COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case no.: 66/LM/Sep04

In the large merger between:

Bytes Technology Group SA (Pty) Ltd

and

CS Computer Services Holdings Ltd

Reasons

Introduction

1. On 17 November 2004 the Competition Tribunal approved the merger between Bytes Technology Group SA (Pty) Ltd and CS Computer Services Holdings Ltd without conditions. The reasons are set out below.

The transaction

2. Bytes Technology Group Ltd ("BTG"), which is controlled by Altron, will acquire, through its subsidiary, Bytes Technology Group South Africa (Pty) Ltd ("BTG SA"), all the issued shares in CS Computer Services Holdings Ltd ("CSH").

Rationale for the transaction

3. According to BTG the proposed transaction would add a range of complementary services to BTG SA's portfolio, including IT services in areas in which BTG does not operate at all. The transaction would also provide economies of scale in certain areas where they are not currently

prevalent in either of the acquiring or target companies. Moreover, CSH is in dire financial straits and would have to close down if an acceptable solution is not found soon.

Pre-hearing

4. A pre-hearing was held on 15 November 2004. The Tribunal indicated that it would call the following witnesses:

    1) Michael Arnold, CEO of FNB: Self-Service Channel
    2) James Baird, MD of NCR International South Africa (Pty) Ltd
    3) Thomas Makoro of Diebold
    4) Peter Barclay, MD of Banking Machine Services ("BMS")

5. The parties indicated that they would call David Lewis Fink, Acting CEO of CSH.

Competitive assessment

<u>The relevant market</u>

6. The product markets in which both parties compete on a national basis are:

1. IT infrastructure outsourcing services; [1]

2. Maintenance services in respect of desktop and point-of-sale equipment; [2]

3. The provision of networking services and products;

4. The provision of SAP solutions; [3] and

5. Maintenance services in respect of ATM equipment

7. In none of the above markets, except the market for maintenance services in respect of ATM equipment, would the merged entity, post the transaction, compete among the top three players, nor would its market shares in any of these markets increase above 12%.[4] However, in the market for Maintenance services in respect of ATM equipment, the merged entity would be dominant, accounting for almost 60% of the market. The effect of the transaction on competition within this product market, therefore, requires closer scrutiny.

The impact of the merger on the market for Maintenance services in respect of ATM equipment

8. In South Africa, the major Banks currently use two competing brands of

1 These services comprise various activities associated with outsourcing and management of one or more elements of the client/server and network communication environment.

2 This concerns maintenance of equipment such as desktops, laptops, printers, scanners, bar code readers, etc.

3 This involves business consulting, blueprinting, configuration, implementation, training and post implementation support of SAP products.

4 The merged entity's market shares post the merger would be 2% in the market for IT infrastructure outsourcing services, 12% in the market for maintenance services in respect of desktop and point-of-sale equipment, 5% in the market for the provision of SAP solutions and 3% in the market for the provision of networking services and products.

ATM machines, namely NCR and Diebold. [5] The brands are represented in the market as follows:

BANK	**ATM BRAND**
FNB	NCR
Standard Bank	Diebold
ABSA	NCR and Diebold
Nedbank	NCR

9. BTG SA is the sole licensed distributor for NCR products (including ATM machines and spare parts) locally, while NCR's main rival, Diebold, does its own distribution and maintenance of Diebold ATM's.[6] NCR has a market share of 60% in the ATM machines market while Diebold has 30%. The remaining 10% is supplied by a competitor known as Wincon Nixdorf, represented locally by AST.[7]

10. Apart from being the sole distributor of NCR machines BTG SA is also involved in the downstream market for the maintenance of NCR brand of ATM's, as is CSH.[8] Although there are five firms in South Africa that provide maintenance services for ATMs, there is only one other competitor, apart from BTG SA and CSH, that services NCR machines, namely Banking Machines Services ("BMS").[9] BMS is an independent service provider that currently has no relationship with NCR South Africa although it does the maintenance of NCR machines. It sources its parts from the UK and USA directly. Post the transaction the merged entity will have a market share of 60%, Diebold 20% and BMS 4%.[10]

11. Contracts for the maintenance of ATMs are usually awarded via a tender

5 Both brands originate from Ohio in the USA.

6 NCR is regarded as the dominant player in terms of ATM machines in the world. It operates through sole distributors but there is no exclusivity arrangement in terms of maintenance.

7 See transcript page 78.

8 CSH acquired the IT Customer Services Division of FNB, which included the in-house ATM maintenance business, in March 2003. Included in the deal was a one-year maintenance contract in respect of FNB's ATM base.

9 BMS is a new entrant into the industry and is presently engaged in a pilot project to service some of FNB's ATM machines.

10 These market share figures are based on the assumption that the Diebold and NCR ATM machines are substitutable. According to FNB it would take between 5-10 years to switch from one ATM brand to the other.

process. Parameters that are, inter alia, taken into consideration are the speed of repairing an ATM and the model that needs to be serviced. It is therefore important to have a national footprint.

12. The Competition Commission reported in its recommendation that some of the entities' customers and competitors had expressed concern about the merger. FNB felt uncomfortable dealing with a dominant firm while Nedcor was concerned that its ability to exert countervailing power would diminish as a result of the merger.[11] It also indicated that switching from the NCR to the Diebold ATM machine, and vice versa, would be very costly. Concerns expressed by BTG's competitors, inter alia, included:

    - BTG would become stronger and the level of concentration in the market for the maintenance of ATMs would be increased; and
    - Whether competitors would be able to secure tenders because of the existence of a dominant player post the merger.

13. We were informed that BMS has the ability to service NCR machines and that it is not dependent on BTG for sourcing spare parts, since it imports spare parts directly from an independent manufacturer in the UK as well as the USA.[12] Diebold has, furthermore, entered into an alliance with BMS for servicing machines which would not only give BMS national footprint but would also make it possible for Diebold to be able to service NCR machines as well. According to Mr. Makoro, Managing Director of Diebold South Africa, the relationship between Diebold and BMS is based on a Memorandum of Understanding - providing additional capacity for service and maintenance of ATM's.[13] Although Diebold would rather supply and service its own ATMs it indicated to the Tribunal that some of its customers that use both ATM brands might prefer to use only one service provider to do the maintenance of the machines. In such instances Diebold would then provide the maintenance for both brands.

14. The Commission's investigation also revealed a possible discriminatory practice in the form of a discount given on license fees in order to use NCR diagnostic kits, which are used to service NCR ATM machines.[14] According to the Commission NCR appears to discriminate against firms who do not have a license to use NCR diagnostic kits by giving them

11 ABSA did not express any concerns about the merger since it has an exclusive maintenance agreement with BTG. Nedbank was also not concerned about the transaction.
12 According to BMS NCR itself had at certain times in the past sourced spare parts from BMS.
13 According to Barclay, of BMS, their alliance with Diebold will ensure that they do cross training in servicing both brands.
14 Diagnostics effectively speeds up the diagnostic process, which in turn lowers labour cost since it enables an engineer to locate a problem within an ATM machine much faster.

smaller discounts.[15] This puts them at a competitive disadvantage when they tender for a contract. BTG, for instance, will get a significant "relationship" discount compared to other South African companies because, according to NCR policy, BTG is the exclusive local distributor of NCR machines and therefore generates a lot of revenue for NCR.[16]

15. According to Mr. Baird, Managing Director of NCR South Africa, the licence programme is a worldwide programme, which was introduced to tighten security with regard to NCR ATMs. The levy is not a revenue-generating instrument but is used for research and development in order to create and keep diagnostics up to date and improve ATM functions. When a company applies for a license to use the diagnostics to service an ATM it will be asked by NCR to identify the individual engineers who will work on the diagnostics of each ATM machine, so that when fraud is committed NCR can trace the engineer responsible for that specific ATM machine. [17]

16. FNB also raised concerns about NCR's discount structures in licensing its diagnostic kits and says that the additional cost will be passed on to the banks and hence the consumer.[18] This fee would also render a new entrant such as BMS uncompetitive in the short term and the banks will be forced to use BTG to lower maintenance costs. However, FNB has admitted that it does have a multiple vendor policy for the maintenance of ATM machines in order to actively benchmark prices as well as encourage innovation between competitors.

17. The merging parties operate in a concentrated industry with a small, but strong, client base where contracts are awarded via tenders. CSH was in financial dire straits because it had lost the FNB contract. It was indeed a failing firm. The merger would thus not result in the removal of an effective competitor. In fact, after the merger, the status quo would remain. BTG, the large player, and BMS, a new emerging player, will remain in the market as competitors, hence competition would not be intensified but will be maintained. FNB has also indicated to the Tribunal that it is considering awarding BMS a contract to service 600 of its NCR ATM's while the balance of 1600 would be serviced by BTG, an indication that banks

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15 The Commission has undertook to investigate the merits of initiating an investigation into NCR's discount policy. See page 16 of its recommendation.
16 The timing of the introduction of the license fee is somewhat under suspicion. BMS was told of this in a letter dated 15 September 2004, a day after BMS received a Request for Proposal to tender for the Maintenance of FNB ATM machines.
17 Diebold, NCR's rival also charges a license fee.
18 This was confirmed by Barclay of BMS, see page 51 and 53 of the transcript.

would still be in a position to replace service providers.[19]

18. Finally BTG's customers are large banking institutions with countervailing power.[20] Makoro confirms this when he points out that Diebold tries to keep prices transparent while limiting any premiums to its customers. [21]

19. We therefore find that the transaction would not substantially prevent or lessen competition in the relevant market nor would it have an adverse effect on any public interest issues.

____________ **<u>17 January 2005</u>**

D Lewis **Date**

Concurring: N Manoim, Y Carrim

19 BMS has, for the past five months, been servicing 18 of FNB's ATM machines as part of a trial run.
20 This is admitted by Arnold of FNB.
21 See page 13 and 80 of the transcript.