Anticipated acquisition by Verint Systems Inc of Witness Systems Inc

The OFT's decision on reference under section 22(1) given on 23 May 2007. Full text of decision published 6 June 2007.

Please note that square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Verint Systems Inc** (Verint) is incorporated in the USA and provides analytical software-based solutions for security and business intelligence purposes. Its 2006 worldwide sales were approximately US$309 million, of which US$[ ] million (approximately £[ ] million) were achieved in the UK. Approximately 57 per cent of Verint's common stock is held by Comverse Technology Inc, which is a provider of software and systems that enable multimedia network based enhanced services.

2. **Witness Systems Inc** (Witness) is incorporated in the USA and a provider of workforce optimisation software and services that enable companies to capture customer intelligence and optimise their workforce performance in customer service operations. Its UK turnover for the year ending 31 December 2005 was US$49 million (approximately £25 million).

TRANSACTION

3. The proposed transaction involves an offer by Verint to purchase the entire issued share capital Witness. The transaction was notified on 14 March 2007 and the 40 working-day administrative deadline expired on 14 May 2007. The transaction has also been notified to the US Department of Justice (DoJ) and the German Federal Cartel Office (FCO). The DoJ granted

early termination, that is cleared the case on 9 March 2007 and the FCO cleared the case in Phase I on 10 April 2007.

JURISDICTION

4. As a result of this transaction Verint and Witness will cease to be distinct. The parties overlap in the supply of interaction management and analysis solutions with a joint share of above 25 per cent and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

5. The parties overlap in the provision of various interaction management and analysis solutions, supplied particularly to contact centre (call centre) operators, financial services trading floors and public safety organisations.

Product scope

6. In the widest sense, the parties' activities form part of business intelligence (BI) or customer relationship management (CRM) and the parties have submitted that the interaction management and analysis solutions they offer may be appropriately viewed as occupying a segment of the broader CRM solutions field.

7. The parties have submitted and most third parties have confirmed, that interaction management and analysis solutions can be further segmented according to function into:

   - voice recording of incoming and outgoing telephone calls

   - quality monitoring, by way of a software application that enables customers to design and fill out forms to aid monitoring of staff quality, and

   - additional software applications (such as speech and data analytics; operational applications used for optimising workforce

performance; e-learning and e-coaching solutions; and survey applications).

8. The parties have submitted that it would be difficult to isolate tenders for voice recording and/or quality monitoring as distinct from tenders which cover other functions. Also, some third parties have commented that they may subsequently buy additional software from the same manufacturer who supplied the original interaction applications. According to the parties' internal documents, there is some value in the ability to offer products suites. Therefore, a cautious approach has been taken and the case has been analysed on the basis of both the narrow functionality areas listed above and interaction management and analysis solution as a whole.

9. The parties have argued that there should not be any further segmentation of the applications in questions by customer group, because there are no significant differences in the underlying technology, most suppliers tend to operate across customer groups and there are no material impediments to expansion across groups. However, one third party has suggested that interaction management and analysis solutions to call centres should be considered separately, because they would be more likely to require additional software applications and to buy complete software suites. There is also a further question as to what ought to be considered to be a contact centre. In the absence of substantive competition concerns even on the narrowest possible frame of reference, it has not been necessary to conclude on this point.

10. This industry in characterised by sales through a number of different channels, for example through resellers, network carriers (e.g. BT, Cable & Wireless), communication infrastructure suppliers (e.g. Nortel, Avaya, Siemens), integrators (e.g. IBM, CapGemini, Accenture) and outsourcing organisations (e.g. IBM, Capita). The parties have submitted that in this industry on average around 60 per cent of sales are made directly to end users. From the demand side, customers are largely able to switch between the different procurement modes. On the supply side, companies can choose a number of different ways to market their product. The OFT has not received any evidence to suggest that the various sales channels should be assessed in isolation.

11. While both the parties and their competitors offer support and servicing for their products, the OFT has not received any evidence to suggest that

servicing should be considered separately from the supply of interaction management and analysis solutions. Neither have we received any third party concerns in relation to servicing. Therefore, for the purpose of this assessment, servicing has not been considered separately.

12. The relevant candidate product markets therefore considered for the purposes of this case are the supply of (i) voice recording, (ii) quality monitoring and (iii) additional software applications as well as interaction management and analysis solutions in general, and the provision of these products specifically to call centres.

Geographic scope

13. The parties have submitted that the geographic scope for interaction analysis and management solutions is global, as suppliers essentially provide the same products globally and as transport costs and country-specific regulatory limits are immaterial. Third parties said that a national technical and sales support presence is important. However, on the available evidence, the cost of such a presence is not considered to be so high as to allow a hypothetical UK monopolist to raise price profitably. One UK reseller submitted that it had originally chosen Verint (previously Mercom) as they had a scalable and reliable product which was already being sold successfully by resellers of its parent company in the USA. While the lack of independently verified data on UK shares makes its comparison with global share data difficult, the OFT has, for the purpose of this assessment also considered UK data, to the extent that it was available. As the transaction does not raise any competition concerns on any candidate geographic market, it has not been necessary to conclude on this issue.

HORIZONTAL ISSUES

Interaction management and analysis solutions (to all customers)

14. The parties estimate their joint global share of supply in this segment at approximately [30-40] per cent (increment [10-20] per cent). Data available to the OFT from other sources (including independently verified data) estimates the parties' joint global shares of supply at [30-40] per cent (increment [10-20] per cent). UK shares are estimated at [30-40] per cent (increment [0-10] per cent). The major suppliers in this sector are the

merging parties and NICE. There is a second tier of smaller vendors, with shares of supply between [0-10] and [0-10] per cent, as well as a long tail of fringe competitors. It is considered that customers who require software suites, could currently choose between the parties, NICE, and to a lesser extent Autonomy eTalk.

Interaction management and analysis solutions for contact centres

15. The parties estimate their combined share of supply at [30-40] per cent, which is broadly in line with information contained in their internal documents. Estimates from other sources range from [40-50] to [70-80] per cent. However, the internal document provided by the third party who believed the joint share to amount to [70-80] per cent estimates the parties' post-merger share at [60-70] per cent.

16. The parties have submitted and third parties have largely confirmed that the parties' focus on different products within the spectrum of interaction management and analysis solutions. While Verint's overall focus is on analytical solutions designed to extract intelligence solution, Witness is primarily a provider of workforce management solutions to call centres, focussing on the operational aspects. The parties have submitted [...] that NICE may be the closest competitor to each of the parties. The parties have also argued that this sector should be considered a bidding market and thus the number of remaining suppliers would be less indicative of the degree of rivalry. Although it does not seem appropriate to characterise it as a bidding market, tendering processes are not unusual.

17. One third party has argued that while there was some tendering for business, this was not always the case. Also, the existence of an incumbency advantage would result in a degree of inertia on the part or the resellers, network carriers and integrators. When we explored this point further we found that some of the available bidding data did not support this claim. While customers contacted have acknowledged that switching may not be straightforward, a majority confirmed that they would consider it if prices increased or product quality and/or the level of service support deteriorated.

18. It has also been put to us by third parties that many resellers and integrators would grant a specific supplier the status of their 'preferred' supplier, which might limit choice. However, the third parties contacted by

the OFT have indicated that labelling certain vendors as 'preferred' or 'approved' supplier would indicate a relationship with a certain supplier; however, nothing would prevent them sourcing from other suppliers, should they no longer feel satisfied with the products and services of their 'preferred' or 'approved' supplier (see also below).

Voice recording

19. The parties have estimated their combined shares in call recording at [30-40] per cent (increment [0-10] per cent).[1] An independent source gives the parties' combined shares as [30-40] per cent (increment [10-20] per cent).

20. The parties submit that a large number of suppliers are active in the voice-recording sub-segment, including NICE, Autonomy eTalk, Envision, VPI, Magnetic North, Aspect, ASC and Telstrat. Third parties have mentioned some of these vendors as alternative suppliers. An infrastructure vendor indicated that there would remain enough global and local voice recording companies post-merger. A response from a network provider also mirrored this view. Internal documents of one merging party show that some of the suppliers listed above are considered and analysed in designing a sales strategy. In addition, it has been submitted by the parties and confirmed by a third that 'Voice over IP' (VoIP) will, going forward, constrain traditional hardware recording devices.

Quality monitoring

21. While the parties estimate their UK combined share of supply at [30-40] per cent (increment [0-10] per cent), estimates from other sources for their global shares range from [30-40] to [40-50] per cent.

22. One third party has submitted that the quality monitoring tool is the most important reason for the parties' customers to buy their product and that mostly contact centres purchase it. This would increase the importance of this tool well beyond the level indicated by the share of supply figure above. One third party estimated the quality monitoring tool to amount to [ ] per cent of the products' overall price. However, the parties have

[1] One of the target's internal documents gives a higher estimate of about [40-50] per cent. However, this document appears to have been intended to portrait Witness as a market leader and relates to a cluster of customers.

provided list prices for the different software components which demonstrate that the relative cost of the quality monitoring tool is between [ ] and [ ] per cent. Another third party estimated the relative price of the component to the overall suite at [ ] to [ ] per cent. In the absence of any customer responses indicating concern about quality monitoring, the OFT is not persuaded on the basis of one complainant's uncorroborated submission that the transaction raises concerns in quality monitoring.

Additional software applications

23. The parties have submitted and third parties largely confirmed that the parties' products in this segment are largely complementary. Their products serve different customer needs and are not considered substitutable. The parties also maintain and this is confirmed by some evidence, that the main economic rationale for the transaction is the ability to provide a broader portfolio of software solutions. [ ] The parties have also maintained that a range of other suppliers (for example NICE, Autonomy eTalk, eLoyalty (partnered with Cisco) and Utopy (partnered with Envision) offer similar products which was confirmed by a third party.

Barriers to entry and expansion

24. The parties submit that the segments where their activities overlap are characterised by low barriers to entry and expansion. They maintain that entry could also be achieved by expansion to this market of companies already active in the broader CRM and BI field, such as Microsoft, Oracle and SAP. For voice recording, the parties argue that the necessary software can be developed within a few months, or indeed licensed from a third party. The parties submit and third parties confirm that entry into voice recording is also further facilitated by the emergence of new technologies, such as telephony over internet (VoIP). In relation to quality monitoring solutions, the parties maintain that barriers to entry are low, with the cost of development estimated at £50,000.

25. Third parties have provided different estimates on the duration and cost of entry. One third party has told the OFT that entry would require years and a significant investment and CRM and BI companies are not seen as likely to be incentivised to enter the market. Some third parties have not been able to identify new entrants, while some have said that entry was in the past most likely to occur through acquisition. One third party has submitted

that the parties' themselves could still be considered as comparatively 'new' in this field. This third party also said that it would expect to continue observing a degree of 'coming and going' in the industry.

26. One third party has raised concerns that the existence of (technically) 'approved' and 'preferred' supplier status in a relationship between a channel partner and a supplier might act as a barrier to entry. The former is given after testing and approving the suppliers' products compatibility with the channel partners' own technology. The latter is a commercial relationship, involving some more advanced testing. However, another third party has told the OFT that while the majority of its partners are 'approved', the 'preferred' status is not limited to a particular number of vendors. Both types of relationship would be non-exclusive and the channel partner could still switch to another supplier any time, should prices increase or the product otherwise no longer satisfy its requirements. Other third parties have confirmed that proposition.

27. There are examples of entry and/or expansion of smaller vendors by establishing a relationship with a network or communication infrastructure provider (Spanlink with Cisco, Telestrat with Nortel, ASC with Siemens). Therefore, the OFT believes that the existence of indirect sales channels may facilitate entry, by reducing the requirement for manufacturers to establish an extensive sales network.

28. The parties have highlighted the strong position of channel partners in this industry and that any post-merger price rises would either be met with pressure from these partners (see below under buyer power) or they would switch to other vendor's products. The latter point has been confirmed by third parties. One third party said they would consider sponsoring entry, if the parties' prices increased above a certain level post-merger.

29. Notwithstanding some third parties' submissions that entry may not be straightforward, given the number of market access channels and the strong position of the channel partners, the dynamic nature of these technology-intensive applications, the tail of smaller players who could expand, and the ability of players in neighbouring markets to expand, it seems reasonable to conclude that, in among other constraints, entry and/or expansion will discipline Verint post-merger.

Buyer power

30. The parties submit and third parties confirm that there is significant countervailing power on the part of large and sophisticated (end) customers, who are usually governmental bodies and financial institutions. Some of these customers are obliged to conduct their purchases in accordance with procurement regulations or choose to do so after a competitive tender process.

31. As discussed above, channel partners also provide an added buffer. The majority of third parties from this level of the distribution chain have confirmed that they have buyer power and can negotiate favourable pricing and other terms with their suppliers (including the parties). Most third parties have identified suppliers to which they could (threaten to) switch.

32. Smaller customers are less likely to have buyer power, but they will have more choice, provided by smaller suppliers who also supply lower-end, less sophisticated and less expensive products and from other market participants. A smaller-sized competitor to the parties told the OFT that they are successful in competing with large players due to lower cost base and speed to market.

33. One third party has identified incumbency advantages and supplied anecdotal evidence on cases where the incumbent was awarded the business without a previous tender process; whilst switching is not straightforward, parts of the bidding data contradict this.

34. On balance, the OFT considers the existence of large intermediate and end customers points to the existence of a degree of buyer power.

THIRD PARTY VIEWS

35. All but one third party contacted were unconcerned about this transaction. This concern is dealt with throughout the above assessment. All customers were unconcerned, which is particularly probative as it is customers that would bear the brunt of any adverse merger effects on price, innovation or quality. On the contrary, many respondents, especially customers, commented that they expect the parties to be able to offer a more attractive product portfolio post-merger, which may have motivated the complaining third party. As that complainant is a horizontal competitor, it is

unclear that alleged price increases or reduction in innovation or service quality would be detrimental to its interests. Conversely, the threat of a more effective competitor would prompt understandable fear of greater competition. The weight of overall third party views, therefore, provide cogent support in favour of the conclusion that the transaction will not reduce competition.

ASSESSMENT

36. The parties overlap in the supply of various interaction management and analysis solutions. The OFT has assessed this transaction both on the basis of this wider segment, as well as on the basis of functionality and customer-based sub-segments. Estimates of their combined shares of supply vary, but most data sources estimate them at [30-40] to [40-50] per cent, with one third party estimated the parties' post-merger joint share at [60-70] to [70-80] per cent.

37. While the transaction involved two of the three current main players in interaction management as a whole and the specific sub-segments, no customer concerns were received. Both the channel partners and large intermediate/end customers will, on the available evidence, be able to leverage a range of supplier options post-merger, which includes NICE, arguably the closest competitor to each party, and if necessary could include expansion by an existing supplier or new entry. Smaller customers have less sophisticated software requirements and will continue to be able to buy from the mid-sized and smaller players. In respect of each class of customers, therefore, the evidence suggests that no anticompetitive merger effects will arise as Verint will continue to face a similar degree of competitive pressure to that prevailing absent the merger. Indeed, there is some evidence from customer views to suggest that the merger may stimulate further competition as Verint will be able to offer a more attractive product portfolio than previously.

38. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

39. This merger will therefore not be referred to the Competition Commission under section 22(1).