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Case No COMP/M.2478 - IBM ITALIA / BUSINESS SOLUTIONS / JV

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Subject : Case No COMP/M.2478 – IBM Italia/Business Solutions/JV

Notification of 23.05.2001 pursuant to Article 4 of Council Regulation N°4064/89

1. On May 23, 2001 the Commission received a notification of a proposed concentration by which IBM Italia Spa ("IBM Italia"), a wholly owned Italian subsidiary of IBM and Business Solutions Spa ("Business Solutions"), a wholly owned subsidiary of Fiat S.p.A. ("Fiat") will form a full function joint venture in the field of information technology ("IT") services (the "Joint Venture").

2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of the Merger Regulation and does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

I THE OPERATION

3. The operation consists in the formation of a full function joint venture. IBM Italia will contribute five businesses active in the supply of IT services to third parties primarily in Italy. Business Solutions will contribute two businesses that are currently engaged primarily in the "captive" supply of IT services to companies within the Fiat group. The Joint Venture will comprise three 50/50-owned legal entities.

II THE PARTIES

4. IBM Italia is - through International Business Machines World Trade Corporation - a wholly owned subsidiary of International Business Machines Corporation ("IBM"), a corporation organized under the laws of the State of New York, which develops,

produces, and markets IT systems, equipment, computer software, and services, principally in the IT area, as well as ancillary products.

5. Business Solutions is Fiat's holding company for the majority of Fiat's companies engaged in the provision of services, including IT, real estate, and employee temping agencies. Fiat, in turn, is active primarily in the manufacture and sale of automobiles, commercial vehicles, agricultural machinery, construction equipment, automotive components, and metallurgical products.

III COMMUNITY DIMENSION

6. The undertakings concerned have a combined aggregate worldwide turnover of more than EUR 5 billion[1]. IBM has world-wide turnover of [EUR 95.667 million in 2000] and FIAT has world-wide turnover of [EUR 57.555 million in 2000]. IBM and FIAT have a Community-wide turnover in excess of EUR 250 million (IBM: […], FIAT: […] in 2000) and do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV CONCENTRATION

7. The formation of the Joint Venture is part of an outsourcing transaction, whereby Fiat establishes a strategic partnership with IBM Italia, with a view to rationalizing its IT spending, but also to expanding its activity through the Joint Venture in some dynamic sectors of the economy, *i.e.*, the provision of IT services. The rationale behind the operation is the creation of a single economic entity, comprising three separate legal entities with slightly different governance rules. […]. Nevertheless, it is self-evident from the Memorandum of understanding signed by the parties that the overall operation cannot be split in separate stand-alone transactions.

8. The legal entities are unlikely to be full function joint ventures on their own, but they are highly interdependent: one entity provides various services to the other two entities and will act as their intermediary and marketing organization. The latter two will be contractually obliged to sell their services through the former. Furthermore, the information available to the Commission indicates that each of the three separate legal entities created by the parties will not appear on the market as an autonomous business force, but will necessarily act together as part of a whole.

9. For the reasons above, it can be concluded that the setting up of the three legal entities forms part of a single concentration.

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1 Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

JOINT CONTROL

10. The Joint Venture will be *de facto* jointly controlled by IBM Italia and Business Solutions. The Joint Venture's share capital will be held by the parents in the following proportion: both IBM Italia and Business Solutions will hold 50% of each of the three companies forming the Joint Venture. Both IBM Italia and Business Solution (or Fiat) are contributing tangible and intangible assets which are vital for the Joint Venture's operations. The three entities forming the Joint venture will be: A) New ITS, to which IBM Italia will contribute its subsidiary Intesa and cash, and Business Solutions will contribute all tangible and intangible assets of the existing ITS business, except for marketing and distribution activities. B) New GSA, to which IBM Italia will contribute all shares of some subsidiaries and businesses: (i) Proxima, (ii) SAP Italia, all tangible and intangible assets of (iii) IBM SAP Services business, (iv) IBM ACG business, and (v) cash. In exchange for a 50% share, Business Solutions will contribute all tangible and intangible assets of the existing GSA business, except for marketing and distribution activities. C) NewCo, to which Business Solutions will contribute the marketing and distribution businesses of New ITS and New GSA, while IBM Italia will contribute cash in exchange of a 50% share[2].

11. IBM Italia will appoint a majority of the Board of Directors in New ITS and New GSA, while Business Solutions will appoint a majority of the Board of Directors in NewCo. Decisions for all three legal entities comprising the Joint Venture will be adopted by a simple majority of the Board of Directors, with the exception of certain decisions requiring a qualified majority, which include the proposal to the shareholders' meeting to amend the statute, increasing or decreasing any of the company's capital, and liquidating any of the companies. In relation to NewCo, a qualified majority is also required for (i) the incorporation of any new legal entity, and (ii) any change to the business plan which would extend the company's activities beyond the IT services sector and (iii) approval of any strategic partnership or alliances.

12. The activities of the three legal entities comprising the Joint Venture will be highly interdependent and integrated, within the framework defined by binding work-sharing agreements: New ITS and New GSA will be the operational companies, while NewCo will be the marketing and distribution arm of the Joint Venture companies structure, with the mission to contribute to the chain of value add creation for New ITS and New GSA.

13. Each of the parties acquires *de facto* joint control over a single economic entity consisting of three separate legal entities with slightly different governance rules. The

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[2] The details concerning the assets contributed by the parents to the overall Joint Venture are the following: IBM Italia contributions are in particular: 1) Sap Italia, subsidiary active in the provision of IT services, including IT management and consulting; 2) Proxima, subsidiary that provides a range of IT services, including consulting services, technological assistance, and training. 3) Intesa, subsidiary principally active in IT management services; 4) IBM SAP Services, a business which is principally active in software development and integration; 5) IBM ACG, a business which is active in software development for ERP application management services. Business Solutions contributions are the tangible and intangible assets of: 1) ITS, a subsidiary of the Fiat group which provides a range of IT services primarily to the companies of the Fiat group, mainly IT management services; 2) GSA, a subsidiary of the Fiat group provides a range of IT services almost exclusively to the companies of the Fiat group, and is principally active in IT development and integration services, as well as hardware and software maintenance services.

parent companies have a very strong common interest to co-operate fully[3] in order to ensure the proper functioning of the Joint Venture as an autonomous economic entity. Therefore, each of the parties has the possibility to exercise decisive influence over the entire Joint Venture.

FULL FUNCTIONALITY

14. The Joint Venture will provide IT services to the Fiat group and third parties. The parties intend that the Joint Venture should have a "strong and highly competitive presence in the IT services market". It will comprise all the existing assets, located in Italy and abroad, currently owned by the various companies and businesses being contributed by IBM Italia and Business Solutions. The Joint Venture will have significant capitalization from the outset, its own independent management and employees. In addition to its senior executives, the Joint Venture is expected to have a staff of almost 5,000 people, including employees and subcontractors.

15. The Joint Venture will have the production, sales, and marketing activities necessary to operate as an autonomous economic entity, will establish prices and terms of sale for its products in accordance with good commercial practices and market conditions, while it will also be offered sales opportunities and support in its marketing activities by IBM. […]. IBM will provide sales support to the Joint Venture through its sales representatives, its network of IBM Business Partners, and its web-site.

16. Although the Joint Venture will sell IT services to the companies of the Fiat group, it will also offer the entirety of its services to third parties. The businesses being contributed to the Joint Venture by IBM Italia are already offering their services to third parties. The business plan forecasts that the annual revenues from merchant sales to third parties attributable to the Joint Venture will increase substantially in the coming years and, in addition to the synergies created by the combination of Fiat's and IBM Italia contributed businesses, will enable the Joint Venture to generate annual merchant sales for around [50-70]% of the total anticipated sales by 2007.

17. On the basis of the above, the Commission has concluded that the Joint Venture will perform on a lasting basis all the functions of an autonomous economic entity.

V THE RELEVANT MARKET

PRODUCT MARKETS

18. The parties propose to define the relevant market as comprising all IT services. However, following the practice of previous Commission decisions[4], the parties have provided EEA-wide data on their activities according to the following seven segments of the IT services market: (i) IT management services, (ii) business management

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[3] This is, *inter alia*, consistent, with, *mutatis mutandi*, points 18, 19, 34 and 36 of the Commission Notice on the concept of concentration under Council Regulation (EEC) N°4064/89 on the control of concentrations between undertakings, OJ 1998/C 66/02. See also the Commission decision Sanofi/Sterling Drug, case M.072 10.06.1991.

[4] Case COMP/M.1561 Getronics/Wang, case COMP/M.1901 Cap Gemini/Ernst&Young, case COMP M.2195 Cap Gemini/Vodafone/JV.

services, (iii) software development and integration, (iv) IT and business consulting, (v) software maintenance and support, (vi) hardware maintenance and support, and (vii) education and training.

19. According to some independent industry analysts (such as the Gartner Group), the overall *IT management services* are categorized in five sub-segments: *Operational services* (day-to-day system management of a customer's IT infrastructure), *application management services* (processes and methodologies for maintaining, enhancing and managing software applications), *help desk management services*, *business continuation services* (back-up facilities, communication equipment), *asset management services* (reporting of financial, physical and asset information).

20. Suppliers of *IT management services* offer the whole range of them, often in a package that may or may not include all of these segments. Accordingly, market share data are apparently not available in respect of this additional sub-segmentation, even if some public sources report growth rates for the individual sub-segments. These growth rate forecasts are in any event consistent with the growth rate forecast of the overall *IT management service* sector. Therefore, considering the lack of data on individual market shares and the supply-side offerings, which may refer to packages of those services, a further sub-division is not considered appropriate for the purposes of this case's product market definition. However, it is not excluded that further developments that might occur in the IT sector might justify such a segmentation in the future.

21. As far as demand-side is concerned, a big portion of demand for IT services is represented by "outsourcing customers", both in the banking, financial, insurance sectors and in other IT intensive sectors, such as telecoms/utilities, but any private manufacturing company or public administrative body is also a potential customer for a firm active in the provision of IT services, due to both technological innovation and the development of e-business.

22. The market investigation carried out by the Commission has confirmed this tendency towards increasing outsourcing. In fact, while in the past IT has been used mainly to support processes, more and more nowadays it is becoming an integral part of the processes themselves, acting as an enabling device in order to optimize the value chain along a process (for example business processes such as Customer Relationship Management, CRM, Supply Chain Management, SCM, Enterprise resource Planning, ERP, etc.). In general, companies (throughout various industries) aim to optimizing the use of IT without becoming themselves IT companies. As technology and systems develop fast and in a complex way, there is room for increasing outsourcing demand in the market. This makes the IT service market constantly expand, which is particularly true for Italy, that is expected to recoup its past technological lag both in the private and in the public sector and to increase its growth rate in the coming years.

23. From the market investigation carried out by the Commission, it has also appeared that, to varying degrees according to the segments considered, a possible further sub-division would be envisageable, by distinguishing the provision of IT services to outsourcing customers between large businesses and smaller organisations, including small and medium size enterprises (SMEs)[5]: in particular, large companies that choose to outsource their IT services requirements tend to rely on external IT service providers for

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[5] See Commission Recommendation 96/280/EC of 3 April 1996, OJ L107/04.

a broader range of IT services than SMEs. Mainly for cost considerations, SMEs tend to handle a wide range of IT services in-house and currently, if they choose to outsource, typically do so for a small number of selected services. This segmentation would be stemming from the different kind of requirements of both group of customers concerning their outsourcing needs and from, supposedly, the different patterns of outsourcing services and contracts. Therefore it would seem possible, to a certain extent, to differentiate between a "big-deals outsourcing" (large organisations turning towards outsourcing for IT services), as opposed to a "selective" outsourcing" (for small and medium organisations or companies). In any event, it is arguable that from a supply side viewpoint, the main IT player are generally present in both demand segments, while some fringe small operators also offer "selective" services in local areas to medium and smaller organisations, therefore representing an additional competitive constraint to larger suppliers for that market segment.

24. However, in the present case, the exact product market definition can be left open since, in all alternative product market definitions considered, this concentration will not lead to the creation or strengthening of a dominant position which could significantly impede effective competition in the Community, in the EEA or in any part thereof.

GEOGRAPHIC MARKETS

25. The parties take the view that the scope of relevant geographic market for IT services is at least EEA-wide. In recent decisions[6] the Commission has not found it necessary to define the relevant geographic market, although it noted that the "IT services are provided on a national basis, mainly due to customized solutions according to languages and local business particularities"[7]. Nevertheless, it has also noted that the market for IT services shows a trend towards the internationalization of supply and demand. This is due to increasing globalization of contractual patterns (contracts are agreed globally and applied nationally or locally), to labor mobility, to centralization of IT management, to the use of English as *lingua franca* for IT applications, and to the use of the Internet enabling operation on a remote basis.

26. In any event, for the purpose of this case it is not necessary to further define the relevant geographic market, since on all alternative geographic market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of it.

VI COMPETITIVE ASSESSMENT

27. The Commission has described, in previous decisions, the market for IT services in general as "a very dynamic and competitive market where customers have considerable leverage to play one supplier against another". In particular, the Gartner Group forecasts (1999-2004) a 16,1% growth in Western Europe concerning *IT services* in general, while for *IT management services* the forecast is 20,1%. As far as Italy is concerned, the growth forecasts are the following: *IT services* 14,4%, while *IT management services* is indicated at 16,6%.

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6 See footnote n°4.

7 case COMP M.2195 Cap Gemini/Vodafone/JV

HORIZONTAL ASSESSMENT

28. The only "affected market" by the operation is the one concerning the segment of *IT management services*, both at Western European level and at Member country level. Concerning competitive conditions, at Western European level, the segment for *IT management services* is characterized by a large number of qualified global operators. The top ten players account for only 51.9% of total Western European sales. In 1999, besides IBM (16,9% market share), strong players were *inter alia* EDS (7,8%) and Debis Systemhaus (6%), in addition to a number of fringe players.

29. On the basis of data from the Gartner Group, in Italy, in 1999, IBM had a market share of 19,6%, while significant *IT management services* providers appeared to be also Telecom Italia (which recently acquired Finsiel) and Elsag S.p.A., with shares of 12,5% and 6,8%, respectively, together with large multinational companies such as EDS (7,4%) and Getronics (5,4%).

30. No appreciable overlap results from the operation at stake due to the fact that Fiat's contributed *IT services* activities are almost exclusively captive. In 2000, merchant sales of Fiat's contributed IT services amounted to [<1%] of European sales. In particular, in *IT management services*, the only affected market at either European or national level, Fiat's contributed activities had merchant sales of *IT management services* accounting for less than [<1%] of 2000 sales of *IT management services* in Italy. However, including in Fiat' s total contribution to the Joint Venture also the "captive" requirements of the Fiat group, now outsourced, the increment (via the Joint Venture) of IBM's shares of sales for the relevant products would amount to an additional [5-10]% market share, as effect of the market span. This latter figure ([5-10]%) is in fact the share of the total demand for *IT management services* in Italy, accounted for by the Fiat group in 1999[8].

31. However, even in this scenario, the transaction does not increase IBM's share of sales (or the Joint Venture's) to a level of dominance in any possible relevant *IT services* market. Moreover, there is no scope for the Joint Venture to exercise any form of market power vis-à-vis customers or competitors, neither at EEA level, nor in Italy, since the market will remain dynamic with significant potential for expansion, and the Joint Venture subject to significant competitive constraints from other well-resourced players.

32. In the market investigation, the Commission has noticed some divergences in public independent reports, and above all in the parties and competitors' estimates concerning the "expansion potential" in Italy of outsourcing demand especially as far as *IT management services* are concerned. This is due mainly to a different consideration given in these reports and by the parties to "captive outsourcing". This is represented by the *IT services* (and/or *IT management services*), which are provided within the same corporate entity by separate companies belonging to the same group, as opposed to *IT*

8 The mentioned figure ([5-10]%) corresponds to both Fiat's merchant's sales and Fiat's captive requirements, expressed as a percentage of the total Italian merchant demand for IT management services in 1999. For the year 2000, since publicly sales data, allegedly, are not yet available, the parties have stated, on the basis of internal estimates based o the Gartner Group forecasts, that IBM' share of sales for the IT management services in Italy would represent approximately [15-20]%, while as concerns Fiat, it would be confirmed the same order of magnitude ([5-10]%) for its own share of Italian demand of the relevant products.

services (and/or *IT management services*) which are instead provided by personnel devoted to IT services within the same company (captive *tout-court*). In particular, according to the parties, the latter would represent the vast majority of the *IT services* (and/or *IT management services*) which are provided "captively". Considering only "captive outsourcing" as a source for new demand would of course result in much lower "potential expansion" estimates than the ones stemming from an overall consideration for *IT management services* satisfied "captively". However, in the light of the above, under both alternative scenarios effective competition would not be significantly impeded by the operation in the EEA or in a substantial part of it, and therefore the foregoing would not result in a different appreciation of the transaction in question.

33. As concerns the possible distinction within outsourcing customers (large businesses vs. smaller organisations, including small organisations and SMEs), the parties have declared to be unaware of any publicly available market share data concerning the provision of *IT services* to these different segments. […], on the basis of IBM own internal estimates concerning the provision of *IT services* to companies with less than around 1,000 employees, in 2000, IBM shares of sales in the provision of *IT services* to companies with less than 1,000 employees do not exceed [less than 10%] of the overall *IT service* market, both at European and at Italian level. Concerning a possible market segment for the provision of *IT management service* to the smaller organizations including SMEs, IBM share of sales would not exceed its 1999 market share of 16,9% (European level) and 19,6% (Italy).

34. […]. The vast majority of *IT services* to be offered by the Joint Venture are principally oriented towards large companies, where a number of valid alternatives to the Joint Venture exist. […][9].

35. Therefore, it does not appear that from the transaction in question any competition concern might stem in respect of the segment of demand represented by outsourcing customers, both large organisations and smaller ones, including small and medium size enterprises (SMEs).

VERTICAL ASSESSMENT

36. The Fiat group currently satisfies [a substantial portion] of its requirements for *IT services* "captively". The remainder of its requirements is sourced from third parties and accounts for less than [1]% and [0-5]% of total European and Italian demand, respectively.

37. The Fiat group and the Joint Venture will then enter into some contractual arrangements. In particular the Joint Venture will enter into a *seven-year IT services agreement* requiring the Fiat group to purchase from the Joint Venture approximately two-thirds of its current total *IT services* requirements. In addition, the Joint Venture will benefit from a *right of first refusal* regarding the remainder of Fiat's *IT services* requirements. However, Fiat's share of demand for *IT services*, including its current

[9] The Joint Venture will customize and install SAP and JDEdwards application packages for its clients. There are many other ERP application packages offered by competing IT service providers that are equivalent to SAP and JDEdwards and available for use by SMEs. SAP and JDEdwards are relatively expensive application packages that require extensive customization, while the parties have stated that SMEs tend to purchase mass-customized software that requires reasonably simple installment services without specific customization. […].

captive demand, represents less than [<1]% and [0-5]% of total European and Italian demand, respectively.

38. In terms of *IT management services*, Fiat share of demand (including its current captive demand) has been estimated by the parties as being approximately [5-10]% of the total Italian merchant demand for IT management services in 1999 and also for 2000[10].

39. Also bearing in mind the potential expansion of the market due to new outsourcing customers in the coming years, the transaction will therefore not foreclose competing suppliers of *IT services* to an extent that could be expected to have a appreciable adverse effect on competition in *IT services* and *IT management services* in the EEA or in a substantial part of it.

VII ANCILLARY RESTRAINTS

40. The parties have agreed a number of arrangements which they claim are restrictions directly related and necessary to the concentration in order to protect the full value of the assets being transferred to JV Company.

41. In particular, the Joint Venture will enter into a series of IT services agreements with companies of the Fiat group, pursuant to which the Fiat group will commit to purchase from the Joint Venture IT services amounting to a minimum yearly total amount. The term of this agreement will be seven years. The parties stated that the yearly amount agreed represents approximately [a substantial portion] of the Fiat group's total IT services requirements and roughly corresponds to the services currently provided "captively" by Fiat's contributed businesses.

42. In addition, as regards the remaining [substantial portion] of IT services that the Fiat group currently sources from third parties, the Joint Venture will be given a right of first refusal, whereby, the Joint Venture will be notified in writing if any company of the Fiat group intends to purchase IT services from a company outside the Fiat group. Should the company in question not accept the Joint Venture's initial proposal, the Joint Venture will be preferred to any third party where the Joint Venture offers terms and conditions at least equally competitive to the best third-party offer.

43. Concerning the duration (seven years) of the services agreement between Fiat group and the Joint Venture, the parties have argued that that length is conceived as such in order to reflect the "outsourcing" aspect of the transaction. On one hand, it would be necessary for IBM to recoup the investments (in terms of capital, personnel, businesses contributed and know how) and reach profitability from the setting up of the venture, while on the other hand Fiat would be assured of the supply of services currently provided "captively" by Fiat's contributed businesses. Furthermore, the revenues currently derived from sales by IBM's contributed businesses would not sufficiently support the costs associated with a structure employing almost 5,000 people and with relevant assets located worldwide. Therefore, it would be necessary for the Joint Venture to have a guaranteed outlet for its IT services for a seven-year period.

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10 See footnote n°8

44. According to the practice of the Commission, purchase and supply obligations which concern a joint venture and the parents companies have to be limited to a transitional period, in order to be considered directly related and necessary to the concentration. In the present case, the aim of the above mentioned obligations appears to be mainly the continuity of supplies for one of the parent company (Fiat), and the warranty of a certain amount of business revenues to the Joint Venture for a number of years (providing for the supply from the Joint Venture to the Fiat group of given quantities and giving to the Joint Venture the status of preferred supplier for the remaining part of Fiat requirements). Under such circumstances, considering the nature of the relevant products and the presence of alternative sources of supply for the Fiat group, the Commission takes the view that the above arrangements (service agreement and right of first refusal clause) are to be considered ancillary to the operation for a period of three years from completion of the transaction, which would cover a transitional period for the replacement of the relation of dependency by autonomy in the market for the Joint Venture.

VIII CONCLUSION

45. In view of the foregoing, it can be concluded that the proposed operation would not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or in any substantial part of that area.

46. For the reasons above, the Commission decides not to oppose the notified operation and to declare it compatible with the common market and with the functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) N°4064/89.

For the Commission

Mario MONTI
Member of the Commission
(signed)