and economically viable substitute for traditional EDI VANs.

4.19 Point-to-point internet EDI, based on technologies such as AS2, has different technical characteristics from EDI VANs. The direct links with trading partners can provide greater certainty of delivery, but make an ‘always on’ internet connection highly desirable, if not essential. We were also told that using AS2 could require greater technical support than using EDI VANs. Cost comparison is not

straightforward as the costs of EDI VAN services are avoided, but additional setup and support costs may be incurred. Whilst point-to-point internet EDI might not be suitable for some users, it appears to be a technically feasible and economically viable substitute for a significant proportion of EDI VAN users. This conclusion is supported by the fact that the majority of users that have provided evidence to the CC stated they believe that AS2 is a substitute for EDI VANs.[7]

4.20 GXS argued that a number of e-marketplaces should be considered as part of the relevant product market as they have the capability to carry EDI messages. There is no standard definition of an e-marketplace. GXS suggested that they were very much like internet EDI VANs, but that for historical reasons they tended to have different owners. However, other parties told us that although e-marketplaces generally provide a wide range of capabilities, EDI messaging was not a major component of their offering. Easylink told us that it saw e-marketplaces as providing a complementary service to EDI communications services but it did not see them as being substitutes. None of the EDI VAN customers we spoke with considered e-marketplaces to be a substitute for EDI VANs, although several of them used e-marketplaces for other purposes. We therefore concluded that e-marketplaces were not part of the relevant product market.

Related products: software

4.21 EDI software can be classified in the following manner:

- communication software: this allows communication, including data transmission, with the VAN;
- translation software: this converts data from the in-house format into the agreed EDI standard before transmission (or the reverse for incoming messages); and

[7]An exception to this is provided by a number of users in the insurance industry, which stated that AS2 was not a viable alternative technology for their sector. This is discussed in greater detail in 5.56.

- application interface software: this imports and exports data between customers' in-house applications and the translation software.

4.22 Communications Software is usually provided as part of the EDI service, but application interface software and translation software are often provided by specialist software providers.

4.23 As a result of the different functions and differences in the conditions of supply, whilst Communications Software is considered as part of the relevant market, application interface software and translation software are considered to be part of a separate related market.[8]

Industry sectors

4.24 We considered whether there might be separate industrial sectors in (a) the core product market for transmission of EDI messages, and (b) the closely-related software market, since the conditions of customer demand exhibited in different industries may themselves be different, particularly with regard to the propensity for customers to switch providers. However, this was not sufficient to lead us to define different industrial sectors as separate markets.

Conclusions: product market definition

4.25 We conclude that the relevant product market is the market for the transmission of EDI messages from one business to another. This market includes:

- point-to-point EDI using leased lines, and similar techniques;[9]
- traditional EDI VANs;
- traditional EDI VANs accessed via the internet;

[8]Enterprise application integration (EAI) software is not included within the relevant product market, but is rather considered as part of the separate related software market. Despite having some communications functionality, EAI is primarily aimed at conducting application interface and translation functions, and is generally not EDI-specific.
[9]Described in 2.6.

- internet EDI VANs;
- web EDI; and
- point-to-point internet EDI, including technologies such as AS2.

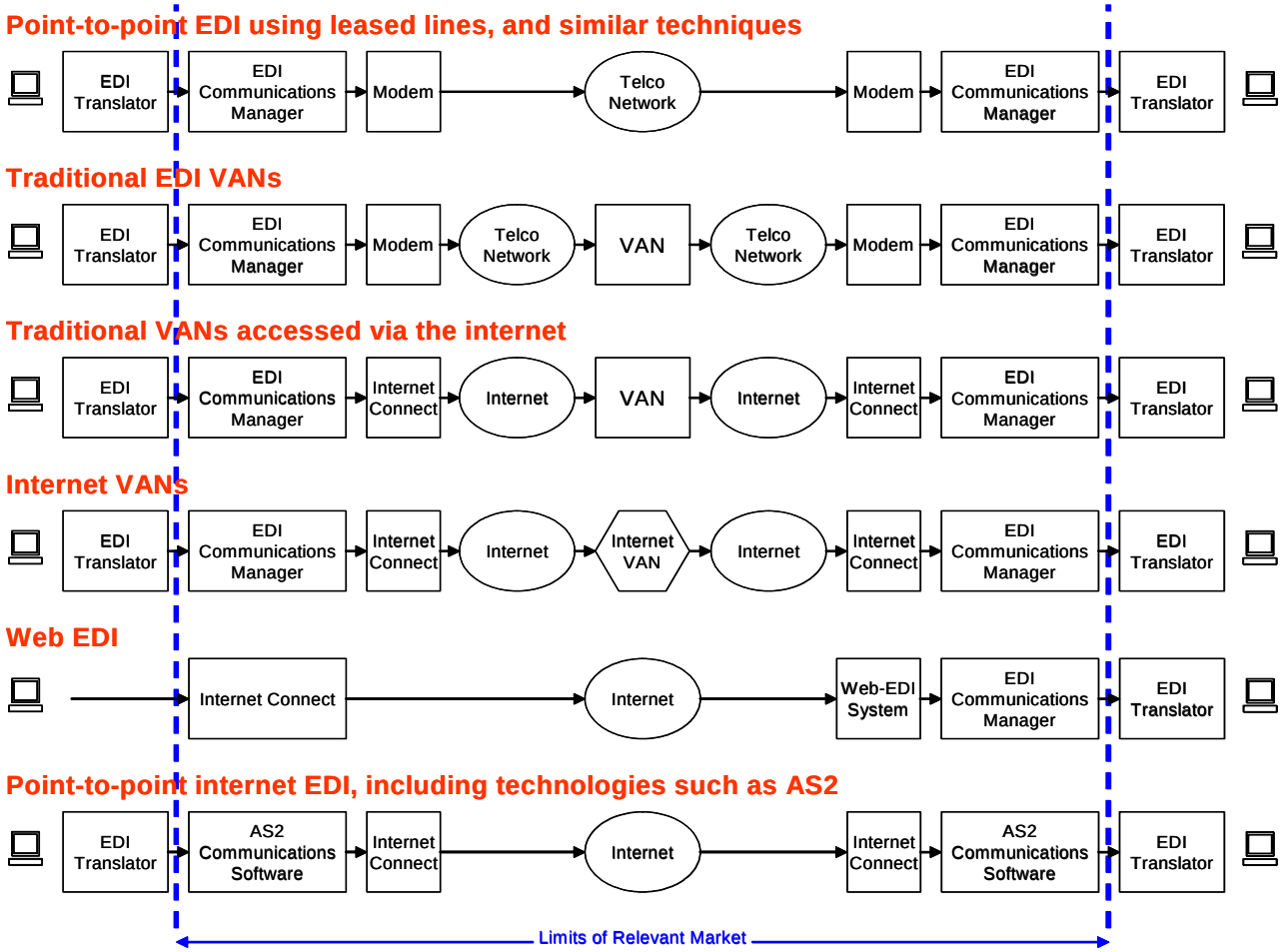
4.26 We describe this group of products as ‘EDI communications services’.

4.27 All these products fulfil the same basic function of transmitting EDI messages from one trading partner to another, and hence satisfy the same customer need. As such, they are expected to provide a competitive constraint upon one another, because of the potential for customers to switch from one service to another. Communications Software is included within the limits of the relevant product market, but other software is not. Figure 4.1 illustrates the extent of the relevant market.

4.28 There is a related market for additional software (such as application interface software and translation software).

FIGURE 4.1

Limits of the relevant product market



Source: CC based on GXS' materials

Geographic market definition

4.29 We observed significant and sustained price differences between the UK and the USA. Price comparisons with Europe were inconclusive. GXS charge the same list prices for certain cost elements of ICS (see 2.22) in Europe as in the UK, but for other elements UK prices are higher. Tradanet, GXS's product with the largest UK sales, operates on a different pricing structure and is not sold outside the UK. EasyLink told us that prices in the UK differ from prices in other countries.

4.30 The pre-eminence of the UK-specific Tradacoms standard in the UK, for EDI with retailers, may act as a factor which distinguishes the UK as a separate geographic market. We were told that some degree of special configuration may be necessary in order to transmit messages in the Tradacoms standard, and an EDI VAN designed to transmit messages based on other standards might need adaptation to supply services to UK customers.

4.31 There are few providers in common between the geographic areas. GXS is present in many countries, but only a very few of the other US companies are present at all in the UK. Elsewhere in Europe, national telecommunications companies have large shares (BT is a significant, but relatively small, EDI provider in the UK—see 5.8).

4.32 Taking account of the differences in prices, the fact that many European and US EDI VAN providers do not sell in the UK, and the UK-specific standards issue, we conclude that at present the relevant geographic market is the UK.

5. Assessment of the competitive effects of the merger

5.1 We are required under the Act to decide whether the merger may be expected to result in an SLC within any market or markets in the UK for goods or services. In this section we look at the competitive effects of the merger having regard to our

guidelines.[10] We first describe the providers of EDI communications services and then discuss factors affecting rivalry in the relevant market, including market shares and existing features of the market. We then discuss the levels of existing competition in the relevant market and the opportunities for market entry. Following a discussion of the counterfactual, we examine the competitive effects of the merger. This leads to our conclusion as to whether the merger situation has resulted, or may be expected to result in a SLC within any market or markets in the UK.

Main providers of EDI communications services

5.2 Prior to the merger, the largest providers of EDI communications services to the UK market were GXS, IBM, Easylink and BT. In this section we focus on their positions as market participants.

GXS

5.3 Prior to the merger, GXS was by far the largest provider of EDI communications services with over two-thirds of the market. Its UK business was based mainly on the Tradanet network set up in 1985 to support trading relationships between retailers and their suppliers. It has retained a particularly strong position as a provider to this group of trading partners.

5.4 As well as providing EDI VANs and communication software, GXS also offers translation software. GXS told us that just over [✂] per cent of its customers use the software that it provides, whilst almost [✂] per cent of customers purchase alternative software from third-party providers. The CC's customer survey showed a higher proportion of GXS's customers using software supplied by another company,

[10] *CC Merger References: Competition Commission Guidelines*.

with 55 per cent of the customers who responded naming an alternative company as their software provider.[11]

5.5 GXS told us that its strategy is to increase the proportion of its revenues accounted for by 'value-added services' and that it has sought to place greater emphasis on what it calls 'monitor, synchronize and collaborate solutions'. The principle of these services is that using software held on GXS's network, customers are able to track orders, shipments and payment online, to exchange information about products with their trading partners, and to streamline and automate their supply chain processes.

IBM

5.6 Prior to the merger, IBM was the second-largest provider of EDI communications services, representing about [✂] of the market for the transmission of EDI messages. IBM told us that it did not see itself as a real competitor in the EMEA region [✂]. IBM provided EDI VANs and communication software but, unlike GXS, IBM did not provide translation software.

Easylink

5.7 EasyLink Services Corporation is a US publicly-listed company. At the time of incorporation, its principal activity was the offering of a commercial email service. In 2001, it acquired Swift Telecommunications Inc., which had contemporaneously acquired the transactions delivery services business of AT&T Corp, including AT&T's EDI VAN business. EasyLink Services Corporation now provides EDI services to UK customers through a UK subsidiary EasyLink, using infrastructure located locally, and its share of UK market revenue for 2004 was around [✂]. It does not use resellers for EDI services in the UK, but rather has a direct relationship with its customers.

[11]The survey had a low response, so we regard evidence drawn from it as indicative rather than conclusive.

BT

5.8 Prior to the merger, the fourth-largest provider was BT with about [✂] per cent of the market. BT has provided EDI VAN services in the UK for 20 years. BT does not actively promote its EDI VAN services directly, although as explained in paragraphs 5.12–5.15 there are a number of resellers that market BT's services. BT provides EDI VANs and communication software but does not provide translation software.

Sterling Commerce

5.9 Sterling Commerce, a wholly-owned subsidiary of SBC Communications, Inc is a leading provider of EDI communications services in North America, with a global EDI VAN services business turnover of [✂]. The bulk of the company's revenues come from its software business and less than [✂] of its UK turnover of [✂] comes from EDI VAN services. As well as supplying EDI VANs and communication software, Sterling Commerce also offers translation software.

Harbinger Commerce

5.10 Harbinger Commerce, a wholly owned subsidiary of Inovis, a large US provider of EDI communications services, has been in operation in the UK since 1987 but operates its UK EDI communications services using its North American infrastructure. The UK turnover is approximately [✂]—about [✂] per cent of its global turnover, including software services. As well as supplying EDI VANs and communication software, Harbinger Commerce also offers translation software.

ICC.net

5.11 ICC.net is a relatively new market participant which launched an internet EDI VAN in the USA in 1998. Its services have been marketed in the UK by Freshlook Internet Commerce Company Limited (Freshlook) since 2002 [✂].

Resellers of EDI VAN services

5.12 Several EDI software providers resell EDI VAN services provided by a third party in conjunction with their own software, including EDI translation software. Often these resellers specialize in particular business sectors. Resellers' customers are typically unaware of the identity of the ultimate provider of their EDI VAN service as they have no direct contact with them. Resellers are particularly important in providing services to smaller customers which often need individualized support.

5.13 GXS told us that the main software providers and resellers are Freeway Commerce, Kewill Systems, Perwill,[12] Data Interchange, SAA Consultants, Atlas, Cyclone Commerce, iSoft and Cleo.

5.14 In the personal lines insurance sector, various software houses, such as SSP and Misys, buy EDI VAN services and then provide them to their broker customers. The commercial arrangements in these cases are different from those followed by resellers, although there are similarities.

5.15 Prior to the merger, GXS did not generally use resellers in the UK except in specific sectors such as bookselling, insurance and pharmaceuticals. IBM, on the other hand, made extensive use of resellers and about half of its business came through this channel, representing [✂] per cent of the total UK market in 2004. BT, [✂], also makes use of resellers, but to a lesser extent than IBM; BT's business through resellers represented about [✂] per cent of the market in 2004. (Market share estimates are shown in Table 5.1.)

[12]On 4 July 2005, Kewill announced that it had acquired Perwill.

Providers of point-to-point EDI software and services

5.16 A number of software houses, including EDI VAN resellers, such as Kewill Systems, Perwill, Freeway Commerce, Cyclone, iSoft, and Cleo have started selling AS2 software for point-to-point internet EDI. This area of the market is also characterized by competition from global providers such as IBM, Tibco, Seebeyond, webmethods, GXS, Harbinger Commerce and Sterling Commerce. Overall there appear to be over 20 accredited AS2 software providers capable of operating in the UK.

Market shares

5.17 Table 5.1 shows estimates of the 2004 market shares in the UK, based on revenues, of the various providers of EDI communications services. The total market size is estimated at around £25 to £30million.

TABLE 5.1 **Share of 2004 revenue from EDI service provision (by total revenue of infrastructure provider)**

Provider	*% share*	*Direct sales*	*Sales using resellers*	*Sales to insurance software houses*
GXS	[✂]	[✂]	[✂]	[✂]
IBM	[✂]	[✂]	[✂]	[✂]
Easylink	[✂]	[✂]	[✂]	[✂]
BT	[✂]	[✂]	[✂]	[✂]
Sterling Commerce	[✂]	[✂]	[✂]	[✂]
Harbinger Commerce	[✂]	[✂]	[✂]	[✂]
Freshlook/ICC.net	[✂]	[✂]	[✂]	[✂]
AS2 and similar	[✂]	[✂]	[✂]	[✂]
Total	**100**	**92**	**5**	**2**

Source: CC analysis of data provided by parties.†

*Denotes market share of less than 0.5 per cent
†In this table percentage figures may not equal column totals because of rounding.

5.18 Prior to 2004 the volume of point-to-point internet EDI communication was very small indeed. However in November of 2004, Asda launched its move to AS2 (described in paragraphs 4.12–4.13). In order to assess the importance of this change, we have estimated the revenue that traditional EDI VAN providers may be expected to lose during 2005, as a result of Asda's AS2 strategy. Our estimates suggest that [✂] per cent of total market revenues will have been lost from traditional EDI VANs as a

result of a reduction in Asda's traffic and also a reduction in the traffic generated by its trading partners. Other businesses are undertaking trials with this type of technology, but it is not clear from third-party evidence that material additional volumes of transactions will be handled this way during the next year or two.

Underlying factors affecting rivalry

Market trends

5.19 The market for EDI communications services is considered to be mature, although there is growth in other fields of e-commerce. In recent years, growth in EDI has come about mainly because of the use of additional message types (ie in addition to orders and invoices).

5.20 GXS told us that the growth in the number of transactions carried by its EDI VAN services in the UK had slowed significantly within the past two years. Whilst demand for EDI VAN services provided by GXS in the UK grew by [✂] per cent in 2002, the rate of increase fell to [✂] per cent in 2003 and to [✂] per cent in 2004. Between 2003 and 2004, the decline in realized prices has offset the volume growth resulting in falls in both Tradanet and EDI*Express revenues during this time period. GXS's list prices have stayed broadly unchanged in recent years, (as have IBM's list prices,) representing a reduction in real terms. GXS' realized prices have fallen, both in nominal and real terms.

Possible substitution from outside the market

5.21 Although alternative methods of communication, including faxes and e-marketplaces, may be viable for some customers, evidence received from customers, software houses and other industry observers suggested that the scope for such substitution does not have any significant constraining effect on the market for EDI communications services.

Customer switching

5.22 It was put to us by a number of third parties that there was limited switching between suppliers because of high levels of 'customer inertia'. This need not imply irrational behaviour. The costs of using EDI VANs are low compared both to the benefits of reliable and efficient exchange of transaction data, and to the value of trading relationships. Most users appeared to find it hard to compare the costs of various EDI VAN service providers, especially given the differentiation in pricing structures. We considered it likely that users considered the potential gains from switching providers to be small, and that these would be outweighed by a combination of the time required to manage the process and the risks of disruption to important trading relationships. Whilst the likelihood of a service failure might be remote, the costs of disruption could be large. For larger customers the balance of these factors would be different as the benefits of switching would be more likely to outweigh the switching costs.

Contract durations

5.23 There do not appear to be any significant contractual barriers to switching in this market. GXS told us that historically neither it, nor IBM, had long term contracts with its customers. Since 2003, GXS, as part of a global initiative, has been actively trying to encourage customers to commit to fixed-term contracts, offering discounts depending on the term that customers commit to. The average contractual term of its fixed-term contracts is just over two years; its historic contracts typically allow for cancellation at six months' notice.

Pricing

5.24 We spoke with a number of customers and they consistently told us that pricing of EDI VAN services was complex and difficult to understand.

5.25 EDI VAN services have typically been based on three types of charges: fixed monthly or annual fees, volume-related charges, and storage charges. Each of these types of charge may have several elements. In consequence a typical charging structure could have seven or eight elements. The structure of these charges differs between the various providers, making it very hard for customers to compare the effective prices of different providers.

5.26 We endeavoured to compare the prices of IBM and GXS, but could draw no firm conclusions from our analysis. There were some indications that for those customers that paid list prices, IBM would tend to be cheaper than GXS. We were also told this by a reseller. However, the actual balance of prices will depend on the pattern of customers' usage of the relevant services.

5.27 Comparison of prices taking account of discounts introduces additional complexity. GXS told us that approximately [✂] per cent of its customers receive either standard or individually negotiated discounts. IBM told us that almost all of its direct customers had been on a standard schedule of charges.

Customers

5.28 In general, EDI adoption has been greatest for business relationships with high numbers of transactions, such as those between retailers and their suppliers or between insurers and brokers for personal lines insurance.

5.29 The customers for EDI VAN services include businesses of all sizes. In relation to EDI VAN services, the distribution of revenues from customers follows the 'Pareto principle' with about 80 per cent of EDI VAN providers' revenues being accounted for

by just over 20 per cent of their customers. 1 per cent of customers represent 37 per cent of revenue.[13]

5.30 The costs of EDI communications services are very small compared to the value of the business transacted and (except for very small businesses) compared to the efficiency gains from EDI as opposed to manual methods of carrying out transactions. We estimate the mean average annual expenditure for a UK user of EDI VAN services to be about £3,500. The distribution of these expenditures is highly skewed—the top 1 per cent spend an average of £129,000 and other 99 per cent spend an average of £2,230 a year.[14] The median[15] annual expenditure is just over £500.

5.31 We found that key decisions regarding the use of EDI were most often determined by the purchaser in a trading relationship, and suppliers would tend to fit in with their customers' requirements. Thus in the retailer/supplier relationship, the retailers largely shape the patterns of EDI use. In the insurer/broker relationship, the brokers, or more specifically the software houses that supply the brokers, determine the patterns of EDI use.

Network effects and interconnection

5.32 We considered whether this market could exhibit 'network effects'. These arise when the value of a product to a customer increases with the number of other customers consuming the same product[16] and could occur with EDI VANs as a larger network allows direct connection with more potential trading partners. Most EDI VANs, however, are interconnected (directly or indirectly), so that customers can

[13]This calculation is based upon the customer spend for all suppliers for whom sufficiently detailed customer information was available to the CC. This includes (but is not limited to) the customers of the two merging parties.
[14]The averages given are arithmetic means. The analysis is based on data received from providers, including resellers, representing the vast majority of the market.
[15]The median is the level of expenditure such that half of all customers spend greater than this amount, and half spend less.
[16]*CC Merger References: Competition Commission Guidelines*, paragraph 3.13.

communicate with trading partners even if they are on separate EDI VANs. The level of any network effects would therefore depend on the extent to which customers perceive communication between VANs, using interconnections, to be equivalent to communication within a VAN and to the extent that companies encourage their customers to cluster on the same VAN.

5.33 Interconnection differs from direct connection in some respects:

- an additional administrative process has to be undertaken to set up each interconnection;
- it is not normally possible automatically to trace messages; and
- some delay may be introduced into the transmission—GXS told us this delay would typically be so short as to be irrelevant, although some third parties told us it could be significant.

5.34 Historic practice within the UK had been not to make any charges to customers for interconnection between networks. In recent years GXS has applied an additional charge to its own customers for message traffic with other VANs, although GXS told us that this charge was sometimes waived as part of an overall negotiation.

5.35 We received a number of views from users of EDI communications services regarding interconnection. Some considered interconnection to be straightforward and essentially a ‘non-issue’. Others had concerns and preferred to be on the same networks as trading partners; the reasons given were the avoidance of complexity (‘less to go wrong’) and the avoidance of possible inter-provider disputes and concerns about possible delays to messages. Some customers prefer to have contracts with several EDI VAN providers rather than rely on interconnection.

5.36 When questioned about their use of interconnection services, 43 per cent of customers responding to the CC's customer survey stated that they make use of interconnection, whilst 45 per cent stated that they communicate with each of their trading partners using the relevant EDI VAN provider, rather than using interconnection services.[17] These results are consistent with the fact that 47 per cent of customers in the sample have only one EDI connection, whilst the remaining 53 per cent of customers are connected to multiple EDI communications services.

5.37 Customers from whom we received evidence generally expressed little or no concern about current interconnection charges, interconnection administration procedures, message transmission times using interconnections and restrictions on message traceability.

5.38 GXS told us that there are other methods by which interconnection can be achieved. Providers are able to establish a mailbox (referred to as a 'commercial mailbox') on GXS's EDI VAN, or another VAN that is in turn interconnected to GXS, and use this to achieve the same functionality as an interconnection. We did not consider it necessary to examine this alternative method of transmission in detail.

5.39 GXS told us that it had an open policy on interconnection and considers all requests from other networks to interconnect according to a defined set of rules, taking account of various factors including the expected volumes of traffic in each direction. GXS also told us that whilst it reserved the right to charge for interconnecting with EDI VANs, to reflect the relative value realised by the providers from the interconnection, such charges have only exceptionally been levied by GXS, and never in the UK.

[17]The remaining 12 per cent told us they did not know what practice they used.

5.40 Freshlook (see paragraph 5.11) told us that ICC.net, the company whose services Freshlook markets in the UK, had had many problems obtaining satisfactory interconnection with GXS. GXS told us that there were special circumstances affecting the suitability of ICC.net as an interconnecting partner and that ICC.net had an indirect interconnection. We did not consider the ICC.net dispute to be significant in the context of our inquiry.

5.41 Taking account of the high number of customers that use interconnections, we considered that the actual differences between direct and interconnected communications were not substantial. We considered that there were some network effects because of the preferences of some customers to be on the same network as their trading partners and because of some perceived potential problems with interconnection, but we did not consider these effects to be significant.

Levels of competition in the relevant market before the merger

Competition between EDI VAN providers

5.42 GXS told us that competition in the market focused on price; a high level of service quality (notably reliability and timely delivery of messages, but also including customer support) was a pre-requisite for participation in the market. Our survey indicated that quality issues were of particular importance and some customers that gave evidence to us expressed preferences for particular providers based on qualitative issues. We acknowledge the possibility of competition based on quality. However, there was insufficient evidence related to quality to enable a useful analysis and we focus our discussion therefore on price.

5.43 GXS told us that there was strong price competition in the market, drawing attention to a recent contract renewal with a major retailer in which the retailer used the threat of moving to a smaller provider to achieve a substantial reduction in price. GXS also

told us that there had been little direct competition with IBM prior to the acquisition but that there had been substantial competition with resellers of IBM's EDI VAN.

5.44 A number of larger customers did consider GXS and IBM (sold directly) to be alternatives and told us that they exploited this in their negotiations.

5.45 We considered it possible that competition between GXS and IBM might have been limited if GXS and IBM had tended to specialise in different sectors, with GXS focusing on retailers and their suppliers and with IBM focusing on other market segments. However, we found that although these two providers differed in the industry composition of their customer bases, there was significant overlap.

5.46 Despite the existence of interconnections between the networks (see paragraph 5.33), a number of customers considered it best to be on the same network as their trading partners. In some cases, trading partners recommended or mandated the use of a particular network. The CC's customer survey shows that about 17 per cent of the respondents recommend the use of a specific EDI provider. Of those companies surveyed which recommend the use of a specific EDI provider, 27 per cent make the use of that provider a mandatory requirement, rather than just a recommendation. Businesses which use the same network as their customers as a matter of policy or because of customer requirements, are, in effect, waiving their option to choose their provider through a competitive process. However such customers' behaviour could only be exploited by their provider if they were readily identifiable.

5.47 We found that levels of switching by users between providers of EDI VAN services were low. Only 13 per cent of customers responding to the CC's survey stated that they previously used an EDI VAN provider (during the past five years) which they now no longer use. Two providers told us that the switching which occurred was

generally because of a change in trading relationships. There are good reasons to expect little switching in this market (see paragraph 5.22), particularly by smaller customers, and we considered that, when combined with the difficulty of comparing prices between GXS and IBM, there was little clear evidence of active competition between GXS and IBM for such small customers' business.

5.48 GXS told us that the incidence of total switching was not a good indicator of the level of competition as many customers had contracts with several providers and could readily switch the proportion of business going to each provider if this would reduce their EDI costs. Our discussions with customers, however, did not suggest that this was used as a method of managing costs. Rather, it appeared that those customers connected to several EDI VANs would transmit data using the EDI VAN appropriate to each of its trading partners.

5.49 We analysed pricing data to study the extent of pre-merger competition, if any, between IBM and GXS. However, this analysis was inconclusive.

5.50 We found that both the type and the level of competition varied, depending on the nature of the customer. Certain large customers could negotiate substantial discounts—particularly those, such as major retailers, which could influence the behaviour of their trading partners (see paragraph 5.46). Small suppliers to retailers tend to be supported by resellers and these had traditionally placed most of this business with IBM. In the personal lines insurance sector the choice of network used by insurance brokers to transact with insurers was generally determined by their software providers.

5.51 We concluded that before the merger there was only limited competition between IBM (and resellers of IBM services) and GXS. This competition where it existed was

generally for larger customers, and appeared very modest for small customers which tended to follow their trading partners' preferences. Competition for reseller business had largely been between IBM and BT. We saw some evidence of competition from the very small (in the UK) providers such as Sterling Commerce and Harbinger Commerce, but this appeared limited and their market shares remain very small, even though they were sometimes used by larger direct customers as a threat in negotiations with GXS or IBM. Competition from EasyLink appeared to be focused in the automotive and life insurance and pensions areas.

Potential competition from point-to-point internet EDI

5.52 A number of customers and software businesses told us that they thought the long-term trend would be towards increasing use of point-to-point internet EDI. However, these businesses did not expect change would necessarily happen very rapidly.

5.53 GXS told us that point-to-point internet EDI represented important competition for EDI VANs and that, although market penetration was limited at present, the experience in the US market, where market penetration was greater, indicated the pattern to be expected in the UK.

5.54 While, apart from the adoption of AS2 by Asda, there appears to have been, as yet, little switching of business from EDI VANs to point-to-point internet EDI, we are aware of a number of companies evaluating this approach. Asda's move might encourage increased adoption of AS2, both because of the interest generated and because of experience gained in the process. However, the specific AS2 software for which a user licence was provided by Asda to its suppliers cannot be used without purchase of additional licences to communicate with trading partners other than Asda.

5.55 In practice, a move to point-to-point internet EDI appears likely only if initiated by the customer in a trading relationship. The major retailers, like Asda, are in a position to push for such a move, but their suppliers are not. However, we did consider that a major, technologically adept, supplier to a retailer might seek to persuade its trading partner to undertake trials of point-to-point internet EDI but that this would only be likely if the retailer had already determined that it wished to conduct such trials.

5.56 We spoke to a number of businesses in the personal lines insurance sector and most considered that a move to AS2 or similar technology was unlikely in that sector.[18] The reasons given include:

- difficulty in achieving an industry change from the current operating model based on EDI VANs and the undesirability of moving on the basis of individual trading relationships;
- unsuitability of point-to-point technologies for brokers, which are often very small businesses, unless supported by an intermediary; and
- concerns about levels of data security. GXS told us that these concerns were unfounded. We understand that AS2 is designed to ensure high levels of security and that therefore the customers' concerns might well be allayed if they were to investigate the technology in detail.

5.57 We considered that the ability to initiate a switch to AS2 or a similar technology was available only to a limited number of users, most notably larger retailers. We noted however, that those users were commercially very important to the EDI VAN providers as their choice of EDI technology would be followed by their suppliers.

5.58 We concluded that we expected growth in point-to-point internet EDI. However, it was difficult to judge the speed and extent of the likely change. We did not expect

[18]We spoke with one insurance business that uses point-to-point EDI. However this business had particular features that made this practical and we consider it likely to be an exception.

rapid movement in the very short term, but considered that if post merger GXS sought to exploit its market position (eg by increasing prices) this could speed up the introduction of point-to-point internet EDI.

Market expansion and entry

5.59 We considered expansion and entry for EDI VAN service providers. Point-to-point internet EDI is part of the same relevant market, but there are many providers of the relevant software and we considered that the relevant issue in this case is customer demand as discussed above (see paragraphs 5.52–5.58).

5.60 We considered that the probability of a new EDI VAN services provider setting up with a new infrastructure was extremely low, given the costs and the level of spare capacity in the industry. Whilst entry into the UK market could occur, this would most likely arise by means of an EDI VAN services provider which was not active in the UK expanding into this market. We therefore focused on the factors affecting expansion.

5.61 The UK market shares of the major US EDI VAN services providers Harbinger Commerce and Sterling Commerce, which have been present in the UK market for several years, suggest that expansion has been difficult. However, these providers do have ample spare capacity and so could easily expand. There has been no substantial entry into the UK market in recent years. Freshlook (see paragraph 5.11) is a new entrant to the UK market, expanding the US-based ICC.net internet EDI VAN business; however its share of the UK market is [✂].

5.62 Most EDI VAN services providers told us that they had infrastructure capacity for expansion; one that reported a capacity constraint indicated that it expected to invest to overcome this. GXS told us that infrastructure capacity could be leased readily if required. Easylink told us that it had available capacity that it could utilize.

5.63 We considered that the ability to build demand was likely to be a more significant obstacle to expansion; providers must establish an effective marketing capability, ensure a good reputation and be able to persuade customers to switch. We would expect that major providers operating in other geographic markets would have an adequate reputation. Customers' reluctance to switch probably forms the main obstacle; however if customers were dissatisfied with their existing provider their reluctance to switch might be reduced.

5.64 We considered that EDI VAN services providers whose customers were concentrated in particular sectors could, with a relatively small outlay to engage staff with the requisite background, market their services to potential customers in other sectors.

5.65 Building demand, and thereby expansion (or market entry), could be facilitated by resellers as they have strong relationships with customers. A reseller that was not satisfied with its existing EDI VAN services provider or providers could switch to a small EDI VAN services provider, or one from outside the UK.

5.66 We concluded that, although it can be difficult to build demand, especially because of customers' reluctance to switch provider, if customers were dissatisfied there would be scope for expansion, both of those EDI VAN service providers with very small UK market shares and of those which at present were not operating in the UK.

Counterfactual

5.67 The IBM business was profitable and we expect that, in the absence of the merger, it would either have continued under IBM's ownership or been sold to a third party. Although IBM told us [✂] (see paragraph 5.6), we do not consider that this would have a material effect in the short-term. Any of the short listed purchasers

would have faced the same market situation in the UK as IBM did and would confront similar issues and incentives. We therefore considered it appropriate to compare the effects of the merger to the situation where the business continued to be owned by IBM.

Effects of the merger

5.68 We consider the effects of the merger compared with the counterfactual, in relation to the relevant markets. We first discuss the change in market shares, GXS's use of resellers and the effects on competition. We then report our overall assessment of the effects on the EDI communications services market, followed by our assessment of the possible effects in related software markets and then assess the possibility of coordinated effects.

Change in market shares

5.69 In 2004 GXS had a market share of [✂] per cent and IBM had a market share of [✂] per cent (see table 5.1). The combined 2004 market share would be [✂] per cent, however we expect the 2005 figure to be somewhat lower because of inroads made by point-to-point internet EDI including the use of AS2 by Asda and its suppliers (described in paragraphs 4.12–4.13).

5.70 The pre-merger situation was characterized by the presence of one competitor with a very large market share, three with relatively small shares and several other participants with very low market shares. The merger removed one of the three competitors with a relatively small market share.

5.71 Market shares are not, however, necessarily a good indicator of market power. In many markets the ability of small and very small competitors to constrain a large competitor may be limited by capacity constraints, but there appears to be ample

spare capacity in this industry and the remaining providers appear to have significant scope to take on new business. They are large companies, with significant presence in other geographic markets and can be expected to have credibility with customers. The issue is to what extent these providers could build demand and provide a competitive constraint on the merged entity.

GXS's use of resellers

5.72 Prior to the merger, GXS had not generally made use of resellers in the UK market. However GXS told us that it saw many benefits from the use of resellers and planned to continue to operate the reseller contracts transferred with the merger. We considered, on the basis of the customer survey, that this was both rational and likely as the resellers have strong relationships with their clients and are generally regarded by them as their EDI VAN providers. Any attempt to displace a reseller by raising prices or by approaching its customers directly could therefore result in the reseller moving to another EDI VAN provider.

Scope for customer negotiation

5.73 It is clear that GXS had a very strong pre-merger market position. GXS's pricing may have been constrained to some degree by IBM, at least for larger customers.

5.74 We considered whether post-merger there were constraints that would prevent GXS from profitably raising prices across the board or to specific market segments.

5.75 We considered that the large retailers could transfer substantial amounts of business to existing market participants, which, while smaller, nevertheless have substantial capacity, or sponsor new entry to the UK market, for example by a US or European EDI VAN provider not currently operating in the UK. In addition, as exemplified by Asda, they would be likely to be able to initiate a change to point to point internet

EDI. Such retailers have scope to influence their suppliers' choice of provider and therefore if GXS were to lose business from such a retailer, it would expect to lose a substantial amount of business from the retailer's suppliers as well. We believed that this was a key factor in the ability of large retailers to negotiate substantial discounts in the past.

5.76 We considered that the software houses that represent personal lines insurance brokers had similar negotiating strength to that of large retailers in that they could transfer large volumes of business to smaller competitors in the market. However, we considered that they might find it more difficult to initiate a switch to a substitute technology.

5.77 We considered that resellers could credibly threaten to move their business to BT—with whom many already had contracts—or another provider, and might be able to encourage new entry by an EDI VAN services provider that was not currently operating in the UK. Easylink told us that they would consider using resellers particularly in those sectors where they do not currently have a presence. Resellers' clients often did not know the identity of the ultimate provider of their EDI VAN; providing service levels were maintained, clients would be unlikely to object to the reseller changing their EDI VAN provider.

5.78 We consider that a limited number of customers could initiate a switch to point-to-point internet EDI and that other customers could switch if this was mandated by their trading partners. We consider that there may be certain circumstances under which a customer faced with a price increase might be able to persuade its trading partner to switch to point-to-point internet EDI.

5.79 We did not consider that smaller customers generally had power in negotiations, except indirectly through their major trading partners.

Assessment of the effects on competition in the EDI communications services market

5.80 Certain groups of customers appeared to have viable alternatives. We considered that for each of these groups (large retailers, software providers to personal lines insurance brokers and resellers) the existence of these alternatives would be sufficient to ensure that the loss of IBM as a competitor would not have a substantial effect.

5.81 Other groups of customers, such as insurers and those suppliers to retailers that did not purchase from resellers, face a reduction in choice as a result of the merger. These customers have little scope for negotiating and often followed their trading partners. These are also the customers for whom pre-merger competition appears to have been of very limited significance.

5.82 Prior to the merger, IBM was a much smaller market participant than GXS. None of IBM, Easylink and BT appeared to provide any vigorous competition to GXS, except through the resellers. Resellers will remain as active market participants after the merger and will have a choice of EDI VAN providers. Use of resellers will be a choice available to customers, including those that have not used resellers in the past.

5.83 In summary, we find that in those areas where IBM would have provided significant competition customers will have sufficient alternatives to resist any lessening of competition. These alternatives are notably BT and Easylink, the other smaller competitors in the market and the possibility of switching to point-to-point internet EDI.

Assessment of possible effects in related software markets

5.84 We considered whether GXS might have the incentives and power to exploit its position in the supply of EDI VAN products and services to increase its position in the related markets for EDI software by displacing the resellers. As discussed in 5.72, we considered that it would not be in GXS's interest to try and displace resellers

Coordinated effects

5.85 We do not consider that the conditions consistent with coordinated effects were present in the market prior to the merger. Neither do we consider that the merger creates market conditions consistent with coordinated effects. Therefore, we conclude that there is no evidence to suggest that the merger has increased the likelihood of coordinated effects where none existed prior to the merger.

6. Provisional findings

6.1 We therefore provisionally conclude that we do not expect that a substantial lessening of competition in any market or markets in the UK for goods or services has resulted, or may be expected to result, from this merger.

6.2 Two of the members of the group provisionally disagree with this view.

Note of dissent

1. Two members of the group disagreed with the provisional findings, putting a different weight on the balance of factors involved in the judgement.

Competition before the merger

2. We believed there was significant competition between GXS and IBM prior to the merger. There were several examples of large customers credibly threatening to switch to IBM. GXS and IBM resellers told us they competed with each other. GXS also told us there was strong price competition (see paragraph 5.43).

3. While we agreed there was little or no direct competition between GXS and IBM for small customers, both the indirect competition through resellers and the impact of direct competition between GXS and IBM for large customers would have constrained the prices charged to small customers. We believed the barriers to switching in the market (see paragraph 5.22) readily explain the lack of switching by small customers.

Potential competition from point-to-point internet technology

4. We agreed with the judgment that the long-run trend in the industry is likely to involve either point-to-point internet EDI or some other newer technology; but we doubted that any alternative to EDI VANs would spread rapidly in the next two to three years. Most of the evidence we received from third parties suggested change would not be rapid (see paragraph 5.52).

5. The only major example of AS2 adoption in the UK is Asda. Its decision was driven by its US parent. However, the specific AS2 software for which a user licence was

provided by Asda to its suppliers cannot be used without purchase of additional licences to communicate with trading partners other than Asda.

6. Most businesses we spoke to in the personal lines insurance sector considered a move to point-to-point internet EDI unlikely (see paragraph 5.56).

Resellers

7. As a result of the merger, resellers who formerly used IBM's VAN services may choose to act as resellers for the merged entity. They will continue to pass on EDI VAN charges to their customers, as they do now, and these prices will be set by GXS.

8. Some resellers may choose to switch to BT's VAN instead, as BT does already make some sales through resellers. However, BT [✂] (see paragraph 5.8). Some might choose to approach EasyLink, which told us it would be willing to consider such approaches, although it has not previously operated through resellers in the UK. The resellers' remaining alternative would be to sponsor expansion by one of the other EDI VAN providers whose UK market share is currently very small, although some of these are major US businesses. However, we considered that the merger, by removing the main EDI VAN provider to resellers, has significantly reduced their capability to act as a competitive constraint on GXS. GXS has a very large market share post-merger, and we considered resellers are likely to be hesitant about approaching another provider to offer vigorous competition in EDI VAN services.

Negotiating power

9. Although some large customers will retain negotiating power, the credibility of their threat to switch has been reduced by the removal of one of the three competitors to GXS with anything other than a minimal market share. In the retail and personal lines

insurance sectors in particular, where IBM was the principal competitor to GXS before the merger, customers may be hesitant about switching to a provider which has not previously had much presence or competed actively for business. We consider the potential for even large customers to switch to alternative technologies such as AS2 is not great within the next two to three years.

10. Therefore we concluded that there is a substantial lessening of competition in the market for EDI communications services in the UK as a result of the merger.