



# **Sportech plc and the Vernons football pools business of Ladbrokes plc**

A report on the anticipated acquisition by Sportech plc of the Vernons football pools business from Ladbrokes plc



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The Competition Commission has excluded from this published version of the 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 ✂. Some numbers have been replaced by a range. These are shown within square brackets.

# Anticipated acquisition by Sportech plc of the Vernons Football Pools business from Ladbrokes plc

## Final report

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Glossary

## Summary

1. Sportech plc (Sportech) is the largest football pools operator in the UK, with a share of around 75 per cent, split between its Littlewoods (70 per cent) and Zetters (5 per cent) brands. Vernons, part of Ladbrokes plc (Ladbrokes), accounts for almost all the remaining share of UK football pools sales. Brittens Pools Ltd (Brittens) is the only other UK-wide pools operator apart from Sportech and Ladbrokes (the parties), and has less than 1 per cent share of supply by turnover. In 2006, more than 800,000 people played the football pools in the UK, together spending almost £80 million.
2. Sportech proposes to acquire, from Ladbrokes, Vernons Pools Ltd and the assets constituting its football pools business, together with the entire issued capital of Vernons Games Limited, Vernons Trustee Company Limited and Vernons Financial Services Limited. In addition, Ladbrokes and Sportech will enter into arrangements for the distribution of football pools products through Ladbrokes' licensed betting offices (LBOs). The proposed acquisition is a relevant merger situation over which we have jurisdiction.
3. The main product offered by Littlewoods, Zetters and Vernons is a weekly 'treble chance' football pool, in which players choose eight or more numbers from a set of 49, each of which corresponds to a football match to be played that week. Players are awarded three points for every match they select which results in a score draw (eg a 1–1 draw), two points for matches which result in a 0–0 draw, and one point for a home or away win. Players can increase their chances of winning by choosing more than eight numbers (the best eight count). Variations on this basic model are also offered. Demand for football pools fell sharply with the introduction of the UK National Lottery in 1994, and has been on a declining trend since then. The UK pools business is now at around 10 per cent of its size in 1994. Effectively, it has gone from being a product with a broad customer base and widespread recognition, to one which is largely confined to a niche of longstanding players (typically males aged over 50).
4. We considered a wide range of evidence as to whether UK football pools operators were in the same relevant market. We noted a range of evidence suggesting that they might be, including: similarities in the services supplied by the parties; demographic similarities in their customer bases; attempts by Vernons to target some of its marketing materials to Littlewoods customers; a number of customers playing both Littlewoods and Vernons pools; some documentary evidence that the parties regarded each other as competitors; and some survey evidence that customers would consider switching between the parties. However, we also noted that the weight of survey evidence, along with historical data on customer movements in response to a number of events, and a detailed analysis of customers who played the pools with both parties, all indicated that past switching between Littlewoods and Vernons (eg in response to price changes) had been limited, and that customers were unlikely to switch in large numbers in the future in response to a price increase.
5. At this stage of our analysis, we left open the question of whether the football pools games of Sportech and Vernons were in the same market, and went on to consider whether either, or both, parties competed in a wider market. We first considered whether the National Lottery was a price constraint on the parties. Survey evidence indicated that the National Lottery was more likely to be seen as a substitute for football pools than any other gambling product or products. We noted that the parties' sales had declined rapidly when the National Lottery was introduced in 1994, and that almost 13 years later they were still in decline. However, we saw little evidence that the parties had responded to this by improving the value of their games to

customers. On the contrary, the proportion of the Littlewoods pool paid out in prizes (the payout ratio) in early 2007, at between 20 and 25 per cent, was substantially lower than that in late 1994 (in comparison, Camelot is required to pay out 50 per cent of revenue from the National Lottery as prizes). Vernons' payout ratio is also between 20 and 25 per cent and fell substantially between 1998 and 2007.

6. We conclude that the parties were not constrained by the National Lottery or other specific non-pools gambling products. We took the view that, post-merger, Sportech's pricing decisions would be based on a desire to maximize profits without accelerating the rate of customer loss. Survey evidence shows that customers who stop playing the pools either save the money or spend it in a wide range of other ways. However, we considered that expanding the market definition to include all alternative uses of disposable income would not be appropriate. We therefore conclude, at this stage, that the market is no wider than the football pools.
7. We then considered the competitive effects of the merger. In particular, we considered whether the merger would remove a competitive constraint, so allowing Sportech to raise entry prices, reduce payout ratios, or reduce service quality or choice. In doing so, we considered the evidence mentioned in paragraph 4. In particular, we noted that:
  - (a) Two surveys of customers who had stopped playing with a football pools operator showed that very few had switched to playing with another operator; a further survey of current customers indicated that few customers would switch to an alternative operator in response to a small but significant price increase. A fourth survey indicated a degree of switching but, having regard to the respective merits and limitations of all four surveys, we considered that the balance of evidence did not support the view that customers saw alternative pools games as close substitutes.
  - (b) Analysis of historical data indicated that: at most, a small number of Vernons customers had switched to Littlewoods when Vernons closed its collector network in 1998; at most, a small number of Littlewoods customers switched to Vernons when Littlewoods increased its prices in 1999; and there is no evidence that marketing initiatives by either party have led to a substantial number of customers switching between Littlewoods and Vernons. This last point was contested by three third parties, but was supported by our analysis of Vernon's recruitment activities, and by our own detailed analysis of the customer lists of Sportech and Vernons.
8. We conclude that customers do not view the pools products of Littlewoods and Vernons as close substitutes, and that therefore the merger would not remove a substantial competitive constraint. Given our view that the market is no wider than the football pools, this implies that the Littlewoods and Vernons pools are either operating in two separate markets, or that they are in the same market but not exercising substantial competitive constraint on each other.
9. We therefore conclude that the proposed merger will not give rise to a substantial lessening of competition in any market for goods or services in the UK.

# Findings

## 1. The reference

- 1.1 On 3 May 2007, the Office of Fair Trading (OFT), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred to the Competition Commission (CC) for investigation and report the anticipated acquisition by Sportech of the Vernons football pools business (Vernons) from Ladbrokes. We were required to report by 17 October 2007. Our terms of reference are in Appendix A.
- 1.2 This document (together with its appendices) constitutes the report that we are required to publish under section 38 of the Act. Non-commercially-sensitive versions of the main-party and third-party submissions are on our website, along with other documents relevant to this inquiry. We refer to them where appropriate.

## 2. The parties

### *Sportech*

- 2.1 Sportech is a UK-listed company. It was founded in 2000 through the reverse takeover of Rodime PLC, which had purchased the Littlewoods Leisure business from The Littlewoods Organisation Plc in the same year. In 2002, Sportech acquired the business of another football pools operator, Zettors International Pools Ltd (Zettors), from Zettors Group plc for £1.35 million.
- 2.2 Sportech's revenue (net of prizes) was £60.8 million in the year ended 31 December 2006. Its operating profit on continuing operations was £18.4 million (before exceptional items). Since June 2006, when Sportech disposed of its sports betting, Internet and telephone businesses, its principal activities have been football gambling and e-gaming. Its football gambling activities are comprised of the Littlewoods and Zettors football pools business, Spot the Ball, and other football-related games. The e-gaming business is comprised of Littlewoods Casino, Poker and Bingo games, and Game On (a gaming website).
- 2.3 The Littlewoods football pools business had around half a million weekly players in 2006; the Zettors pools business had around 35,000 customers. Sportech's football gaming business accounted for £50 million (82 per cent) of Sportech's gross win revenue (amount staked less prizes) and £17 million (95 per cent) of Sportech's operating profit in the year ended 31 December 2006.

### *Ladbrokes*

- 2.4 Ladbrokes describes itself as one of the world's leading betting and gaming companies. Following the purchase of two hotel groups in 1987 and 1999, Ladbrokes was renamed Hilton Group plc. In 2006 it sold Hilton International Hotels and reverted to the Ladbrokes name as Ladbrokes plc. Ladbrokes has the largest LBO presence in the UK with over 2,000 shops,<sup>1</sup> while Ladbrokes.com has 2 million registered customers. The group made profits of £268 million on gross win revenue of £1,009 million in the year to 31 December 2006.

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<sup>1</sup>Source: Ladbrokes plc annual report and accounts.

- 2.5 Ladbrokes acquired Vernons in 1989. Vernons accounts for 24 per cent of UK football pools sales, and made an operating profit of over £5 million on turnover of £[REDACTED] million in the year ended 31 December 2006. As such, it represents less than 2 per cent of the profits and turnover of Ladbrokes.
- 2.6 Further information on the financial background of both parties is contained in Appendix B.

### **3. The proposed merger and the relevant merger situation**

#### ***Outline of merger situation***

- 3.1 Ladbrokes told us that since 1994 it had discussed (with The Littlewoods Organisation Plc and, later, Sportech) a possible merger of the Littlewoods and Vernons pools, but had not agreed on a price. On 18 May 2006, representatives of Sportech and Ladbrokes met to discuss the acquisition of Vernons. This followed an approach to Ladbrokes from another party. A third approach was made later in May, and a mini-auction process commenced in June 2006.
- 3.2 [REDACTED]
- 3.3 [REDACTED]
- 3.4 On 9 February 2007 the parties concluded heads of agreement and on 7 March 2007 Sportech announced that it had entered into exclusive negotiations with Ladbrokes regarding the potential acquisition of its Vernons pools business. A sale and purchase agreement has been drafted though not yet concluded. In order to finance the acquisition, Sportech will need to agree a revised long-term loan facility with its bankers and raise further equity; Sportech told us that it foresaw no difficulty in achieving this.

#### ***The rationale for the merger***

- 3.5 Sportech told us that falling customer numbers had led to smaller jackpot prizes, making the pools less attractive and so reducing customer numbers further. Sportech believed that with the acquisition of Vernons it could slow down this vicious circle of decline by:
- (a) increasing the pool size, and thus the jackpot prize, so attracting more customers; and
- (b) [REDACTED].
- 3.6 Sportech also expects some cost savings to arise from the merger (see paragraph 3.9). Regarding (a) above, Sportech explained its proposals for running the pools businesses post-merger. It plans to retain the three separate brands (Littlewoods, Vernons and Zettors) with different levels of entry price for each brand, but with a [REDACTED].<sup>2,3</sup> See paragraph 4.2 for an explanation of how the football pools game works.

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<sup>2</sup>The jackpot goes to the player or players who score the most points, up to a maximum of 24 points. Winning the jackpot by getting 24 points depends on the player selecting eight matches which prove to be score draws, and this is independent of the number of players in the pool. However, we note that a player who gets, say, 23 points has a better chance of winning the jackpot if there are fewer other players (because in that case it is less likely that another player will have won 24 points).

<sup>3</sup>In asserting this, Sportech has assumed that the total amount staked and the payout ratio remain the same.

- 3.7 Sportech said that [REDACTED]. We note that survey evidence (see paragraphs 4.10 and 5.14) indicates that the vast majority of customers have very little knowledge of jackpot levels and would not respond to an increase in the jackpot. Sportech's plans to [REDACTED] would need to comply with the relevant regulatory requirements—see paragraphs 4.13 to 4.20 and Appendix D.
- 3.8 Regarding paragraph 3.5(b), Sportech told us that [REDACTED].
- 3.9 Sportech expects to achieve synergies valued at £[REDACTED] a year by year two of the merger, with restructuring costs of £[REDACTED] in year one (see Appendix B). The largest source of synergies is in payroll (£[REDACTED] a year); others include property and [REDACTED] (see paragraphs 6.8 and 7.18, and Appendix B, paragraph 37). Sportech's 'deal rationale' also notes that the acquisition '[REDACTED]', suggesting that it would enable Sportech to [REDACTED] (see paragraphs 5.26 and 5.27 and footnote).
- 3.10 Turning to Vernons, Ladbrokes told us that the City's expectation was that it would invest in growing the Ladbrokes business or return cash to shareholders in keeping with Ladbrokes' declared gearing ratio. Ladbrokes' management's preference was to invest in growth opportunities, principally in remote betting and gaming, international and casino opportunities.
- 3.11 Ladbrokes cited a paper presenting the proposed disposal of Vernons to its February 2007 board meeting, which, inter alia, noted the following in describing the strategic logic of the proposal:
- (a) the football pools operation was a non-core business;
  - (b) the declining pools market;
  - (c) [REDACTED]; and
  - (d) the possibility that the changing regulatory environment might serve to increase operating costs.
- 3.12 Ladbrokes noted that successive annual strategy reviews had identified disposal of Vernons at a satisfactory price as a desired course of action, and told us that the Ladbrokes board took little time in approving the agreement reached with Sportech in January/February 2007.

### ***Jurisdiction***

- 3.13 Under our terms of reference (see Appendix A), we are required to investigate and report on whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a 'relevant merger situation' as defined by the Act. Under section 23 of the Act, a relevant merger situation is created if two or more enterprises have ceased to be distinct and if either the share of supply test or the turnover test is satisfied.
- 3.14 The acquisition by Sportech of all the assets of Vernons under the scheme of arrangement proposed will, if it proceeds, result in two enterprises ceasing to be distinct. Under the scheme, Sportech and Vernons will come under common ownership and control and therefore cease to be distinct enterprises. Neither of the parties has disputed that this is the case.
- 3.15 The share of supply test is met if, as a result of the merger, a share of at least one-quarter of the supply of goods or services of any description in the UK, or in a

substantial part of the UK, is created or increased. Section 23(5) of the Act provides that the CC shall apply such criterion (whether value, cost, price, quantity, capacity, number of workers employed or some other criterion of whatever nature), or such combination of criteria, as it considers appropriate to decide whether the 25 per cent share of supply test is met, in relation to both the particular supply of goods or services and the measure by which the share of supply is assessed.

- 3.16 Data from the parties indicates that in 2006 Littlewoods had UK sales (amounts staked) of £55.8 million, Zetters of £2.8 million, Vernons of £18.6 million and Brittens (the only other UK pools operator) of £0.4 million. From these figures, Sportech accounts for 77.3 per cent of the supply of football pools services in the UK by value, while Vernons has 22.2 per cent. On that basis, the acquisition would increase Sportech's share of supply of football pools services in the UK from 77.3 to 99.5 per cent, and the share of supply test is satisfied.
- 3.17 The turnover test is met if the value of the turnover in the UK of the enterprises being taken over exceeds £70 million. Vernons' turnover is less than £20 million. However, under our terms of reference, as the share of supply test is satisfied, we are not required to consider the application of the turnover test.

### ***Conclusions on the relevant merger situation***

- 3.18 We conclude that the merger will result in a relevant merger situation: arrangements are in progress or in contemplation which if carried into effect will result in enterprises ceasing to be distinct and the share of supply test is satisfied.

### ***Activities of the parties***

- 3.19 The activities of the parties overlap in the areas of (a) the supply of football pools and (b) fixed-odds numbers games.<sup>4</sup> The parties' combined annual revenue from fixed-odds numbers games is approximately £[REDACTED]. Sportech estimates that total supply of fixed-odds numbers games in the UK is worth in excess of £100 million a year while Ladbrokes estimated it at £400 million. The increment, in terms of Sportech's revenue from fixed-odds numbers games, is £0.53 million (which represents under [REDACTED] per cent of Sportech's total revenues). We note that a wide range of fixed-odds betting games is available apart from those supplied by the parties. Suppliers include William Hill, Coral, and Camelot, which offers 18 lottery games priced at £1 and £2. These games are generally sold over the counter though may also be played by scratchcard, online or via fixed-odds betting terminals in LBOs. Given the parties' combined revenue in the supply of fixed-odds numbers games and the very small increment resulting from the merger, we do not expect any competition concerns regarding the supply of fixed-odds numbers games to arise from the merger. We therefore focus on the supply of football pools.

## **4. The football pools business**

### ***The gambling sector***

- 4.1 Gambling is a fast-growing sector in the UK: consumer spending has doubled since 2000 to more than £50 billion a year.<sup>5</sup> Gambling may be categorized as 'hard' or 'soft', depending on its propensity to give rise to 'problem' gambling. High-stakes,

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<sup>4</sup>See Appendix C, Table 3.

<sup>5</sup>Source: Gambling Commission, *Basic Facts About the British Gambling Industry*, 2006.

short-odds, frequent-play games such as poker and roulette are described within the industry as ‘hard gambling’, while low-stakes, long-odds games are described as ‘soft gambling’. The National Lottery is the most popular form of soft gambling in the UK, accounting for around £94 million of stakes a week. This is followed by bingo, with weekly stakes of £10 million. Consumer spending on football pools is less than £2 million a week (ie around 0.2 per cent of the total spending on gambling).

## **The game**

- 4.2 The main product offered by Littlewoods, Zettors and Vernons is a weekly ‘treble chance’ football pool, in which players choose eight or more numbers<sup>6</sup> from a set of 49 numbers, each of which corresponds to a football match to be played that week. Players are awarded three points for every football match they select which results in a score draw (eg a 1–1 draw), two points for matches which result in a 0–0 draw, and one point for a home or away win. Players can increase their chances of winning by choosing more than eight football matches (the best eight results count). Players with the highest points win prizes—23 or 24 points are typically needed to win a share of the jackpot. Variations on this basic model are also offered.
- 4.3 The ‘pool’ consists of the stakes received from players. A proportion of this money goes into the prize fund—[20 to 25] per cent in the case of Littlewoods, [20 to 25] per cent for Zettors. Vernons’ payout ratio varies from week to week, and ranged between [20 and 25] per cent in the first half of 2007. Most of the prize fund is paid out as a jackpot to the highest-scoring player. Littlewoods has a weekly prize fund of around £[£] of which around £[£] goes into the jackpot. Vernons has a fund of around £[£] a week of which around £[£] is in the jackpot, Zettors has an £[£] fund and a £[£] jackpot. The precise figures vary from week to week. When more than one player achieves the highest, second-highest or third-highest score, prizes are divided between winners.
- 4.4 Pools operators offer a variety of other games alongside the basic treble-chance game, including Spot the Ball and prizes for predicting half-time scores. Players of the Littlewoods and Vernons pools are also offered a free chance to win £2 million if they select eight draws with scores of 2–2 or above.<sup>7</sup> This combination of results has occurred only three times since the introduction of the £2 million prize, and it has never been won.
- 4.5 The vast majority of customers (95 per cent<sup>8</sup>) play the pools weekly, although most pay for their entries in advance rather than paying each week. Coupons—ie the forms listing the football fixtures on which a player makes his selection and enters his bet—are posted out, and players can submit their entries by post or phone. Sportech also operates a network of collectors, who visit players’ homes to collect entries and payment, and deliver the following week’s coupon. Approximately half of Littlewoods customers play via the collector network. Vernons closed its collector network in 1998.<sup>9</sup> The points accruing from the result of each match (see paragraph 4.2) are published in several Sunday newspapers; they are also broadcast on several Saturday sports television programmes (during the UK football season<sup>10</sup>), the values

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<sup>6</sup>In practice, the pools operators require players to bet a minimum amount which means that most choose a minimum of 10 or 11.

<sup>7</sup>This prize is not drawn from the prize fund created by the pool.

<sup>8</sup>Source: GfK survey.

<sup>9</sup>The pools can also be played with Littlewoods, Zettors or Vernons over the Internet, though this channel is as yet used by few customers.

<sup>10</sup>Outside the UK football season, the pools are based on other football games including the Australian league.

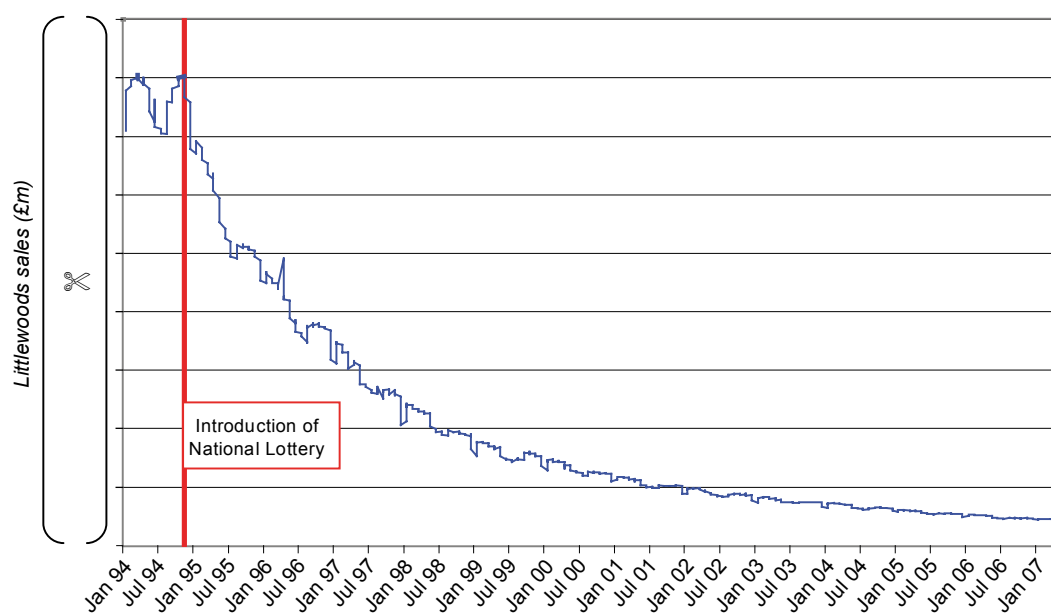
of prizes are published in the *Daily Mail* (see paragraph 4.18), and winners are contacted by the pools operator.

## History

4.6 Both Littlewoods and Vernons were established in the 1920s. In 1994, the football pools had around 10 million players. Following the introduction of the UK National Lottery in 1994, demand for the football pools fell sharply. In 1995, Littlewoods and Vernons each experienced a decline in sales of 30 per cent. By 1996, sales of both Littlewoods and Vernons pools were around half their 1994 levels—the two together had sales of around £500 million that year, in contrast to National Lottery sales of over £5 billion. Although demand for the National Lottery fell slightly after its introduction, and has not grown substantially since then, demand for the pools has continued to decline. Littlewoods' sales fell by two-thirds from 1996 to 2000, and by 60 per cent from 2000 to 2006. Overall, and despite substantial growth in the broader gambling market, the value of the pools industry has fallen by around 90 per cent since the introduction of the National Lottery. Figure 1 shows the impact of the National Lottery on Littlewoods' weekly revenues. The equivalent data for Vernons shows a very similar picture.

FIGURE 1

### Impact of National Lottery on Littlewoods



Source: Sportech.

## Customers

4.7 Three out of four football pools players are male.<sup>11</sup> Only 6 per cent are aged 44 or below. The spread of customers across different 'social grades' is similar to that for the UK as a whole, although there are some differences according to how customers play the pools. Customers who play via a collector (Littlewoods) are less likely to be in the AB category (9 per cent, compared with 17 per cent of all players) and more

<sup>11</sup>Source: except where specified, all the data referred to in paragraphs 4.7 to 4.10 comes from the CC survey of pools customers outlined in paragraph 4.8.

likely to be in the DE category (43 per cent, compared with 33 per cent), and one in three are female. The relatively small number who play online are more likely to be in the AB grade (29 per cent), tend to be younger (42 per cent under 55, compared with 26 per cent), and almost half are female.

- 4.8 GfK carried out a survey of around 1,100 football pools players for the CC. Among respondents, around 85 per cent had been playing the football pools for over 10 years, 70 per cent for over 20 years, and more than half have played for over 30 years. Around 83 per cent also play the National Lottery, 70 per cent doing so weekly. Camelot told us that over a year 70 per cent of the adult population played the Lottery, suggesting that pools players are more likely than average to do so.
- 4.9 Among respondents to the GfK survey, the most common reason cited for playing the pools, rather than other forms of gambling, was tradition, or that the player had always done so (44 per cent). In total, 39 per cent of customers gave a specific reason for playing the pools (such as convenience, better chance of winning, or more fun). However, only 7 per cent said that it made them enjoy football more, while 78 per cent did not usually check to see if they had won. Most played with their current pools operator because they had always done so, or were unable to give a reason, and only one in four said that they would move to a different pools operator if their current operator stopped providing the game. In the past five years, around 2 per cent of players surveyed by GfK had stopped using a pools operator because another offered better value in terms of entry prices, prizes or winning chances.
- 4.10 Only 5 per cent of customers told GfK that they knew the proportion of entry money provided as prizes. However, only 25 per cent of these customers (1 per cent of all customers) correctly identified that it was in the 21 to 30 per cent range. Similarly, only 5 per cent claimed to know the proportion of prize money taken for expenses and commission, but only 5 per cent of these (less than 0.5 per cent of customers) correctly identified the proportion as 61 to 70 per cent. Fewer than 5 per cent could estimate the expected top prize from their pools provider within £50,000 bands.

### *Industry representation*

- 4.11 The industry is represented by the Pools Promoters' Association, which has two members: Sportech and Vernons. Its principal function is to ensure appropriate responses to relevant Government consultation. It also negotiates for the right to use the results of the Australian Football league and the four English Semi-Professional Leagues in its members' pools competitions. The parties also jointly finance a Pools Panel, which decides (for the purpose of scoring the pools) the results of football matches which feature on pools coupons but which do not take place.
- 4.12 Further background information about the industry is provided in Appendix C.

### **Regulation**

- 4.13 During the course of the inquiry a fundamental shift to the regulatory regime applying to the pools operators took place. For a considerable period the relevant statutory law applicable to pools betting had been contained in the Betting Gaming and

Lotteries Act 1963 (BGLA).<sup>12</sup> However, the Gambling Act 2005 repealed the BGLA in full with effect from September 2007.<sup>13</sup>

- 4.14 The provisions of the Gambling Act do not address football pools specifically save that section 65 specifies that a 'pool betting operating licence' may be issued as one of the ten operating licences listed under the Act. Since September 2007 the relevant provisions directly affecting the licensing of pools providers are included in a number of statutory instruments (SIs) and in particular SI 2006 No 3272 (Commencement No 6 Transitional Provisions).
- 4.15 From 1 September 2007 all operators providing services for pools betting<sup>14</sup> require a 'pool betting operating licence' from the newly-established Gambling Commission. There are two types of activity that can be specified in an application for a pool betting operating licence: non-remote pool betting and remote pool betting.<sup>15</sup>
- 4.16 Section 13 of Schedule 2 of the BGLA required that every pools betting business had to take the form of the promotion of competitions for prizes for making forecasts as to sporting or other events, each bet being an entry in a particular competition, and the winnings in respect of the bets being the prizes or shares in the prizes (which must be wholly in money). Section 13(d) also required that:
- in each competition, the prizes shall be equally available for all the bets, and accordingly the question which bets qualify for, or for shares in, the prize or prizes and, save so far as it depends on the amounts staked, the amounts of the respective shares in the prizes, shall be determined solely by the relative success of the forecasts embodied in the respective bets.
- 4.17 This provision was interpreted and applied by the pools industry as having imposed an obligation on pools promoters to ensure that punters' winnings must be directly proportional to the size of their respective bets. In the case of 'booster' prizes offered by both Littlewoods and Vernons, some punters pay more than the standard bet (£1 rather than 75p on an 8-from-10 (Littlewoods) or an 8-from-11 (Vernons)) but receive a proportionally higher prize if they win.
- 4.18 Section 21 of Schedule 2 of the BGLA required the pools providers to publish the percentage of the pool used to cover their expenses and commission. Littlewoods, Zetters and Vernons all met this requirement via advertising in the *Daily Mail* on Thursdays.
- 4.19 Schedule 2 of the BGLA is not reproduced in any relevant SI issued pursuant to the Gambling Act 2005. Since the introduction of the new regime in September 2007, when a licensed pool provider applies for a fresh pool operating licence, it will have to demonstrate compliance with the conditions set out by the Gambling Commission in its 'Licence Conditions and Codes of Practice' (LCCP) dated June 2007.
- 4.20 The LCCP do not replicate (either in their present form or in a revised form) any of the detailed provisions of the BGLA and there are very few requirements in the LCCP which are specific to football pools. In contrast to the detailed prescriptive terms of

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<sup>12</sup>Section 1(1)(A) and sections 4(A) and 4 of the BGLA are concerned chiefly with regulation of the premises in which pools betting can take place; the restricted use of premises as a place where persons may deliver completed coupons and the restriction of pools betting business on race tracks.

<sup>13</sup>Section 356(3)(f), (4) and Schedule 17.

<sup>14</sup>Including racecourse pool operators, football and other sports pool operators and 'fantasy-football'-type competitions.

<sup>15</sup>Non-remote refers to the fact that the betting process is carried out in person as opposed to over the telephone or Internet, eg the tote. Remote pool betting operators provide facilities for pool betting via means of remote communication, such as the Internet or telephone.

the BGLA, the LCCP constitute far more general principles which are concerned with ensuring the overall integrity and fairness of betting arrangements. The relevant LCCP provisions are discussed in more detail in Appendix D. Although it remains to be seen how the Gambling Commission will enforce the LCCP principles in practice, Sportech has told the CC that it regards the general principles which are set out in the LCCP 'as replicating in practice the kind of specific provisions that were in the previous legislation [BGLA]'.

## 5. Market definition and market shares

- 5.1 The CC's assessment of the proposed merger is framed in terms of (a) identification of the relevant market and (b) whether the merger would increase the market power of companies in the market so defined. In practice, the analysis of these two issues overlaps considerably, and many factors are relevant to both.<sup>16</sup> We begin by considering the analytical framework for market definition, before considering a wide range of relevant evidence.

### *Analytical framework*

- 5.2 The generally accepted approach to market definition is the SSNIP test, and the CC adopts this approach where it is feasible.<sup>17</sup> The test considers whether a hypothetical monopolist would be able profitably to sustain a small but significant non-transitory increase in price (SSNIP) (or worsen the product offer equivalently in terms of quality or variety). The application of the SSNIP test is an iterative process, starting from the narrowest possible market and then including the nearest substitutes.<sup>18</sup> In practice, the SSNIP test is often used as a conceptual framework: it is not always possible to obtain clear empirical evidence as to the likely outcome of a price rise. As our guidelines note, there is inevitably an element of judgement involved in defining the market, and the CC will adopt the methodology most appropriate in the context of the relevant merger situation.<sup>19</sup>
- 5.3 In the present case we note that 'price' has a number of interconnected components. Players pay an entry price to play the pools, and a proportion of this money (just over [20 to 25] per cent) goes into the pool from which winnings are paid out. The value of the pools to customers depends on the entry price, the proportion of stakes returned to players as prizes (the payout ratio), and the value of the jackpot and other prizes. In practice, customers have very little knowledge of the payout ratio or the jackpot (see paragraph 4.10), so much of the evidence we discuss relates to possible customer responses to changes in the entry price (payout ratios are discussed further in paragraphs 5.16 and 5.17).

### *Use of a notionally competitive price*

- 5.4 In most merger inquiries, the CC uses existing prices as the benchmark in applying the SSNIP test, because the key issue is the impact of the merger on existing competition.<sup>20</sup> In some cases this approach may not be appropriate, either because the parties under investigation are coordinating to sustain prices above the competitive level, or because the market is already to some extent monopolized. In such cases, application of the SSNIP test at current price levels may lead to a broader

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<sup>16</sup>*Merger References: Competition Commission Guidelines, CC2, paragraph 1.24.*

<sup>17</sup>*Ibid, paragraph 2.2.*

<sup>18</sup>*Ibid, paragraph 2.5.*

<sup>19</sup>*Ibid, paragraph 2.2.*

<sup>20</sup>*Ibid, paragraph 2.10.*

market definition than if the test were applied to competitive prices (because, if current prices are above competitive levels, customers may respond to a 5 per cent increase above current prices by switching to more distant 'substitutes' which they would not consider using in response to a price 5 per cent above competitive levels).<sup>21</sup> Our guidelines note that where the CC believes prices to be substantially above the competitive level, prices more indicative of the competitive level might be more appropriate in defining the market.<sup>22</sup> Another possibility is that suppliers are *not* pricing up to the point at which they are constrained by alternative products—ie that a price increase above existing levels would be profitable. This point is discussed further in paragraphs 5.63 and 5.64.

- 5.5 We take the approach that SSNIP questions can appropriately be applied to existing prices in this case. We note two instances (paragraph 5.59, second footnote, and paragraph 5.63) when the use of a notionally competitive price might have changed the analysis.

### *Sportech's price increase*

- 5.6 Sportech has raised a further, related, point as to whether existing price should be taken to be the entry prices it charged prior to the merger, or those following a price increase it implemented for the start of the 2007/08 British football season. It argued that when considering the profitability of a price increase, rather than current prices (ie the prices prevailing at the point of the inquiry when the analysis was undertaken, ie June/July 2007), the starting point of the analysis should be the prevailing prices in the counterfactual, ie the prices including Sportech's August 2007 entry price increase of 25 per cent (on average across the different types of bets), implemented to coincide with the start of the new football season in August 2007 (the entry price of its most popular (8-from-10) game was increased by 33 per cent). This was the first increase in Littlewoods and Zettlers entry prices since 1999.
- 5.7 Sportech argued that this price increase pre-dated its plan to acquire Vernons, and was not contingent on the acquisition. We examined internal documents from Sportech regarding the August 2007 price increase, and from both Sportech and Ladbrokes regarding the proposed acquisition. These points are discussed in Appendix E. It appears that Sportech's interest in acquiring Vernons dates back at least to 2005, and was central to Sportech's strategy by August 2006, when the plans for a price increase were presented to the board. Sportech argued that [REDACTED].
- 5.8 However, we note that both the price increase and the acquisition of Vernons (if completed) will have a major impact on Sportech's business in the future. On the basis of the evidence provided, we do not believe it is possible to reach the conclusion that Sportech's management took these two business decisions in complete isolation from one another. While we note that the price increase has already been implemented, ie before Sportech knew the outcome of the present inquiry,<sup>23</sup> we consider that Sportech's ability to sustain this price increase, or future price increases, could in principle depend on whether or not it acquires Vernons (again, the extent to which the proposed acquisition will in fact affect Sportech's ability to sustain higher prices is the subject of our analysis of competitive effects). We consider the impli-

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<sup>21</sup>This phenomenon is generally known as the 'cellophane fallacy' following the error committed by the US Supreme Court in *US v El Du Pont de Nemours & Co*, [1956] 351 US 377 which was a case concerning packaging materials including cellophane.

<sup>22</sup>CC2, paragraph 2.10.

<sup>23</sup>Sportech told us that it had already implemented the price increase to some customers before the publication of our provisional findings report in August 2007 and that it would be fully implemented during the course of September.

cations of the price increase at specific points where it is relevant to our analysis (see, for example, paragraph 5.59).

### *Network effects*

- 5.9 Sportech also argued that an increase in the price of a bet, ie the entry price, should not be seen as a price increase in the normal sense, because it would lead to an increase in the prize fund. A more complex mechanism is at work here, in that some players are likely to stop playing in response to an increase in the entry price, so that for those who continue to play, it is unlikely that the prize fund will initially increase in the same proportion as the entry price.<sup>24</sup> However, to the extent that the prize fund does increase, this may make the game more attractive to non-players. If sufficient new players are attracted by the initial increase in the prize fund, original players may find that the prize fund increases in the same proportion as the entry price, or by a higher proportion.
- 5.10 Sportech argued that, subsequent to its latest price increase, it would engage in [X] which would increase demand for its pools, so giving rise to positive network effects because increased numbers of players (at the higher price) would lead to higher prizes and therefore a more attractive pool. Sportech said that [X]. We note that it is not clear that these network effects will necessarily transpire, nor, if they do, that this will be as a result of the price increase. Furthermore, customers will have to respond to the price increase immediately by paying more, whereas any awareness among customers of higher jackpots will take some time and marketing effort by Sportech.
- 5.11 In this section, we begin by considering the potential impact of network effects on the SSNIP test. Then we consider the evidence as to whether such network effects are likely to occur in practice. Finally we consider the question of whether price increases should be seen as reducing customer value. A related question is how, in the light of such network effects, we should assess evidence as to how customers might respond to increases in the entry price. This point is discussed in paragraphs 5.57 and 5.58.

### *The SSNIP test*

- 5.12 From the perspective of applying the SSNIP test, if an increase in entry price were to lead to an increase in the attractiveness of the product, this could have the effect that such a price increase would lead to a smaller reduction in demand than would otherwise be the case (or even, potentially, an increase in demand). As such, a positive network effect will tend to increase the likelihood that a hypothetical monopolist of a product or set of products would find a small but significant price increase profitable, and therefore that the product(s) in question should be seen as a relevant market, rather than being part of a broader market.

### *Evidence*

- 5.13 Sportech referred to a CC-commissioned survey by ORC of lapsed customers, which found that 19 per cent of Littlewoods customers had stopped playing the pools or played less often because they 'didn't win enough', though none of the respondents explicitly cited 'price' as a reason for lapsing. Sportech argued that the survey supported the proposition that a larger jackpot was likely to attract new customers. In our

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<sup>24</sup>Even if customers did not respond to the price increase by stopping or playing less, the prize fund would increase by much less than Sportech's revenue, as only [20 to 25] per cent of the additional revenue from the price increase will be paid out in prizes.

view, a more relevant statistic may be the proportion of customers who stopped playing with Littlewoods because of the size of the prize fund: ORC found that only 3 per cent had stopped or played less for this reason. In addition, we do not consider that these customers will necessarily be attracted to playing the Littlewoods pools again following its current price increase (see paragraph 5.6).

5.14 Other survey results raise further questions as to whether a price increase would lead to positive network effects:<sup>25</sup>

(a) Analysis of GfK survey results indicates that the price of selections is the most important factor in choosing between pools (or choosing not to play), with a weight of 59 per cent, while the size of the prize fund has a weight of 19 per cent.<sup>26</sup>

(b) 24 per cent of respondents to the Swift 2 survey (commissioned by Sportech) said that they would respond negatively if their pools company increased the cost of playing by 10 per cent—the majority would stop playing the pools, while others would buy fewer lines or play less often. While the number of customers who would actually change their behaviour might be lower than claimed by the survey, this result suggests that a substantial proportion of customers see an increase in entry price as a reduction in value, without recognizing any countervailing benefit of a higher prize fund.<sup>27</sup>

(c) The GfK survey found that players had practically no knowledge of prize levels—see paragraph 4.10.

(d) Sportech's own survey (Swift 2) shows that 94 per cent would not change their behaviour if jackpots increased (following an increase in customer numbers), suggesting that, even if customers were aware of prize levels, they would not respond to them.

### *Customer value*

5.15 Sportech argued that its recent price increase was a 'product repositioning' which would slow customer attrition, reinvigorate the business, and ultimately enhance the value of its pools product to players. In our view, the evidence above suggests that customers would not initially respond to an increase in the price by taking into account the value of the pool. Sportech believed that over time the creation of winners would create an understanding of the scale of prize levels. However, the very low levels of awareness of the level of prizes indicates that, even if the pool size were to increase, few current or lapsed customers would notice this. [X], Sportech's own survey indicates that few current customers would wish to bet more if the jackpot was increased, and we have seen no evidence that lapsed customers would be willing to start playing again.

5.16 Notwithstanding the above, players are still likely, on average, to derive some benefit from a higher prize fund (even if this is not sufficient to fully compensate them for an increase in the bet price) so an increase in the entry price of 10 per cent should be regarded as a genuine price increase, but of less than 10 per cent.<sup>28</sup> By the same

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<sup>25</sup>See paragraphs 5.34 to 5.43 for a fuller description of the customer surveys undertaken in relation to this inquiry.

<sup>26</sup>Factors which influence the expected winnings (size of prize fund, first dividend, number of pools entrants) had a combined weight of 41 per cent. Sportech argued that customers were likely to have been confused by the exercise, but we note that the approach we adopted (conjoint analysis) is a common market research methodology.

<sup>27</sup>In contrast, only 14 per cent would respond negatively to a reduction in the payout ratio of 10 per cent, which Sportech acknowledged as a genuine reduction in value.

<sup>28</sup>We have been unable to establish what the precise value to players of a given change in the prize fund would be.

token, a (say) 10 per cent decrease in the payout ratio is a reduction in the value for money offered by the pool. But again, given lack of player awareness of the level of the payout ratio or of typical prize funds, this is unlikely to be perceived by customers.<sup>29</sup>

5.17 Finally, we note that 20 to 25 per cent of increased revenues from a price rise will go into the prize pool. For example, if a price rise led to additional revenues of £100,000 a week, the prize pool would increase by just over [£20,000 to £25,000] a week. As such, the low level of payout ratios has a strong tendency to dampen any network effect.

5.18 In the following discussion we consider:

(a) whether the Littlewoods, Zettors and Vernons pools are in the same market as one another (in practice, we concentrate on Littlewoods and Vernons, given Zettors' much smaller scale); and

(b) whether the parties' football pools are part of a broader market.

### ***Littlewoods and Vernons***

5.19 We consider evidence on whether the parties are in the same market under the following headings:

(a) product characteristics (paragraphs 5.20 to 5.22);

(b) customer demographics (paragraphs 5.23 and 5.24);

(c) documentary evidence (paragraphs 5.25 to 5.29);

(d) marketing activity (paragraphs 5.30 to 5.33);

(e) survey evidence (paragraphs 5.34 to 5.43);

(f) event studies (paragraphs 5.44 to 5.50 and also Appendix F);

(g) customer overlaps (paragraphs 5.51 to 5.53 and also Appendix F); and

(h) elasticity and critical loss analysis (paragraphs 5.54 to 5.65 and also Appendix F).

#### ***Product characteristics***

5.20 The Littlewoods and Vernons pools have a number of similar characteristics which are not shared by any other significant supplier in the UK, for example:

(a) a similar history and 'heritage' appeal, with strong cross-brand awareness (over 80 per cent of Littlewoods customers are aware of Vernons and vice versa); and

(b) product design: both offer the same 'treble chance' game with bets of '8-from-10', '8-from-11' etc, based on the same football match results. Pools Panel decisions apply to both. Both meet their statutory publication obligations in the same way

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<sup>29</sup>Unless the player actually won the pool.

(ie *Daily Mail* on Thursday). Both also offer the same Spot-the-Ball games,<sup>30</sup> and £2 million prize funds (with the same rules) along with their basic pools games.

- 5.21 Littlewoods' and Vernons' pools offers have tended to evolve in tandem to some degree: both introduced a £1 million prize, subsequently increased to £2 million (see paragraph 4.4), around the same time; both reduced the number of lines on a coupon to 49 following the introduction of the Lottery (essentially reducing the number of matches while making the game more similar to the National Lottery 'Lotto' game). Sportech's introduction of half-price season tickets is similar to Vernons' 'buy-one-get-one-free' offer (although it was introduced two years later). The parties argued that these changes were not in response to each other's activities, but a reaction to the impact of the National Lottery.
- 5.22 On the other hand, the parties' products also differ in a number of important ways, including:
- (a) Vernons does not have a collector network. Ladbrokes told us that when it closed the Vernons collector network in 1998, only [X] per cent of customers switched to other ways of playing the pools—the rest just stopped playing. Littlewoods collection customers may be similarly reluctant to see Vernons as a substitute.
- (b) Littlewoods has higher entry prices and a higher jackpot than Vernons. This has some influence on customers: [X] per cent of Littlewoods customers, but only [X] per cent of Vernons customers, give 'larger jackpot' as a reason for choosing their pools operator, while [X] per cent of Vernons customers give 'cheaper price per line'<sup>31</sup> as a reason, compared with only [X] per cent of Littlewoods customers.<sup>32</sup> Either operator could, in principle, reposition itself to offer the same price per line as its competitor, but it is unlikely that Vernons could provide a jackpot that would emulate that of Littlewoods. Another difference is that Vernons only offers players points for predicting half-time scores whereas Littlewoods offers cash prizes.

#### *Customer demographics*

- 5.23 Both of the parties have ageing customer bases, which tend to be skewed towards older males compared with the population at large. For both, the majority of customers have been playing the football pools for 20 years or more, although Vernons has a larger proportion of newer customers ([X] per cent started playing within the past ten years) than Littlewoods ([X] per cent of whose direct customers, and [X] per cent of whose collected customers, started in the past ten years).<sup>33</sup>
- 5.24 The parties' customers also have a broadly similar profile in terms of social category: both have almost twice as many DE customers as AB customers, although within Littlewoods there is a considerable difference between collected customers (9 per cent AB, 43 per cent DE) and direct customers (22 per cent AB, 30 per cent DE).<sup>34</sup>

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<sup>30</sup>In fact, Vernons offers Littlewoods' Spot the Ball game to its customers.

<sup>31</sup>A line, ie a combination of any eight customer selections, is the basic unit price of the pools operator. For instance, an '8-from-10' bet provides 45 permutations of eight results, ie 45 lines. Each line is, in effect, a different chance of winning. The current price per line of the three games is: Littlewoods 1.667p, Vernons 0.455p, Zetters 0.125p.

<sup>32</sup>Source: GfK survey.

<sup>33</sup>Source: GfK survey.

<sup>34</sup>Source: GfK survey.

### *Documentary evidence*

- 5.25 Minutes of an August 2006 Sportech board meeting note that: [REDACTED].
- 5.26 Apart from this, Vernons is not mentioned as a competitive threat in the internal documents submitted to us by Sportech, except that in its August 2006 strategy document, one of the threats listed is that '[REDACTED]'.<sup>35</sup>
- 5.27 Vernons, in its internal Marketing Plan for 2007, lists [REDACTED] planned promotions for the year, [REDACTED] of which are based on a 'Littlewoods price comparison'. In the plan, Vernons appears to see some scope for improving its customer retention at the expense of Littlewoods, noting that: [REDACTED].
- 5.28 Vernons' 2007 Budget and Marketing Plan views soft gambling as a market segment comprising pools, lotteries and bingo and dominated by the National Lottery (although its Marketing Plans in 2005 and 2006 both refer to a 'football pools market'). [REDACTED] Vernons commented that in both its 2005 and 2006 Marketing Plans, which ran to 34 and 45 pages respectively, the word 'Littlewoods' appeared twice, and that neither of these references was to Vernons targeting Littlewoods customers.
- 5.29 We have seen a substantial number of internal documents from the parties, with few references to each other's activities. In our view, the above documentary evidence suggests that Littlewoods may be seen as a benchmark by Vernons. However, the evidence is not sufficient, in itself, to imply that the two necessarily view one another as close competitors.

### *Marketing activity*

- 5.30 We considered whether Vernons' marketing activities were evidence of competition between the parties. Vernons regularly claims in its marketing literature to be better value for money than Littlewoods, eg offering as many chances to hit the top jackpot as Littlewoods but at only one-third of the cost. (The marketing literature does not point out that the top jackpot from Littlewoods is typically much larger than that from Vernons, or that both pay out around [20-25] per cent of stakes in prizes and, in that respect, offer similar value for money.)
- 5.31 In 2006, Vernons undertook three large mailshots, in addition to ongoing promotions. Its June promotion was sent to [REDACTED] people, at least half of whom were current or former Littlewoods or Zettors customers (ie people who had indicated in an omnibus survey that they had played the football pools, but who did not appear on Vernons' customer records). Vernons won [REDACTED] customers in this way. Even if we assume that all of these were ongoing Littlewoods customers who responded to the mailing by switching to Vernons, this would account for only [REDACTED] per cent of Littlewoods' weekly customers and [REDACTED] per cent of Vernons' weekly customers. Vernons' other mailshots were not targeted directly at Littlewoods customers.
- 5.32 Littlewoods does not appear to direct any of its marketing efforts against Vernons—either by referring to Vernons in its marketing messages, or directing mailshots to Vernons customers. This asymmetry may be due to the fact that Vernons has a somewhat smaller, and lower-spending, customer base than Littlewoods. Ladbrokes told us that Vernons' strategy of targeting Littlewoods customers had not been successful. However, we noted that Vernons went ahead with its June 2007 campaign, which had a similar message and mailing list (ie including past/current

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<sup>35</sup>[REDACTED]

Littlewoods players) as that in the year before. Ladbrokes said that [X]. Ladbrokes told us that [X].

- 5.33 In response to our provisional findings report, three third parties commented in detail about the effects of Vernons' marketing activity. We consider these comments in Section 8 of this report.

#### *Survey evidence*

- 5.34 Prior to August 2007, neither company had undertaken an entry price increase since 1999, when Littlewoods raised its prices. We expect that the full effect of Sportech's current price increase will not be felt immediately.<sup>36</sup> Where such limited information is available to assess the likely impact of a SSNIP by either or both parties directly, customer surveys are a potentially useful way of assessing how customers might respond to price increases. However, questions of this kind have the drawback that what customers say they would do in particular circumstances may not always be an accurate guide to their behaviour, and as such they may be less reliable than questions about actual current or past behaviour.

- 5.35 In this case, given the size and nature of the Littlewoods and Vernons customer bases, a survey based on a representative sample was the only practical means of obtaining reliable information on how customers behaved and how they were likely to respond to a range of stimuli, including price increases. We consider four surveys:

(a) a 2006 survey by Swift Research of 250 lapsed Littlewoods customers, commissioned by Sportech (Swift 1);

(b) a survey, also by Swift Research, of 500 football pools customers, commissioned by Sportech in the course of our inquiry (Swift 2). Swift surveyed a disproportionately large number of customers in smaller subgroups, such as Zettors customers and online players, so that robust conclusions could be drawn about customers in these groups. Around half of the responses were from these subgroups. These responses were given a very low weighting in Swift's report, in order to ensure that results were representative of the general population of pools players. As a consequence, statements about the overall population from this survey are effectively based on around 250 responses;

(c) a survey of around 1,100 pools players, conducted for the CC by GfK; and

(d) a survey of around 300 lapsed pools players, conducted for the CC by ORC.

- 5.36 Swift 1 shows that, of 250 former Littlewoods players who had lapsed in the previous two years, eight had switched to, or increased their spending on, Vernons pools when they stopped playing Littlewoods—accounting for 3 per cent of the sample.<sup>37</sup> Respondents to Swift 2 (current pools players) were asked how they would react to their provider increasing the cost of playing by 10 per cent.<sup>38</sup> Around 25 per cent said that they would change their behaviour. Of these, 5 per cent (around 1 per cent of all customers) said that they would switch to another pools company. The survey also asked how customers would respond to changes in the payout ratio and the prize

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<sup>36</sup>One reason for this is that 74 per cent of football pools customers pay in advance (source: GfK survey).

<sup>37</sup>The fact that switchers are a small proportion of lapsed customers reflects the general decline in pools players: customers who stop playing with Littlewoods because they have lost interest in the pools are unlikely to switch to Vernons. However, this does not necessarily imply that customers who would stop playing with Littlewoods because of a price increase would not switch to Vernons.

<sup>38</sup>This was based on current prices, rather than those that would apply after Sportech's price increase, in order to avoid confusing respondents.

fund, but given the extremely low awareness of these factors (see paragraph 4.10), we focus primarily on questions from this survey regarding entry prices.

- 5.37 GfK asked customers what they would do if their main operator no longer provided a pools product. This scenario effectively assumes an infinite price increase. It was not included because of an expectation that such an event would occur in reality. Rather, its purpose was to elicit information about the relative attractiveness of alternative choices, from as broad a range of customers as possible. A potential drawback of this approach is that the ranking of substitute products, while it may represent the preferences of customers as a whole, may not accurately represent the preferences of marginal customers—ie those who would be more likely to switch in response to a price increase. Price-insensitive customers (those less likely to respond to a price increase) may on average be more avid players of the pools than price-sensitive customers, and therefore more likely to start playing with another pools provider if they had to stop playing with their current provider.<sup>39</sup> If so, results based on a scenario which ‘forces’ these price-insensitive customers to either switch or stop playing the pools might overstate the extent of switching that would occur in response to a price change (where price-insensitive customers have the additional option of accepting the price change and staying with their current provider).
- 5.38 One in four respondents to the GfK survey said that they would move to another pools operator if their current provider ceased providing service. There was some asymmetry in this: 36 per cent of Vernons customers said that they would use another pools operator whereas only 19 per cent of Littlewoods customers would do so. Respondents to Swift 2 were also asked how they would react if their current provider stopped running the pools: one in three said that they would play the pools with another provider. These results suggest a much higher diversion towards pools than that suggested by Swift 2’s results relating to price increases, and this difference may indeed be because most customers who would switch to another pools operator if their current one stopped providing would not change their behaviour in response to a price increase.
- 5.39 GfK also presented customers with a range of alternative pools offers at different prices (based on current price levels), and asked them to choose between providers. The results indicate that:
- (a) if Littlewoods increased its price by 5 per cent, 7 per cent of its customers would switch to Vernons (similar results were registered for customers who do and do not have their coupons collected); and
  - (b) a 5 per cent increase in prices by Vernons would meet with very little response from its customers—only 2 per cent would stop playing and none would switch to Littlewoods (2 per cent would switch to Littlewoods in response to a 10 per cent price increase by Vernons). In addition, 2 per cent more respondents would play with Vernons than do so at the current price.
- 5.40 ORC surveyed around 300 Littlewoods and Vernons customers who had played the football pools in 2006 but had not done so in the first five months of 2007. In fact, just under two-thirds of respondents confirmed that they had stopped playing or played the pools less often during the past 12 months. Around one-third (37 per cent) gave reasons relating to the product, eg not winning often enough, the poor chance of winning, the size of the prizes, loss of interest. One in four (24 per cent) stopped

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<sup>39</sup>The GfK survey provides some support for this view: respondents who gave price-related reasons for playing with their current provider tended to be less likely to say that they played the pools—as opposed to other gambling products—out of tradition, or because they had always done so.

playing for reasons such as a change in financial or personal circumstances. Only 2 per cent who had stopped playing with one pools operator in the past 12 months had started playing or played more often with another over the period, while 17 per cent who had done so had started playing the National Lottery or played it more often. In response to a separate question, 7 per cent of respondents said that they had stopped playing with their previous football pools provider because of a switch to another (pools or non-pools) gaming activity. This suggests that in some cases an increase in playing one type of game may have happened within 12 months of a decrease in playing of another (notably the pools) without any causal link between the two.

- 5.41 Many of the surveys' findings were intuitive. However, they also contain some puzzling results—notably GfK found that more people would play with Vernons if it increased price (and 7 per cent of Littlewoods customers would apparently stop playing with Littlewoods if Littlewoods *reduced* prices by 5 per cent). GfK also found, in contrast to the other surveys, that more customers would switch to another pools operator than would stop playing pools in response to a price increase. This may have been the result of the use of showcards as part of the survey: customers were allowed to say that they would not play at all rather than choosing between pricing offers, but they might have felt that to make this choice was to 'opt out' of the exercise. Ladbrokes commented that the approach used had the effect of forcing the consumer to make decisions in a way which did not reflect how such decisions were made in reality. Third Party C argued that our use of results from the GfK survey was selective. Our view is that the GfK survey provided reliable evidence as to the past and current behaviour of pools players. However, we consider that responses to the showcard-based scenarios used in the survey must necessarily be treated with more caution than responses to factual questions. In the light of the inconsistencies described above, and the methodological problems noted by Ladbrokes, we consider that we are unable to rely on responses to the questions regarding relative price change in the GfK survey. Swift 2 found that 13 per cent would change their behaviour in response to a 10 per cent reduction in the jackpot, and that 14 per cent would do so in response to such a reduction in the payout ratio, despite evidence from GfK (see paragraph 4.10) that players have practically no knowledge of either jackpots or payout ratios. Third Party C said that 'whether the customers used by Sportech for the surveys were known "hard core" loyalists or randomly selected does not seem to have been investigated'. However, Sportech's evidence describes the selection methodology used for the survey, which was essentially random except that some customers (those without phone numbers, aged over 75, or who had asked not to be called) were excluded. We saw no reasons why these exclusions would bias the results.
- 5.42 Responses to customer switching questions in the four surveys are set out in Table 1. Taken together, the results suggest only a modest degree of switching between Littlewoods and Vernons:
- (a) one in three or four would consider switching to an alternative pools operator if their current provider stopped operating football pools;
  - (b) 6.5 per cent said that they preferred an alternative provider's offer when their current provider's prices were 10 per cent higher;
  - (c) when asked directly (by Swift 2) how they would respond to a 10 per cent price increase, only 1 per cent said that they would switch to another pools provider; and

(d) in practice only 3.5 per cent of customers who had stopped using Littlewoods said that they had switched to Vernons or Zettors.

5.43 The surveys have somewhat different implications as to the proportion of customers who have switched, or would switch, to other gambling products as opposed to spending less on gambling. Swift 1 found that 31 per cent had increased spending on other gambling when they stopped playing the pools, but ORC results suggest that few customers actually reduce spending on one gambling product *in order to* spend more on another. The results are broadly consistent with Swift 2 when expressed as a proportion of those who would respond to a price increase: 4.4 per cent of all customers told Swift 2 that they would switch to non-pools gambling, equivalent to around 17 per cent of those who would respond to a price increase, while the result from Swift 2 that four in five of those who responded to a price increase (21.1 per cent out of 25 per cent) would save the money, bet less each week or play less frequently is broadly consistent with the ORC result. The GfK results are not consistent with these findings—in particular, we note that only 1.5 per cent of customers chose the alternative of not playing, when presented with showcards. In the light of the other evidence this number seems implausibly low.

TABLE 1 Summary of survey results

Survey	Swift 1	ORC	Swift 2		GfK	
Year	2006	2007	2007		2007	
Respondents	Lapsed Littlewoods players	Lapsed pools players	Current pools players		Current pools players	
Number interviewed	250	300	250*		1,100	
Stimulus	None	None	10% price increase	Current operator closed down	10% price increase	Current operator closed down
Would not play with, or would spend less with current provider (%)	-	-	26		7.5	-
Switched, or would switch to alternative pools provider (%)	3.5	2†	1	36	6.5	24
Switched, or would switch to other (non-pools) gambling (%)	31	5‡	4.4	15	1.5§	11
Spent, or would spend the money on non-gambling products (%)	65	76	19	49		55

Source: Swift, GfK and ORC surveys.

\*As discussed in paragraph 5.35, around 500 were interviewed, but low weights were applied to around half of these, such that they had very little effect on the results.

†The number who stopped/reduced playing one pools game and increased/started another.

‡Calculated as 7 per cent who had switched to another gambling product, minus 2 per cent who had started the pools.

§Would not purchase current or alternative provider options. This result is based on customers comparing showcards with different price offers: when the price offered by their current provider was 10 per cent above current levels, an additional 1.5 per cent said that they would not play the pools.

### Event studies

5.44 We considered three events which could potentially have caused customers to switch between Littlewoods and Vernons:

- (a) Vernons' closure of its collector network in 1998;
- (b) Littlewoods' price increase in 1999; and
- (c) Vernons' introduction of a 'buy-one-get-one-free' offer in 2003.

- *Vernons' closure of its collector network*

5.45 This event caused Vernons to lose around £[redacted] in stakes per week. There is nothing in the data we have seen to suggest that the closure of the Vernons network led to increased demand for Littlewoods' collector services. However, this result is inconclusive because:

- (a) At the time of the closure, Littlewoods' collector network generated stakes of around £3.2 million a week, so even if it had won all of the lapsed Vernons customers, this would only have increased its collected stakes by around 4 per cent.
- (b) There is a great deal of variation in the data over this period, as Littlewoods continued to lose customers at a rate of around 25 to 30 per cent a year following the introduction of the National Lottery.
- (c) Collector business is based to some extent on the personal acquaintance between the collector and customer, and as such may offer less scope for substitution than other ways of playing.
- (d) Ex-Vernons customers would only have been able to switch to a Littlewoods collector if there was one operating in the same area.

- *Littlewoods' price increase*

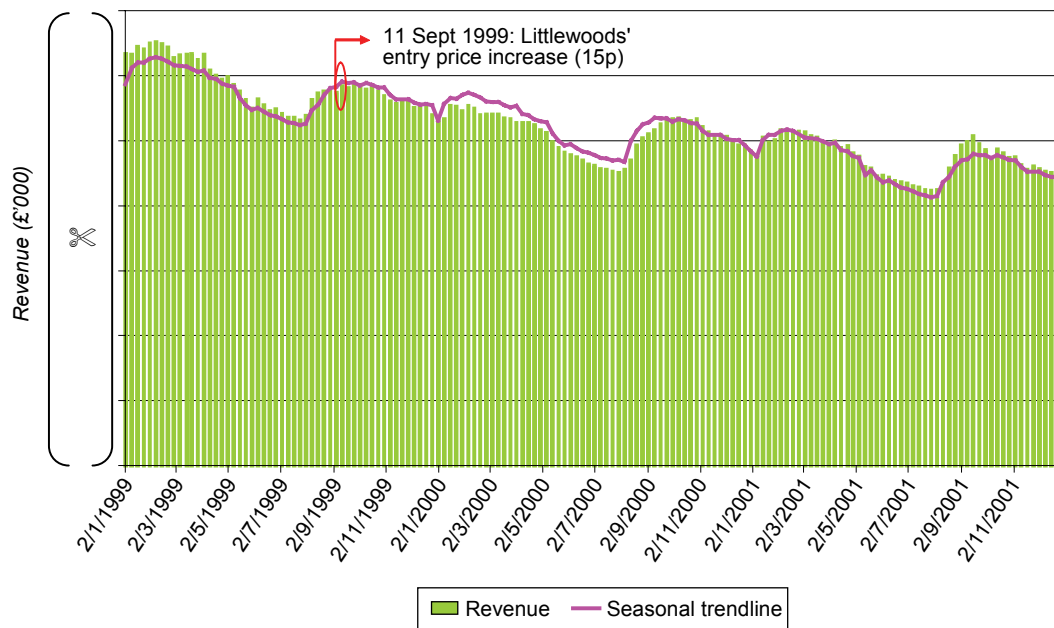
5.46 In September 1999, Littlewoods raised its entry prices by 15p on all bets—equivalent to a 25 per cent price increase on its most popular 8-from-10 bet.<sup>40</sup> In the 12 weeks prior to the price rise, Littlewoods' sales were down to an average of 76 per cent on the same period the previous year. If this trend had continued (ie absent the price rise), Littlewoods could have expected sales of around £35 million in the 12 weeks *after* the price rise. Instead, it had sales of around £37.5 million: an uplift of around 8 per cent. Had Littlewoods customers continued placing the same bets as before (at the higher prices), Littlewoods would have had sales of around £44 million (an additional £6 million over 12 weeks, or £500,000 a week), suggesting that a substantial number of customers either spent less or stopped playing with Littlewoods. Around this time, Vernons' revenues were around £[redacted] to £[redacted] a week, so if even a fraction of Littlewoods 'lost' revenue of £500,000 a week had been diverted to Vernons, we would expect to see a substantial uplift in Vernons' revenue. However, the data indicates that no such uplift occurred (see Figure 2). Figure 3 provides further evidence that the number of Vernons' new recruits did not increase in 1999 or in subsequent years. With regard to Figure 3, Vernons told us that the figures from 1996 to 1999 included a number of collector customers who transferred to postal and telephone distribution as a result of the closure of the Vernons collector network. Vernons' collector customers were generating around £[redacted] per week in gross stakes when the network was closed. At an average stake of around £[redacted], this suggests that Vernons had around [redacted] collector customers at the time. Vernons estimates that around [redacted] per cent of these customers (ie around [redacted] customers) were successfully transferred to direct channels. We note that (on the basis of the data behind Figure 3) Vernons had around [redacted] new recruits from 1996 to 1999, and [redacted] new recruits from 2000 to 2003—a difference of [redacted]. As such, even if all [redacted] ex-collector customers were recorded as new recruits, Vernons still had substantially more genuinely new recruits in the four years up to 1999 (when Littlewoods increased its prices) than in the following four years. Again, this is an indication that the price increase did not cause Littlewoods customers to switch to Vernons.

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<sup>40</sup>But only 7 per cent on an 8-from-11 bet, and 2 per cent on an 8-from-12.

FIGURE 2

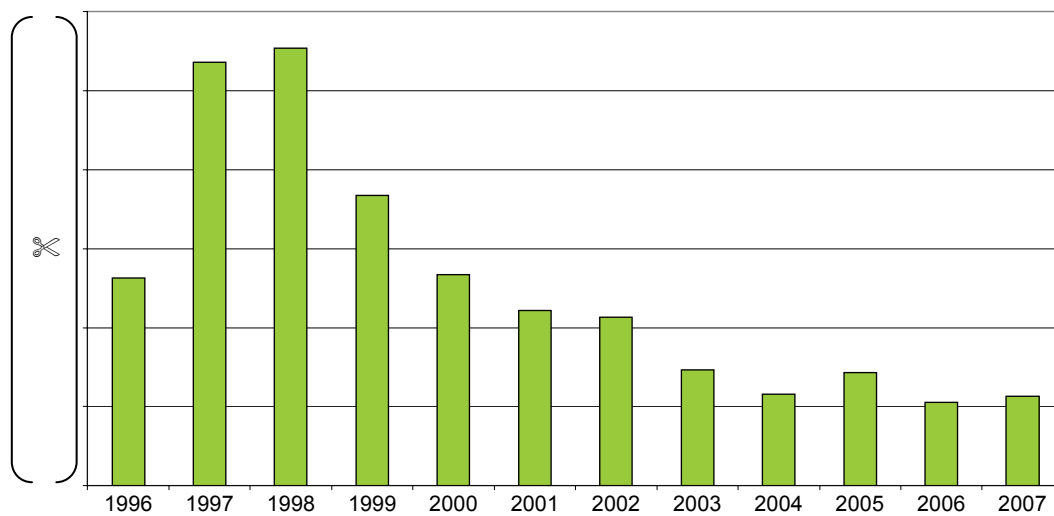
**Vernon's revenues, 1999 to 2001**



Source: Ladbrokes.

FIGURE 3

**Vernon's new recruits, 1996 to 2007**



Source: Ladbrokes.

5.47 Again, the result should be treated with some caution: the event occurred almost eight years ago; it is possible that customers then were less 'committed' to the football pools than those who are still playing now. Nevertheless, the event appears to provide evidence that Littlewoods customers do not see Vernons as a substitute. (It is possible that Vernons customers see Littlewoods as a substitute, on which this event provides no information.)

- Vernons' 'buy-one-get-one-free' offer

- 5.48 In January 2003, Vernons customers were offered a free game each time an entry was purchased. This appears not to have had a discernible impact on Vernons' sales at the time, but on the resumption of the football season in August 2003, Vernons appeared to halt the decline in its sales for a period. Overall, Vernons' revenues over the 2003/04 season were down less than [%] per cent on the year before,<sup>41</sup> whereas in 2002/03 they had been down more than [%] per cent on the year before.
- 5.49 As such, the effect, if any, of the Vernons offer was to slow the decline of its customer attrition, [%].<sup>42</sup> Whether it achieved this by attracting new customers or retaining existing ones is unclear, but the latter appears more probable given relatively low rates of customer acquisition. In either case, it is not evident that this had any impact on Littlewoods: its revenues were down by 15 per cent on the previous year during the 2002/03 football season, but by only 13 per cent during the 2003/04 season (ie after Vernons introduced its offer). If all the uplift of £[%] which Vernons may have achieved had been at the expense of Littlewoods, the latter's revenues would have been around 2 per cent lower over the 2003/04 season.
- 5.50 Weekly time series data on amounts staked is volatile, and it is difficult to observe whether any uplift Vernons experienced in 2003 was due to the introduction of the 'buy-one-get-one-free' offer and, if so, whether this was at Littlewoods' expense. In addition, given Vernons' size relative to Littlewoods, one would expect the impact of the offer on Littlewoods to be, at most, limited. However, our analysis of this event has provided no evidence of competition between the parties.

#### *Customer overlaps*

- 5.51 GfK found that 11 per cent of pools players played with both Littlewoods and Vernons while a further 1 per cent played with both and also with Zetters. The parties expressed surprise that a significant number of customers were dual-sourcing.<sup>43</sup> We note that a customer who has played with both parties could potentially be more willing to switch some or all of his/her spending between them. On the other hand, it could suggest that some customers do not see the different pools games as close substitutes (because if they did, they could perhaps more conveniently put all their stakes into one game).
- 5.52 We analysed customer databases and identified customers who appeared to be customers of both parties. We found that between 4 and 8 per cent of football pools players had both (a) played with each of Littlewoods and Vernons in the past 18 months, and (b) changed their weekly spending with at least one of the two at some point over the period. We identified the most usual or 'modal' weekly stake of each of these players on each pools game, and looked at whether they had, at any time over the period studied, spent more or less than their usual stake with either party. Only one in five had both spent more than usual with one provider at any time, and spent less than usual with the other, at any time over the 18 months. This implies that at most 1 per cent of customers switched spending from one provider to the other over the period.
- 5.53 Again it should be noted that no entry-price changes took place over the period in question. As such, we cannot immediately conclude from the analysis that only a small number would switch in response to such a price change. However, we also

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<sup>41</sup>After adjusting for the fact that the 2003/04 season was one week longer than the 2002/03 season.

<sup>42</sup>Based on projecting the 2002/03 revenue decline to 2003/04 and comparing with the actual.

<sup>43</sup>But see paragraph 5.27.

looked at whether dual-sourcing customers had responded to marketing activities over the period. We identified no such response. This is consistent with our understanding that Vernons' marketing activity had relatively little success in winning current Littlewoods customers, whatever its success in retaining or reactivating its own customers, and recruiting lapsed or 'new to pools' customers (this point is discussed in more detail in Section 8).

*Elasticity and critical loss analysis*

5.54 Finally in this section, we bring together the different sources of evidence as to the price elasticity of football pools players. In particular, we consider:

(a) how customers would respond to an increase in entry price, or a decrease in the jackpot and/or payout ratio; and

(b) whether such an increase by Littlewoods, absent the merger, would lead to customer switching to Vernons (or vice versa).

5.55 The following analysis is based on the customer survey data and events discussed above; as such, it is subject to the same caveats as the underlying evidence.

- *Entry price*

5.56 Swift 2 found that just over 20 per cent of Littlewoods customers would respond to a 10 per cent increase in the entry price, suggesting a price elasticity of around  $-2$ . The GfK survey indicates that Littlewoods would lose 8 per cent of revenue in response to a 10 per cent price increase, suggesting an elasticity of  $-1.8$ .<sup>44,45</sup> However, when Littlewoods raised its prices by up to 25 per cent in 1999, revenues rose by 7 per cent, implying a much lower elasticity of  $-0.7$ . Similarly, Sportech expects to lose around [ ] per cent of its customers following its August 2007 price increase (see paragraph 5.6), suggesting a price elasticity of close [ $> -1.0$ ].<sup>46</sup> Results are summarized in Table 2.

TABLE 2 Summary of elasticity evidence

	<i>Evidence</i>	<i>Implied elasticity</i>
Swift 2	10% deterioration	$-1.94$ to $-0.84$
GfK survey	5% entry price increase	$-3.60$ to $-2.20$
	10% entry price increase	$-1.80$ to $-1.20$
1999 price increase	Maximum 25%	$-0.72$
2007 price increase	Average 25%	[ $> -1.0$ ]

Source: Swift, GfK, Sportech.

5.57 We questioned why Sportech would increase prices by 25 per cent if it believed the results of the Swift survey, which indicated that even a somewhat smaller price increase (10 per cent) would lead one in five customers to stop buying its product.<sup>47</sup> Sportech told us that the expected response to its proposed price increase was a

<sup>44</sup>Comparing the Swift 2 and GfK results suggests that for a similar elasticity (around  $-2$ ), a 10 per cent price increase can in principle lead to a 20 per cent loss of customers but only an 8 per cent loss of revenues. The revenue loss is a smaller percentage than the customer loss because those customers who do not switch are paying a higher price.

<sup>45</sup>GfK also measured the effect of a 5 per cent price increase: we cite the response to a 10 per cent price increase here for ease of comparison.

<sup>46</sup>We note that [ ].

<sup>47</sup>26 per cent said that they would react to an increase in the cost of playing, split between 8 per cent (of all customers) who would play less and 18 per cent who would stop playing that pools game (based on Littlewoods customers).

short-term effect and that it anticipated an increase in customer numbers as the product became more attractive. Sportech's internal documents show that it expects customer numbers to [redacted]. We note that this prediction depends on Sportech's assumption that customers will be aware of the larger pool and will change their behaviour in response to it (see paragraph 5.58). We also note that at least some of the subsequent customer growth which Sportech expects may be attributable to its planned improvements in infrastructure and distribution, and [redacted].

5.58 Sportech also argued that its entry-price increase was not a worsening of terms and therefore was not equivalent to a formal SSNIP test. This point is discussed in paragraphs 5.9 to 5.17. In contrast, Sportech argued that the hypothetical entry-price increase set out in the Swift 2 survey represented a genuine worsening of terms. Respondents to the Swift 2 survey were not presented with the prospect of an increased jackpot accompanying the price increase, and Sportech's argument suggests that, if they had been, their response to the price increase would not have been as negative. This view appears to be based on an assumption that pools players are unaware of the link between the amount staked and the prize fund, but that if they were made aware of such a link this would change their response to a price increase. Sportech commented that whether the price increase was a worsening of terms was an empirical question which depended on the value that customers placed on the chance to win the higher jackpot that resulted from the price increase. We note that Swift 2 found that 94 per cent of customers said that they would not change their behaviour at all if the jackpot increased (following an increase in the number of customers).

5.59 In our view, the own-price elasticities of demand of around  $-2$  implied by Swift 2 and GfK are not consistent with past experience<sup>48</sup> or with Sportech's decision to increase prices. They also have the drawback that they are based on questions which were asked prior to Sportech's increase in entry prices in August 2007: following that event, Sportech's remaining customers may be more, or less, responsive to further price increases, or, if surveyed again, they might answer differently from having recently experienced a price increase.<sup>49</sup> We consider that survey respondents may have exaggerated the likelihood that they would react to a price increase, and true elasticities are likely to be somewhat lower. We also note that the customer reaction may depend on how Sportech manages the price increase. The minutes of its Price Board from May 2007 state that 'to cushion the impact of the price change' [redacted]. While this means the customer will have to renew more often, future campaigns will incentivize the customer to renew for longer.

- *Diversion*

5.60 Swift 2 found that, of customers lost as a result of a proposed entry-price increase by Littlewoods, around 5 per cent, or 1 per cent of all customers, would switch to Vernons. As described in paragraph 5.42, such a low rate of switching is broadly consistent with findings from Swift 1 and ORC which found, respectively, that 3.5 per cent and 2 per cent of lapsed customers had started using another pools provider (though these numbers are based on the behaviour of lapsed customers, who were not responding to a price increase).

5.61 Sportech provided us with some analysis of this result, and its implications for the ability of the merged group to raise prices. In light of concerns about the reliability of

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<sup>48</sup>We have seen no evidence that customers have become more price-elastic since the 1999 price increase.

<sup>49</sup>Responses might also have differed had customers been asked to consider increases on a notional competitive price (see paragraph 5.4), although this would have involved asking them to compare two hypothetical prices.

the elasticity estimates from Swift 2, we carried out our own analysis, using a technique that depends on the diversion rate rather than the overall elasticity.<sup>50</sup> The implication of our analysis<sup>51</sup> was that, on the basis that 1 per cent of Littlewoods customers would switch to Vernons if prices increased by 10 per cent (ie the Swift 2 result), the acquisition of Vernons would not make an increase in entry prices profitable.

5.62 We note also that this analysis suggests that Sportech may be able profitably to raise prices in future. However, we considered that the weight of evidence from this particular analysis did not support the view that the acquisition would have a material impact on the profitability of such a price increase.

5.63 We note that a company which is maximizing short-run profits would normally be expected to price at a level at which its own-price elasticity was greater than  $-1$  (ie such that an increase in price would lead to a proportionately greater reduction in demand). If this were not the case, the company should be able profitably to increase prices. If we were to take the view that the parties were pricing below the profit-maximizing level, we might consider that a notional profit-maximizing price (see paragraphs 5.4 and 5.5) would be a more appropriate benchmark for applying the SSNIP test. The reason for this is that if prices are 'too low' (in that companies are not pricing up to the point at which they would be constrained by their nearest competitor), then an increase in the current price might lead to less switching than would an increase in the competitive price.<sup>52</sup> In practical terms, a possible concern is that low levels of customer switching (in 1999 or expected in 2007), or stated willingness to switch (in survey responses), might be a result of the parties pricing below the profit-maximizing level. In other words, if they were pricing at a higher level (as indeed Sportech is following its August 2007 price increase (see paragraph 5.6)), customers could potentially express a greater willingness to switch between them in response to (further) price increases. In practice, however, we note that:

(a) If this were the case, it is likely that customers would also have a greater willingness to switch to other non-pools and non-gambling products.

(b) We have no information as to what the rate of switching would be in such a case.

5.64 We are unable, on the basis of the evidence available to us, to form an expectation as to what price levels would be profit-maximizing for the parties, nor as to what level of switching, or willingness to switch, between the parties would prevail at such price levels. In particular, we do not consider that the evidence supports an expectation that the level of cross-switching between the parties would be higher than at present.

5.65 Turning to responses to a change in the jackpot and/or payout ratio, Swift 2 found that, of the customers who said that they would stop playing in response to a reduction in the jackpot, 15 per cent would switch to Vernons, while 25 per cent of customers who said that they would respond to a reduction in the payout ratio would switch to Vernons. Our analysis suggests that, on this basis, a merged group may be able profitably to reduce the jackpot and/or the payout ratio. However, we consider that the diversion to Vernons implied by Swift 2, in response to a change in the jackpot or payout ratio, is less reliable than that implied in response to a change in the price, because customers do not know the level of jackpots or payout ratios (see paragraph 4.10), so claims that they would respond in a specific way if they were

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<sup>50</sup>See Appendix F.

<sup>51</sup>Sportech's analysis produced similar results.

<sup>52</sup>This effect is known as the 'Reverse Cellophane Fallacy' (see Froeb, L and G Werden (1992) 'The Reverse Cellophane Fallacy in Market Delineation', *Review of Industrial Organisation*, 7:2, 241–274).

changed are also less reliable. In view of this, we do not consider that the results demonstrate that the acquisition would have a material impact on the profitability of a reduction in the jackpot or payout ratio for Sportech.

### *Summary*

- 5.66 Football pools operators have similar product characteristics to one another, and it appears that their pools games continue to evolve in tandem with each other. The two also have similar customer demographics, which contrast with those of the population at large. To a limited extent, documents internal to the parties that we have seen contain some suggestions that the two have seen each other as competitors, as do Vernons' marketing activities to date (although Littlewoods does not seem to direct its marketing activities against Vernons). Survey evidence is mixed, but on balance suggests that a relatively small number of customers would switch to the other's pools offering in response to an increase in the entry price or a reduction in the jackpot or payout ratio. While the opportunity for event studies was limited, the lack of sales uplift for Vernons when Littlewoods increased its entry prices in 1999 suggests that customers do not see the two as close substitutes. Our own detailed analysis of customer lists supports the view that customer switching between the two is limited.

### ***Possible broader market***

- 5.67 Next we consider whether the pools operations of Sportech and Vernons may be part of a broader market or markets.

### *National Lottery*

- 5.68 The most prominent potential substitute for football pools is the National Lottery. The introduction of the National Lottery in 1994 had a major impact on the pools, which have continued to decline since that date and now have revenues of around 10 per cent of 1994 levels. Like the pools, the National Lottery 'Lotto' game is a 'numbers' game, played weekly, with low stakes, long odds and large jackpots.<sup>53</sup>
- 5.69 There is a large overlap between players of the pools and the National Lottery. While this reflects the mass popularity of the Lottery, which is played by 70 per cent of the adult population, its popularity is even greater among pools players, 83 per cent of whom play the Lottery (see paragraph 4.8). However, as with football pools (see paragraph 5.51), the fact that two products are bought by some of the same customers need not imply that they are substitutes. Indeed, the fact that, despite having adopted the Lottery, the parties' customers continue also to play the pools could be interpreted as evidence that they do not regard the two as substitutes.
- 5.70 The National Lottery is discussed in various internal documents of Sportech and Ladbrokes. Sportech's [redacted] lists 'the lottery and "[redacted]" as a threat, while Ladbrokes sees the soft gambling market segment as being dominated by the National Lottery. The documents express concern about future actions by Camelot, perhaps unsurprisingly given the scale of the Lottery business and its historical impact on football pools. In addition, Vernons' marketing literature appears to give broadly similar prominence to comparisons with Littlewoods and the Lottery.

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<sup>53</sup>There is, of course, a very large difference in the size of the jackpot available to National Lottery as opposed to pools winners.

- 5.71 Among respondents to the GfK survey, only 11 per cent said that they would switch to a non-pools gambling product if their main operator no longer provided the pools (of these, 82 per cent, or 9 per cent of all respondents, said that they would switch to the National Lottery). Swift 1 (see paragraph 5.35(a)) found that over 30 per cent of lapsed customers had in fact switched to other gambling products, and most of these (around 25 per cent of all respondents) had switched their spending to the National Lottery, while Swift 2 found that 3 per cent of customers would switch to the National Lottery in response to a 10 per cent price increase.
- 5.72 Sportech argued that, following the price rise for the 2007/08 season, it would be most constrained by the National Lottery. Having raised the price of its most popular bet to £1, it argued that this would be a psychological cut-off point, and that any increase above £1 would meet with a strong reaction from its customers, particularly as the National Lottery's most popular product is also £1. We did not see any evidence in support of this argument. We note in this context that many products have raised their prices to above £1 at one time or another, that Camelot currently offers a Lottery product (EuroMillions) priced at £1.50, and that the 'barrier' may be weaker for the majority of customers who pay in advance (and therefore do not pay £1 at a time), or who play more lines for a higher price. Finally, we note that an inability to raise prices above £1 would not prevent Sportech from reducing its payout ratio.
- 5.73 A number of other points suggest that the Lottery in particular may not be a competitive constraint on football pools:
- (a) Although the parties lost substantial revenues following the introduction of the National Lottery, they did not respond by attempting to improve the competitiveness of their product, for example by increasing the payout ratio to ensure higher jackpots. (Vernons introduced a soccer-based lottery product called 'Easy Play' in 1998, which was sold through the National Lottery retail network. The product was not a success, and was withdrawn the following year. In addition, both parties added a £2 million prize draw to their pools products: see paragraph 4.4.)
  - (b) Tax cuts enjoyed by pools providers around the time the Lottery was introduced were not passed on to pools players.<sup>54</sup>
  - (c) National Lottery rollovers do not appear to reduce demand for the pools.
  - (d) An internal Sportech document (see paragraph 5.77) points to the possibility of future price increases for the football pools.

### *Non-gambling products*

- 5.74 Both the GfK and Swift 1 surveys indicate that, if they stop playing with their current pools provider, more than half of customers are unlikely to spend the money on any other gambling products: 55 per cent told GfK that they would save the money, or spend it on non-gambling activities if their current operator stopped providing a pools game; 65 per cent of lapsed customers told Swift that they had either increased savings (55 per cent<sup>55</sup>) or spent the money on non-pools products (10 per cent).

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<sup>54</sup>Sportech argued that one would only expect these tax cuts to be passed on to customers if the relevant market were football pools. Vernons told us that it increased its payout ratio following the tax cuts, although we note that it has subsequently reduced it again.

<sup>55</sup>As Sportech noted, this result should not be taken too literally: most likely, respondents did not name the alternative use to which they put this money.

- 5.75 The extent to which customers would reduce their spend on the pools in response to a price rise is unclear for a number of reasons:
- (a) Force of habit or customer inertia is strong among pools players: more than 85 per cent of customers have been playing the pools for ten years or more, 70 per cent for 20 years or more (see paragraph 4.8).
  - (b) Customers may be very reluctant to stop playing the pools in case their numbers come up: 69 per cent always use the same numbers; a player who always plays, say, 11 numbers with Littlewoods could play the same 11 numbers with Vernons (or vice versa, albeit that playing the same numbers with Littlewoods is more than twice as expensive)—they could not play the same 11 numbers with the National Lottery which allows players to select only six numbers.
  - (c) Three in four customers pay in advance, and this may also aid customer retention.
  - (d) Four in ten customers have a positive preference (other than tradition or habit) for playing the pools rather than other forms of gambling.<sup>56</sup>
- 5.76 When Littlewoods raised its entry prices in 1999, there was clearly a customer response (ie its revenues did not rise by 25 per cent, the increase applying to its most popular 8-from-10 bet) indicating that at least some customers stopped playing, or switched to cheaper bets (eg an 8-from-10 rather than an 8-from-11). However, Littlewoods found it profitable to sustain a substantial price increase at that time—the increase in revenues was about 8 per cent—suggesting that it was not constrained by Vernons or non-pools gambling products at the time of the price rise.
- 5.77 Sportech prepared a ten-year financial model in the run-up to the August 2006 board presentation which included assumptions that Littlewoods and Zettors prices would be [X] increased—by 25 per cent in [X]. Therefore on balance we consider that this document has some weight as an indicator that further price increases might occur (see Appendix E).
- 5.78 Our view based on all the evidence provided and gathered is that Sportech itself cannot be certain what the impact of the recent price increase will be, and that when it has had time to assess the response to the price increase, it is possible that it may decide that it is not at the profit-maximizing price, and raise prices further (or, indeed, reduce them).
- 5.79 In the context of applying the SSNIP test (see paragraph 5.2), Sportech argued that:
- (a) If a price rise of 5 per cent applied to all football pools providers were found to be unprofitable, because a sufficient number of consumers would switch away to other uses or simply stop spending, then the relevant market should be found to be wider than football pools, even if the underlying customer survey evidence does not point to readily identifiable alternatives.<sup>57</sup>
  - (b) Those customers who would simply stop spending in the face of such a price increase, but who do not identify any immediate alternatives, should not simply be ignored—the loss of these customers would nevertheless act as a constraint

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<sup>56</sup>All statistics from GfK survey.

<sup>57</sup>While this reflects the logic of the SSNIP test, we note that it is common in economic analysis to identify markets for which the market demand is elastic, such that a small price increase across the market would lead customers to stop buying the product—ie that the market is ‘not worth monopolizing’.

on pricing, potentially rendering a SSNIP unprofitable, and was therefore relevant to the assessment of both market definition and the competitive effects of the merger.

- 5.80 Sportech recognized the practical difficulties which the evidence created in identifying the precise boundaries of the relevant market. Sportech argued that a pragmatic solution in light of the particular features of this case might be for the CC to view the market as either football pools or as Sportech and Vernons each being in markets of their own (provided that the CC recognized the constraints which existed outside the defined markets), even though such an outcome would be incompatible with the economic logic of the SSNIP test.
- 5.81 In our view, given the wide range of alternative spending or saving products to which football pools customers might switch in response to a price rise, a market definition which took account of all these alternatives would not be workable, even if we thought they were a constraint on pools prices.

### *Supply-side substitution*

- 5.82 Supply-side substitution refers to the extent to which an increase in the price will prompt other companies to start supplying at short notice services of a similar type and function, thus acting as a constraint.<sup>58</sup> We note that no such response occurred to Sportech's 1999 price increase. All the existing pools are 'heritage' products with strong cross-brand name recognition among pools players. The scope for entry is discussed in more detail in paragraphs 7.26 to 7.28, but we take the view that any entry would not be at sufficiently short notice to be considered as supply-side substitution.

### **Conclusion on product market definition**

- 5.83 Our analysis above indicates that there are strong similarities between the products supplied by pools operators and between their customer bases, some evidence of competitive interaction between the parties, and evidence that at least some customers are willing to switch between them. The lack of recent price changes<sup>59</sup> means that we are unable to observe the true extent to which customers would in fact switch between pools providers, although some survey evidence and event studies suggest that switching might be very limited in response to a price increase. Turning to the possibility of a broader market, we recognize the impact of the National Lottery on the football pools industry. However, we do not consider that the National Lottery or other gambling or non-gambling products are seen as close substitutes by the remaining set of football pools customers, most of whom have been playing the pools since before the introduction of the National Lottery 13 years ago.
- 5.84 Our guidelines<sup>60</sup> note that market definition is not regarded as an end in itself, but rather as a framework for analysing the effects of a merger on competition. The guidelines further note<sup>61</sup> that the CC should not devote disproportionate resources to determining exactly whether a particular competitive constraint results from within the market (and so should be included in the market definition) or from outside the market.<sup>62</sup> In the light of the above considerations, we conclude that the market is no

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<sup>58</sup>This supply-side substitution will usually come from companies with existing facilities producing similar products.

<sup>59</sup>The response to Sportech's August 2007 price change is not yet known—but see paragraph 8.12.

<sup>60</sup>*Merger References: Competition Commission Guidelines, CC2*, paragraph 2.1 et seq.

<sup>61</sup>*Ibid*, paragraph 2.6.

<sup>62</sup>*Ibid*, paragraph 2.6.

wider than football pools. The extent of competition between Littlewoods and Vernons is discussed in further detail below, in Section 7.

### **Geographic market**

- 5.85 Both parties agreed that the UK was the relevant geographic market. The parties' UK customers are spread throughout the UK. Littlewoods' collector network does not reach every address in the UK, but it is not concentrated in any specific areas. Littlewoods charges the same terms across all its distribution channels, and we have seen no evidence that it experiences varying degrees of competitive pressure across different locations. Vernons does not have a collector network. In our view, there is therefore no benefit to treating any specific areas in the UK as distinct geographic markets.
- 5.86 Around 5 per cent of players of UK pools are located outside the UK, mostly in Mauritius.<sup>63</sup> The Act requires us to determine whether the merger may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK.<sup>64</sup> We therefore do not further consider the parties' customers outside the UK. We conclude that the geographic scope of the relevant market is the UK.

### **Market shares and concentration**

- 5.87 The merger will effectively make the merged entity the sole large-scale UK supplier of football pools. Sportech currently accounts for approximately 74 per cent of football pool supply in the UK, based on revenue. As a result of the merger, its market share would be approximately 99 per cent. Brittens would account for less than 1 per cent of all football pools supply in the UK (see Table 3).

TABLE 3 Shares of football pools revenues, 2001 to 2006

	<i>Sportech</i>		<i>Vernons</i>	<i>Sportech +</i>	<i>Brittens</i>
	<i>Littlewoods</i>	<i>Zettlers</i>		<i>Vernons</i>	
2001	[80–90]	[0–10]	[10–20]	[90–100]	[0–5]
2002	[70–80]	[0–10]	[10–20]	[90–100]	[0–5]
2003	[70–80]	[0–10]	[10–20]	[90–100]	[0–5]
2004	[70–80]	[0–10]	[20–30]	[90–100]	[0–5]
2005	[70–80]	[0–10]	[20–30]	[90–100]	[0–5]
2006	[70]	[5]	[22]	[90–100]	[0–5]

Source: Sportech and Ladbrokes.

Note: Figures based on revenue. No revenue figures are available for Brittens for 2005 and 2006; we have assumed constant revenues since 2004.

- 5.88 Clearly, if the individual pools operators or games were each seen as distinct markets in themselves, each would have a 100 per cent share of its own market.
- 5.89 In terms of customer numbers, Vernons has increased its share from [15 to 20] per cent in 1999 to [30 to 35] per cent in 2006. Third Party C argued that this was evidence that Vernons was winning business from Sportech. Sportech told us that it reflected the fact that it had retained a collector network, and that the rate of decline of this side of the business was more rapid than direct entries. Vernons also made this point. Table 4 compares shares of customer numbers for Littlewoods collection and direct customers with those of Vernons (all direct). Much of the decline in

<sup>63</sup>The parties told us that this was as a result of local gaming laws and a strong local collector network.

<sup>64</sup>Section 36(1)(b).

Littlewoods' market share is indeed explained by the falling revenues from its collector network: the increase in Vernons' share of customers, from around one-fifth in 1999 to one-third in 2007, was almost matched by Littlewoods direct customers. Total customer numbers fell by around 70 per cent over the period.

TABLE 4 Shares of football pools customers, 1999 to 2006

	<i>Littlewoods collection %</i>	<i>Littlewoods Direct %</i>	<i>Zetters %</i>	<i>Vernons (Direct) %</i>	<i>Total customers (m)</i>
1999	[50–60]	[20–25]	5	[15–20]	[2.5–3.0]
2000	[50–60]	[20–25]	5	[20–25]	[2.0–2.5]
2001	[45–55]	[20–25]	5	[20–25]	[1.5–2.0]
2002	[45–55]	[20–25]	5	[25–30]	[1.0–1.5]
2003	[40–50]	[20–25]	5	[25–30]	[1.0–1.5]
2004	[35–45]	[25–30]	[3–8]	[30–35]	[1.0–1.5]
2005	[35–45]	[25–30]	[3–8]	[30–35]	[1.0–1.5]
2006	[30–40]	[25–30]	[3–8]	[30–35]	[0.5–1.0]
2007	[30–40]	[30–35]	[3–8]	[30–35]	[0.5–1.0]

Source: Sportech and Ladbrokes.

*Notes:*

1. Customer numbers are estimated as the maximum number of entries in any week of each year (excluding extra draws).
2. Sportech could not provide information on Zetters customer numbers prior to 2004: a share of 5 per cent has been assumed for earlier years.

## 6. Counterfactual

- 6.1 In considering the competitive effects of an anticipated completed merger, we compare the effects of the merger with what we expect would happen if the merger did not take place (the counterfactual). We considered what would have happened to both Sportech and Vernons in the absence of the merger over a period relevant to our assessment of the competitive effects of the merger (see Appendix E).
- 6.2 The evidence suggested to us that Vernons is not under financial pressure. Ladbrokes told us that Vernons' management had been successful in delivering consistent EBIT of around £5–£6 million a year, through tight cost management and business re-engineering, despite an annual rate of decline in football pools volumes of approximately 7 per cent. Nonetheless Ladbrokes said that Vernons [redacted].
- 6.3 Given this, we considered that there were two main options open to Ladbrokes in the absence of the merger: continuing to operate Vernons as an independent pools operator, or to sell it to another purchaser. We considered each of these options in turn.

### *Vernons in the absence of the merger*

- 6.4 Ladbrokes told us that if the merger did not go ahead, [redacted] (see Appendix E).
- 6.5 Although Vernons is currently a declining business, it does not seem likely that its closure would occur within a short enough timeframe to be of relevance to the inquiry.
- 6.6 Ladbrokes told us that if the merger did not go ahead, Vernons would continue as a pools operator. However, it said that it would no longer [redacted].
- 6.7 We considered whether, absent the merger, Vernons would reduce the value of its product offering in order to extract more revenue from the business. In 1995, Vernons had an operating profit of £5.5 million on turnover of £117 million. By 2006,

its turnover had fallen to only £18 million, but its operating profit remained above £5 million. Ladbrokes said that [REDACTED]. We note that Vernons has also reduced its payout ratio over the period. [REDACTED]

6.8 Vernons' [REDACTED].<sup>65</sup> Ladbrokes told us that [REDACTED], it had predicted that the payout ratio for Vernons in 2008 would reduce to [REDACTED] per cent [REDACTED]. Ladbrokes had earlier provided us with [REDACTED].<sup>66</sup>

6.9 On the basis of this evidence, we conclude that, if the merger does not go ahead, Ladbrokes could continue to operate Vernons as a profitable business, independent of Sportech, over at least the next two to three years. While the evidence was mixed, we conclude that Vernons' payout ratio and jackpot level would continue to decline, that absent the merger it would be unlikely to make any substantial investment in the business, but also that it [REDACTED].

### ***Sportech in the absence of the merger***

6.10 We also considered what Sportech would do if the merger did not proceed. Sportech told us that without the merger, it would adopt the policies set out in its Corporate Strategy Statement dated 28 March 2007. This identifies three key operational areas requiring investment in order to grow the business, namely products, technology and distribution. Sportech told us that its plan to [REDACTED]. While we note Sportech's argument that the merger would enable it to offer higher jackpot prizes, and therefore a more attractive offering, we saw no evidence that Sportech's plans to reinvigorate its business was dependent on this or on the acquisition of Vernons generally.

6.11 Sportech implemented a price rise during the course of the inquiry—see paragraph 5.6. We expect that in the absence of the merger, Sportech would attempt to sustain that price rise. We note that, should the price rise not prove profitable, Sportech would not necessarily find it profitable to reverse the decision—customers who stop playing Sportech pools in response to a price rise might not start again if prices were returned to their earlier level.

### ***Conclusions on the counterfactual***

6.12 We conclude that in the absence of the merger the parties would continue to run the two pools operations (ie counting Littlewoods and Zetters as a single operation) independently of each other, in a similar market structure as before.

## **7. Assessment of the competitive effects of the merger**

7.1 In this section we set out our assessment of the competitive effects of the merger. We look at the expected effects of the merger compared with what would have happened in the counterfactual, to determine whether the merger is likely to give rise to an SLC. We consider whether there are any adverse effects of the merger, either because of unilateral actions the merged entity would be able to take by itself or because of coordinated actions it could take together with others.

7.2 We begin by considering the scope for coordinated effects resulting from the merger.<sup>67</sup> As discussed in paragraphs 5.87 and 5.88, the merger will give the parties

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<sup>65</sup>Similarly, Sportech's [REDACTED].

<sup>66</sup>Vernons argued that the two documents were based on different assumptions.

<sup>67</sup>The CC's approach to coordinated effects is set out in CC2, pp30–33.

almost 100 per cent control of football pools supply in the UK. As such, any coordination with other suppliers of football pools is unlikely to give the merged group any additional advantage. For this reason, we do not consider that the proposed merger will have coordinated effects. So our discussion of competitive effects of the merger will focus on unilateral effects.

### ***Unilateral effects of the merger***

- 7.3 To the extent that the parties act as a competitive constraint on each other, that constraint would be removed by the merger. We consider whether this could allow Sportech to:
- (a) raise entry prices for playing the pools;
  - (b) reduce the payout ratio;
  - (c) reduce service quality and/or innovation; and
  - (d) reduce the choice of products or services offered to pools customers.
- 7.4 Whether the merger will increase Sportech's ability to exert unilateral market power by raising entry prices or reducing payout ratios, service quality or choice depends crucially on whether customers are willing, at present, to respond to such actions by switching from Sportech to Vernons or vice versa. We consider the evidence relating to substitutability below, before going on to consider the scope for the merged entity to take the measures set out in paragraph 7.3.
- 7.5 Despite strong similarities (along with some differences) in the pools games of Sportech and Vernons, most customers have continued to play with the same provider for a very long period, whether from preference or habit. GfK found that most (86 per cent) had been playing the pools for at least ten years, and over half (54 per cent) for over 30 years, while only 6 per cent had stopped using another pools operator in the past five years.
- 7.6 Vernons' marketing activity appears to have a limited effectiveness in winning customers from Sportech: as discussed in Section 8 (paragraph 8.10), we estimate that it wins no more than [1 to 3] per cent of active Sportech customers per year. This is consistent with a 2006 survey of lapsed Littlewoods customers by Swift, which found that only 3 per cent of those who left Littlewoods in the previous two years had started playing Vernons. Our survey of lapsed customers found no evidence that customers stopped playing with one pools provider in order to play with another. Our analysis of customer records found that 5 to 10 per cent of pools players had played with both major operators and had varied their spend between providers over an 18-month period, but at most 1 per cent had switched between suppliers. Surveys of current players found that, if their current pools company stopped providing a pools game, one in three or four would go on to play the pools with another operator. As described in paragraphs 5.36 and 5.37, these results may exaggerate the likely response to customers to a change in the product offering, which we now consider.

### ***Entry price increase***

#### ***Customer perception***

- 7.7 On the basis of the discussion in paragraphs 5.9 to 5.17, we consider that an increase in the entry price would be regarded as a genuine price increase by cus-

tomers, and would not be offset by a perceived improvement, or expected future improvement, in the value of the product.

#### *Constraint following latest price increase*

- 7.8 Sportech argued that its recent price increase (see paragraph 5.6) was independent of the merger, and that following this increase it would be constrained from implementing further price increases.
- 7.9 As discussed in paragraph 5.8, we consider that the extent to which Sportech's price increase (a) proves profitable or (b) gives rise to large-scale customer switching will influence Sportech's future decisions as to whether it should sustain, reduce or increase prices further. To the extent that Vernons was a competitive constraint on Sportech, we consider that such a constraint would continue to exist after the price increase. Given Sportech's lack of recent experience in varying entry prices, the outcome of the price increase is uncertain and the merger could in principle make a difference.
- 7.10 As to the question of whether, with its most popular bet priced at £1, Sportech would be constrained by the 'psychological barrier' of £1, or by the £1 price of the National Lottery's most popular bet, or both, we consider that, for the reasons given in paragraph 5.72, Sportech would not be materially constrained in this way.

#### *Customer response to an entry price increase*

- 7.11 As part of our customer survey we provided showcards to respondents and found that, when presented with a choice between playing with their current provider at prices 10 per cent above current levels, or choosing the alternative provider at its current prices,<sup>68</sup> 6.5 per cent more chose the alternative provider than if the two were compared at current prices. This exercise is to some extent artificial—whether customers would really switch in practice is open to question—and produced some puzzling results (see paragraph 5.41). Only 1.5 per cent said that they would not play the pools at all in response to such a price increase. In contrast, our survey found that 66 per cent would stop playing the pools if their current operator closed down. Similarly, Swift 1 found that 65 per cent of lapsed Littlewoods customers had in fact diverted the money to non-gambling uses.
- 7.12 The Swift 2 survey found that only 1 per cent of customers would switch to a different pools provider in response to an entry price increase of 10 per cent, whereas 19 per cent would stop playing and spend the money on non-gambling products.
- 7.13 As noted, only one entry price increase has occurred in the past ten years—in 1999, when Littlewoods increased its 8-from-10 price by 25 per cent. This was a large increase and met with a substantial response from customers—revenue data indicates that up to 18 per cent of customers may have stopped playing with Littlewoods (some may have simply decreased their spending, or increased it by less than the price rise). Given the relative size of Littlewoods to Vernons, the impact of this on Vernons should have been substantial, but no such impact was in fact recorded.
- 7.14 We conclude that customers do not see the parties as close substitutes, and because of this the parties do not materially constrain one another from raising entry prices, and that the merger would not give Sportech more power unilaterally to increase its prices.

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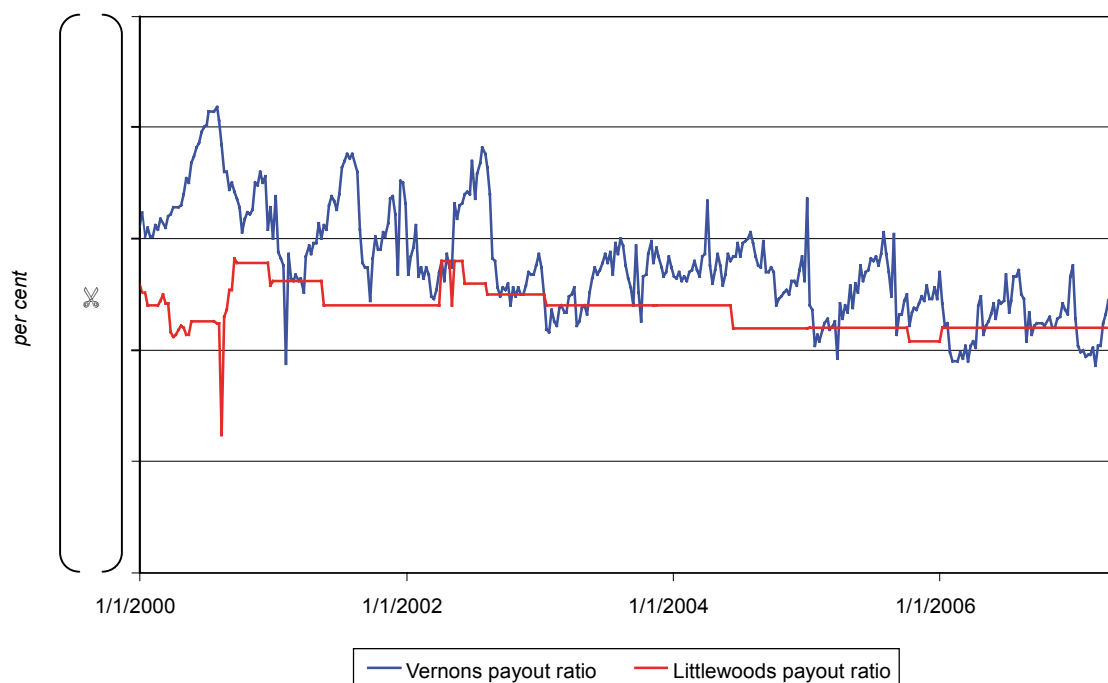
<sup>68</sup>Littlewoods or Vernons: Zettors was excluded from the exercise.

## Reduction in payout ratio

- 7.15 Both parties have found it profitable to make substantial and ongoing reductions in their payout ratios since 1998. As noted in paragraph 5.72, Sportech's argument relating to the £1 threshold does not apply to the payout ratio—ie even if Sportech was constrained to hold its main entry prices at £1, it could in principle continue to make incremental reductions to its payout ratio.
- 7.16 In the past, Littlewoods' and Vernons' payout ratios have diverged considerably from one another, particularly in 2000, as illustrated in Figure 4. However, this does not appear to have led to changes in the revenues of either provider, suggesting that customers did not respond to these differences by switching from one to the other.
- 7.17 Indeed, while entry prices are likely to be well known to customers, our survey evidence indicates that customers have practically no knowledge of the payout ratio (or indeed the typical jackpot, which depends on the number of players, how much they have bet, and the payout ratio). If anything, the payout ratio appears to be constrained (at [20 to 25] per cent) largely by [ ] (see paragraph 6.8 and its first footnote), [ ] alternative offers such as the National Lottery (50 per cent) or sports betting (up to 80 per cent).
- 7.18 We note that Sportech's [ ].<sup>69</sup> We have seen some conflicting evidence as to what Vernons' payout ratio would be absent the merger (see paragraph 6.8). However, given the lack of knowledge among players of either company's payout ratio, we do not consider that the parties are currently constraining one another in the payout ratios that they set.

FIGURE 4

### Payout ratios



Source: Sportech and Ladbrokes.

<sup>69</sup>[ ]

- 7.19 We conclude that the parties do not materially constrain one another from reducing payout ratios, and that the merger would not give Sportech more power unilaterally to reduce its payout ratio.

#### *Reduction in service quality*

- 7.20 The parties have, over time, added features to their products such as the £2 million prize and ‘buy-one-get-one-free’ offers. However, they have done this without increasing the overall value of the prize fund. As such, these innovations should, in our view, be seen mainly as attempts by the parties to create a basis for attractive marketing messages to customers.
- 7.21 Furthermore, we have seen no evidence that such commercial decisions by the parties had any impact on each other’s customer revenues. Therefore we do not interpret these activities as being responses to each other’s behaviour.
- 7.22 Vernons’ closure of its collector network could be seen as a reduction in the quality of its product offering. However, we have seen no evidence that customers responded to this by switching to Littlewoods or other pools games.
- 7.23 In the light of this, we do not consider that the parties compete with one another in the quality of service they offered to customers. As such, we conclude that the merger would not lead to a reduction in service quality.

#### *Reduction in choice*

- 7.24 The GfK survey indicates that, while many pools players remain with their current providers through force of habit, a substantial proportion claim to do so because of specific features of the pool itself—suggesting that they may have a preference for their current pools provider over alternatives. From a customer perspective, Vernons offers more chances of winning and a lower entry price than the Littlewoods pool, which offers a higher potential jackpot. We also note that some customers see playing a particular pools game as a tradition, and that if Sportech were to merge the pools fully in the future, players would no longer be able to carry on this tradition. Sportech told us that its current plan was to retain the Vernons brand. This point is considered further below; see paragraphs 7.29 and 7.30.

#### *Competition for new customers*

- 7.25 We also considered the effect of the merger on competition for new customers. We note that 5 per cent of GfK respondents who identified Vernons as their main provider said that they had started playing football pools in the past year. Only 1 per cent of Sportech customers, and 3 per cent of pools players overall, told GfK that they had started playing the pools in the past year. As such, ‘new to pools’ customers appear to account for a very small share of the market. Third Party C argued that the question in the GfK survey was ambiguous, in that some respondents who said they had recently started playing the pools may in fact have stopped playing the pools for a period of time and then started again. We consider such an interpretation unlikely, for the reasons set out in the second footnote to paragraph 8.6. However, we note that, if the question had been interpreted in this way, the number of customers who were ‘new to pools’ would be even smaller than indicated by GfK’s survey.

## **Market entry**

- 7.26 The scope for market entry is discussed in Appendix G. Sportech and Ladbrokes said that barriers to entry as a football pools operator in the UK were insignificant, but that entry was nonetheless unlikely due to the decline in the popularity of football pools. Sportech said that if its business could be turned around successfully, this would attract entry, and that potential entrants were waiting to see how Sportech's growth strategy would fare. In our view, Sportech would not be pursuing its stated strategy if it expected that a successful outcome of that strategy would lead to market entry of a sufficient scale and speed to prevent Sportech from exercising market power.
- 7.27 The only other pools provider in the UK, Brittens, told us that it had no intention of expanding its operations to a larger scale.
- 7.28 We conclude that the scope for market entry, of a degree that would prevent Sportech from exercising market power, is at best very limited.

## **Effects of the merger and the SLC test**

- 7.29 We note that the merger will affect Vernons customers in a number of ways. In particular, Sportech plans to [redacted]. Against this, we note that Sportech plans to invest in the business while, absent the merger, Ladbrokes plans to reduce investment in Vernons (see Appendix E). Finally, the merger could be perceived by some customers as leading to a reduction in choice.
- 7.30 However, we do not interpret these effects as evidence of an increase in Sportech's market power. This is particularly in view of the lack of evidence that, in the absence of the merger, customers would switch between the suppliers in response to a worsening of terms. We consider that the proposed changes to entry prices and the payout ratio reflect differing views between the managements of Sportech and Vernons as to the profitability of price increases,<sup>70</sup> and as to the most profitable level at which to set the payout ratio and prize levels. In our view, the high level of customer inertia, and the lack of customer awareness of payout ratios and prize levels, means that both parties already have considerable market power over their respective customer bases. Significantly, both parties appear to view the risk of customers abandoning the pools as a greater constraint on their prices than the presence of the other pools operator. As such, while Vernons customers may or may not be offered less attractive terms following the merger, in our view any such change in terms will not be the result of an SLC.

## **8. Responses to our provisional findings report**

- 8.1 Three third parties—Third Party A, Third Party B and Third Party C—provided us with detailed responses to our provisional findings report. These comments focused particularly on Vernon's marketing activity (see paragraphs 5.30 to 5.33 above). The third parties told us that Vernons recruited a substantial number of new customers each year and argued that, given the nature of its marketing, a significant proportion of these must have been won from Sportech, and that Vernon's marketing activity was therefore a competitive constraint on Sportech. The following discussion is an assessment of the implications of those comments for our conclusions.

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<sup>70</sup>And possibly better information on Sportech's part about customer price elasticity from being able to observe the results of the Littlewoods price increase in 1999.

- 8.2 Vernons marketing documents record that it recruited around [redacted] customers in 2006, and [redacted] from January to September 2007.<sup>71</sup> We note that Vernon’s revenues are declining by about [redacted] per cent a year (in nominal terms), suggesting either that the level of customer losses exceeds that of customer recruitment, or that new customers play only once, play less frequently, or place smaller bets. As noted in Appendix C, paragraph 15, Vernons has a first-time renewals rate of [redacted] per cent, suggesting that many (almost [redacted]) new recruits do not become regular customers.
- 8.3 Third Party B said that the prospect database held by Vernons had approximately 500,000 Littlewoods/Zetters customer names/addresses,<sup>72</sup> while Littlewoods players were otherwise targeted ‘as directly as possible’ through modelling and profiling. We note that an important distinction must be drawn between direct-mail recipients who are (a) current Sportech customers,<sup>73</sup> (b) lapsed Sportech customers and (c) people who match the profile of Sportech customers. In our view, attempts by Vernons to win current Sportech customers would be primary evidence of competition between the two. Attempts by Vernons to win lapsed Sportech customers could increase the difficulty to Sportech of reactivating these customers. However, we note that Sportech’s customer base has fallen by around 500,000 since 2002, indicating that (a) there are a great many lapsed Sportech/Littlewoods customers and (b) Sportech has had limited success in reactivating these lapsed customers.<sup>74</sup> As such, we take the view that recruitment of such customers by Vernons (which reduces, to some extent, Sportech’s prospects of reactivating these customers) would have considerably less impact on Sportech than recruitment by Vernons of current Sportech customers (which—if the customer stops playing with Sportech—means that Sportech loses a current source of revenue). As a result, we consider that Vernons’ recruitment of lapsed Sportech customers does not place a significant competitive constraint on Sportech. We have seen no evidence that Vernons’ attracting new players with a similar profile to pools players would exercise a competitive constraint on Sportech.

#### *Recruitment by Vernons of Sportech customers*

- 8.4 Third Party B disputed Vernons’ claim that the strategy of targeting Littlewoods customers had been unsuccessful, and said that the June mailshot which we discussed as evidence of this (see paragraph 5.31 and Appendix C, paragraph 24) was a small-scale promotion with an untypical offer (a high minimum entry). However, our focus on the June campaign was based on Third Party B’s own evidence that only this campaign was directed exclusively towards active or lapsed pools players. Third Party B told us that in other, larger-scale campaigns, only 20 to 30 per cent of the mailing list were people who had identified themselves as football pools players in lifestyle surveys. The remaining 70 to 80 per cent were those with similar lifestyle profiles or players of other soft gambling products.
- 8.5 Similarly, Third Party C argued that the findings on the effectiveness of Vernons’ marketing activity were partly judged on a June mailer, and that this should be multiplied by a large factor to reflect gains more closely. Third Party B told us that 20 to 30 per cent of those receiving Vernons’ other two large mailshots were known

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<sup>71</sup>Vernons told us that if the merger did not go ahead it would [redacted] (see paragraph 6.6).

<sup>72</sup>Sportech noted that its customer database was confidential. Vernons told us that it was unable to ascertain how many of the customers on its prospect database were former or current Littlewoods/Zetters customers.

<sup>73</sup>Including those who stop playing at the end of the British football season and resume at the start of the next season.

<sup>74</sup>We note, for example, that a March 2007 ‘reactivation mailing’ of 93,000 long-term (3½ to 7 year plus) lapsed customers by Sportech led to the acquisition of only 700 customers, a response rate of 0.8 per cent, and was unprofitable. A mailing of short-term lapsed customers in April 2007 had a somewhat higher response rate of 4 per cent, but was sent to just under 10,000 people.

Sportech customers.<sup>75</sup> Vernons told us that the January and August mailshots had together recruited [X] customers in 2006.<sup>76</sup> If we assume<sup>77</sup> that 30 per cent of these were Sportech customers, and that all of this 30 per cent were current Sportech customers (in practice it is likely that a substantial proportion will be lapsed customers), Vernons would have won just over [X] Sportech customers from these two mailshots (with a further [X] from the June mailshot). Given the uncertainty as to what proportion of new customers from this mailing were from Sportech mailing lists, and were in fact current Sportech customers, we also considered evidence from the GfK customer survey.

- 8.6 If Vernons were winning a substantial proportion of 'live' customers from Sportech, we would expect to see this reflected in survey evidence. GfK found that 5 per cent of Vernons customers had started playing football pools in the past year. If the GfK respondents are representative of Vernons' total customer base<sup>78</sup> (of around [X]), this would suggest that Vernons is recruiting around [X] 'new-to-pools' customers a year (see also paragraph 7.25).<sup>79</sup> If this is the case, then the remaining Vernons new recruits ([X] in 2006, and [X] from January to September 2007) would be either current or lapsed Sportech customers (or lapsed Vernons customers of whom Vernons no longer had a record).
- 8.7 One possibility is that current Sportech customers start playing Vernons but also continue to play with Sportech, only less frequently or for a smaller amount. They could also continue to play for the same frequency and amount, but this would not have any impact on Sportech and so is unlikely to act as a competitive constraint. According to the GfK survey, just over 10 per cent of Vernons customers (for whom Vernons is the main pools provider) also play with Littlewoods and vice versa. However, our analysis of customers who played with both parties over 72 weeks provided very little evidence of customers reducing their spending with one provider to spend more with the other, whether in response to marketing campaigns or for other reasons. On this basis, we would expect that if Vernons recruits active Sportech customers, the effect of this on Sportech should be visible in the number of customers who actually stop playing with Sportech.
- 8.8 However, GfK found that only 1 per cent of Vernons customers—equivalent to around [X] of Vernons' customer base—had stopped playing the pools with Littlewoods in the past year. We note that this is broadly consistent with estimates in paragraph 8.5 that Vernons wins around [X] customers a year from Sportech over the three campaigns. Third Party C noted that 'most of the Vernons customers actually switched around the years 2000 to 2002 when there was a switching trigger ... the time period the CC have taken into account is one during which switching is likely to be lower'. However, we have seen no evidence of switching from Littlewoods to Vernons over the time period mentioned by Third Party C, or (to date) following the 2007 price increase. In addition, we note that Vernons has been consistently promoting a lower 'price' than Sportech in recent years (see paragraph 8.12).

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<sup>75</sup>Again, it is likely that a proportion of these are lapsed customers.

<sup>76</sup>Third Party A told us that the August 2007 mailing activity had already attracted over [X] new customers.

<sup>77</sup>On the basis of Third Party B's evidence above; Third Party B further told us that others included in these mailshots had a high propensity to be pools players. We have no evidence of this. We note that Vernons mailed over 1 million people in each of its two large mailshots, while Sportech has around 500,000 customers, so that, at the maximum, 50 per cent of mail recipients could have been Sportech customers (on the strong assumption that the same 1 million people were contacted in each mailshot).

<sup>78</sup>As the sample was designed to be.

<sup>79</sup>Third Party C argued that GfK's question 'For how long have you been playing the football pools?' is ambiguous in that some customers may have stopped for a period of time and then started again. In our view, it is unlikely that many respondents who had been playing the pools for years, but who stopped playing each year at the end of the UK football season, would respond by saying that they had been playing for less than a year. Our analysis of customer movements over 72 weeks, and the fact that only 1 per cent of Vernons customers told GfK that they had stopped using Sportech in the past year, provide strong evidence that very few customers who we class as 'new to pools' had in fact recently stopped playing Sportech pools.

- 8.9 In summary, the results of the GfK survey indicate that well over half (around [X]) of the approximately [X] to [X] customers Vernons recruits each year are 'new to pools'. So at most [X] to [X] are switching from Sportech. The survey also indicates that only around [X] Vernons customers have stopped playing with Sportech in the past year, which suggests that customers are leaving Sportech to play with Vernons at a rate of around [X] a year. The origin of the remaining [X] to [X] recruits is unclear, but it appears likely that a substantial number had stopped playing the pools (with Littlewoods/Zettlers, or with Vernons) some time before they were recruited by Vernons. We note in this context a comment by Third Party C that 'past players normally respond better [to mailings] than live players as by definition they are not locked into the brand'. (Again, we note that there are many lapsed pools players: the industry has suffered a 90 per cent decline in revenues since the introduction of the National Lottery.)
- 8.10 Taking [X] to [X] customers as the possible range of customers who could be switching from Sportech to Vernons, we note that this is equivalent to approximately:
- (a) [1 to 3] per cent of Vernons customers;
  - (b) [1 to 3] per cent of Sportech customers; and
  - (c) [0.5 to 1.5] per cent of football pools players.

#### *Other comments by Third Party C*

- 8.11 Third Party C suggested that it would be possible for us to survey a sample of the [X] new customers Vernons had recruited since 1999 to determine the proportion that had switched from Sportech. However, our findings are based on a broad range of survey evidence, event studies and analysis of customer movements. As such, we considered the evidence base to be robust, and saw no reason to believe that a further survey would provide useful additional information.
- 8.12 Finally, Third Party C argued that we should examine the evidence for switching in August and September 2007 'to establish the true level of switching', as Sportech's price rise represented a major trigger for switching. Sportech provided us with weekly coupon entries for this period. It gained [X] customers at the start of August (the beginning of the football season). In the following weeks the number of customers (ie the number of coupons sold) declined at a similar rate to that over June and July (by up to [X] per week). Towards the end of September it lost over [X] customers in one week. Vernons gained around [X] more customers in August 2007 than in August 2006 but this does not appear to have been at Sportech's expense, as Sportech also gained customers over the period.<sup>80</sup> Vernons' customer gains in September 2007 were lower than in September 2006, again suggesting that it has not yet picked up any new recruits as a result of Sportech's price increase.

#### *Conclusion*

- 8.13 As described in paragraph 8.10 and the preceding discussion, our assessment indicates that at most around [1 to 3] per cent of Sportech's customers are switching to Vernons each year. By way of comparison, Littlewoods' pools turnover declined by between 11 and 15.5 per cent each year from 2003 to 2006, while Zettlers' fell even faster (see Appendix B, paragraphs 5 and 13). As such, we consider that the continu-

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<sup>80</sup>It is likely that a substantial proportion of these were 'reactivated'.

ing decline as customers stop playing the pools is a somewhat greater challenge to Sportech than the threat of customers switching to Vernons. Furthermore, we note that ongoing marketing activity from Vernons has not led Sportech to increase the proportion of the pool that is paid out to customers in prizes—indeed, this proportion has decreased over the years (see paragraph 7.15 and Figure 4). Finally, we have regard to the broad range of evidence presented in this report, notably:

- (a) survey evidence indicating that only 1 per cent would switch pools operator in response to a 10 per cent price increase (see paragraph 5.42);
- (b) time series data indicating that when Littlewoods increased prices by up to 25 per cent in 1999 Vernons did not experience any increase in revenues or customer recruitment (see paragraph 5.46); and
- (c) our analysis of customer lists which indicated that only around 1 per cent of customers had switched between Sportech and Vernons over a 72-week period (see paragraphs 5.51 to 5.53).

8.14 On this basis, we consider that Vernons' marketing and recruitment activities have not acted as a significant competitive constraint on Sportech.<sup>81</sup>

## **9. Conclusions on the SLC test**

9.1 We conclude that the anticipated acquisition of Vernons by Sportech will, if carried into effect, result in the creation of a relevant merger situation under section 23 of the Act and that we have jurisdiction to consider the competitive consequences of the merger.

9.2 For the reasons set out above, we conclude that the merger will not give rise to an SLC in any market for goods or services in the UK.

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<sup>81</sup>As discussed in paragraph 5.32, Sportech does not target its marketing activity against Vernons and has a lower rate of customer recruitment.