



Game Group PLC and Games Station Limited

A report on the completed acquisition by Game Group PLC of Games Station Limited

16 January 2008

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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 Some numbers have been replaced by a range.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.

Acquisition by Game Group PLC of Games Station Limited

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Glossary

Summary

1. On 9 August 2007 the Office of Fair Trading (OFT) referred the completed acquisition of Games Station Limited (Gamestation) by Game Group PLC (GAME) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). Our terms of reference are set out in Appendix A. We are required to publish our final report by 23 January 2008.
2. GAME is a specialist retailer of new (or 'mint') and pre-owned video games (including new PC games), video games consoles and related accessories. GAME operated 817 stores at 31 January 2007: 395 of these are in the UK. GAME also operates a small number of concession stores in larger retail outlets. In addition, GAME has two websites serving the UK market, Game.co.uk and Gameplay.com. In the UK and Ireland it had turnover of £586.4 million in 2006.
3. Gamestation is a specialist retailer of mint and pre-owned PC and video games, video games consoles and related accessories operating stores in Great Britain only. The business was acquired by Blockbuster UK in October 2002. Gamestation, pre-merger, operated 217 stores in Great Britain and 35 franchises within Blockbuster stores. In addition, Gamestation operates a website which offers both new and pre-owned games. Gamestation had turnover of £229.2 million and an operating profit of £2.4 million in the year ended 31 December 2006.
4. In November 2005, Blockbuster Inc made known its intention to divest Gamestation through several public announcements in the USA. On 2 May 2007 GAME acquired Gamestation for a total cash consideration of £74 million. The transaction included the entire share capital of Games Station Limited and its wholly-owned subsidiary Gamestation Limited. GAME acquired 217 operating UK stores and the head office and warehouse in York. The 34 Gamestation concessions within Blockbuster stores were not included in the transaction.
5. As a result of this transaction, Gamestation has ceased to be distinct from enterprises carried on by GAME. The UK turnover of Gamestation exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.
6. On 12 June 2007, GAME gave initial undertakings to the OFT under section 71 of the Act. When the merger was referred in August 2007, the CC adopted those undertakings. We considered whether any further changes were necessary to prevent pre-emptive action by the parties which might prejudice the reference or impede the application of effective remedies at the end of the inquiry. As a result, on 18 October 2007 the CC accepted interim undertakings given by GAME and Gamestation.
7. The video games software, hardware and accessories market is variously estimated as being worth between £2 billion and over £3 billion in 2006, depending on the exact definition of these products and whether sales of pre-owned products are included. The market has grown significantly in recent years. The pattern of growth is cyclical, the launch of new generations of consoles embodying new technologies (such as higher speeds, clearer graphics, Internet connectivity etc) boost sales of consoles and software, as has happened since 2006 with the launch of latest generation consoles such as the Playstation 3, Xbox 360 and the Wii.
8. Specialist gaming retailers such as the merged parties, in addition to selling mint products, also sell pre-owned software and hardware. Customers can trade-in old or unwanted products in return for credit to be used against future purchases. Cash is

also offered but typically less than the value of the credit. Gamestation has a substantially higher proportion of its hardware and software sales made up from pre-owned than does GAME.

9. The parties told us that their pre-owned activity allows them to offer cheaper products to price-sensitive customers in competition with lower-cost retailers such as Internet retailers and supermarkets. They also said that trade-in credits represented in effect a reduction in the net cost of subsequent purchases.
10. Mint products are available from a variety of retailers: the parties, independent gaming specialists, high street stores like Woolworths and Argos, entertainment retailers like HMV and Zavvi, electrical specialists (eg Currys, Comet), supermarkets and Internet retailers. Trade-in and pre-owned tend to be offered mainly by specialists and Blockbuster, although pre-owned products can also be sold and bought through second-hand shops, via Internet trading and auction sites, and through informal trading (such as car boot sales).
11. Over the last few years the market share of specialist retailers, and particularly general high street retailers, has declined. The share of supermarkets and Internet retailers has increased and the parties attributed this to their typically lower selling prices.
12. We found that there were distinct product markets for consoles, software and other peripherals. We did not find distinct markets for different types of games or hardware. We considered whether there were any different markets corresponding to different types of retailer but we found that many customers purchased these products at a variety of retailers, that many appeared to look around for the best deals, and that there were no obvious barriers to customers switching between different types of retailer.
13. We considered carefully whether mint and pre-owned products were in the same market. Much of the evidence put to us demonstrating that they were in the same market was unconvincing. However, there was survey evidence indicating that customers would choose between mint and pre-owned on the basis of relative prices, and we note that all third parties we spoke to believed that there was a competitive interaction between them. We therefore conclude that mint and pre-owned are in the same market.
14. The effect of the merger is to bring the two largest specialist retailers together.
15. In mint products we found that many customers viewed GAME and Gamestation as the next best alternative retailer for each other. Nonetheless, we see that there are many alternative retailers open to customers. Therefore, even though the customers of one of the parties might switch by preference to the other, if the merged entity were to raise prices the customers would also be able to switch to a wide variety of other retailers, such as the Internet and supermarket retailers who have been increasing their market share.
16. There are fewer alternative retailers for pre-owned, and again GAME and Gamestation were often named as each other's closest competitor, although alternatives exist in independent specialist and second-hand retailers, Blockbuster, and online retailers and auction sites. We note that sales via online channels have grown rapidly in the last two years. We looked at the extent to which the parties' ability to raise prices for pre-owned would be prevented by customers switching to mint products at other retailers. We found that while the parties' pre-owned prices were on average below mint prices charged by the cheapest retailers, there were

many exceptions to this for individual products. This might indicate that customers do not necessarily switch to other retailers in response to relative prices. However, retailers are differentiated in the service, environment and range they offer, and evidence from various surveys indicated that consumers would be willing to switch between pre-owned and mint products in response to changes in relative prices. Because supermarkets and Internet retailers are generally cheaper than the parties, we expected that such switching would tend to be away from the parties.

17. We also considered whether the parties could profitably reduce the trade-in values offered as a result of the merger. The same alternative sales channels exist for consumers as for pre-owned. A significant proportion of customers indicated that they would be willing to use online trading or auction sites in response to a price change. In addition, because the parties rely on trade-ins to create pre-owned stock, yet their ability to increase their sale prices for pre-owned is constrained, the parties will be unable to reduce trade-in prices because of switching and lost margins on their pre-owned business.
18. Some of the parties' pricing policies indicate that the number and proximity of local competitors can affect their pricing. However, we note that the size of any such effect is small and the parties have reduced their use of local pricing. We also consider that Internet retailing is emerging as an effective competitive constraint that applies nationwide. We therefore concluded that there is a national market for gaming products.
19. Lastly, we looked at whether the merger could be expected to harm suppliers or if the merger would increase the parties' buying power to the detriment of competitors. While the greater size of the merged party is likely to allow it to negotiate improved terms in some cases, the improvement in discount rates that can be achieved is unlikely to be great enough to threaten the ability of others to compete, and in so far as cost reductions are transferred through to customers these are a potential benefit to consumers. As suppliers tend to be large multinational companies, and very little product development is UK-specific, we did not expect the merger to harm investment or innovation by suppliers. We also concluded that suppliers were unlikely to give unfair allocation of scarce stock to the merged parties, and that any allocation of special editions or exclusive products would not be likely to affect competition between retailers.
20. In reaching our decisions, our evaluation of the evidence on constraints and the incentives that will apply to the parties post-merger was finely balanced. Taking account of all the evidence in the round, two of the four members of the Group concluded that the merger was unlikely to allow the parties to increase prices or reduce service for mint or pre-owned products or cut trade-in prices. The other two members of the Group took a different view, concluding that the evidence in this inquiry supported an adverse finding in relation to the sale and trade-in of pre-owned software.
21. Because the Group was evenly divided as to the conclusion to be drawn from the available evidence concerning pre-owned software, the Chairman exercised her casting vote¹ in favour of the finding that the facts found in this inquiry did not support an anti-competitive outcome.

¹Competition Act 1998, Schedule 7, paragraph 21. It should be noted that the Act (Schedule 7, paragraph 20(2)) requires that at least two-thirds of the members of the Group conclude that there would be an anti-competitive outcome for there to be an SLC finding.

22. Therefore we conclude that the merger of GAME and Gamestation has not resulted in and may not be expected to result in a substantial lessening of competition (SLC) in the markets for the supply of gaming software, consoles or peripherals in the UK.

Findings

1. The reference

- 1.1 On 9 August 2007 the OFT referred the completed acquisition of Gamestation by GAME to the CC for investigation and report. The reference was made under section 22 of the Act. Our terms of reference are set out in Appendix A. We are required to publish our final report by 23 January 2008.
- 1.2 This document, together with the appendices, constitutes our findings which we are required to publish and notify to GAME under the CC's *Rules of Procedure*.² Further information, including non-commercially-sensitive versions of main-party and third-party submissions, summaries of evidence, and our provisional findings report published on 10 December 2007 can be found on our website.³ We commissioned a survey of consumers who had purchased and traded-in gaming products; a report of the survey, the BMRB Video Games report, is also published on our website.⁴ We cross-refer to these documents where appropriate.

2. Industry background and the parties

- 2.1 This section provides a brief overview of the video gaming industry; it then describes the parties to the merger.

Industry background

- 2.2 GAME and Gamestation are primarily retailers of new (known as mint) and pre-owned video and personal computer (PC) games software and console hardware and accessories. A video game is an electronic game in which a player uses a controller (such as keyboard, joystick or game pad) to interact with the game in order to generate visual feedback on a screen (eg television).
- 2.3 The electronic systems used to play video games are known as platforms; these include video games consoles and hand-held gaming consoles. The term video games console is used to distinguish a machine designed for consumers to use primarily for playing video games from a PC, which has many other functions.
- 2.4 A video games console consists of the following components:
- controllers, such as a joystick, or directional pad;
 - console/base unit: the base unit in a video games console is the hub through which the television, video game controllers, and game program connect; and
 - game media: most games consoles have their programs stored on external media (eg optical discs).
- 2.5 All video games consoles require a screen of some sort as a source of visual output. Usually they are connected to a television. Hand-held consoles generally incorporate their own screen.

² *Competition Commission: Rules of Procedure, CC1*. Paragraph 10.3.

³ www.competition-commission.org.uk.

⁴ www.competition-commission.org.uk/inquiries/ref2007/game/pdf/survey_bmr_b_video_game_report.pdf.

- 2.6 Over 37 million video games consoles were sold in the UK between 1995 and 2006. Gaming is particularly popular in the UK and more games are sold in the UK than France and Germany combined.⁵ The UK is the third largest market in the world after the USA and Japan.⁶ Gamers span a variety of ages and classes, and we were told that the profile of gamers has recently shifted to include more women and older customers.⁷
- 2.7 There are various estimates of the size of the gaming market. Estimates by Mintel (2006)⁸ and Verdict (2006) of the size of the UK market for video games hardware and software plus PC game software from 2001 are shown in Table 1. Verdict estimates that the market comprises 63 per cent software and 37 per cent consoles and peripherals, although this varies from year to year depending on when new consoles are released.
- 2.8 The parties' estimate of total sales of gaming software and hardware is considerably higher, at £[redacted] billion, than the estimates by Mintel and Verdict. This estimate includes sales of pre-owned products (£[redacted] million), which would account for approximately 15 per cent of the total market. The Mintel estimates in Table 1 do not include pre-owned sales; Verdict's figures do—it estimates that in 2006, pre-owned sales accounted for £161 million, around 8 per cent of total gaming product sales (although sales figures we have seen from a range of retailers leads us to believe that this is a substantial underestimate of pre-owned sales).

TABLE 1 Sales of video games hardware and software, and PC game software

	<i>Mintel estimates</i>			<i>Verdict estimates</i>		
	<i>Value £m</i>	<i>Value at constant 2006 prices £m</i>	<i>Index of real value</i>	<i>Value £m</i>	<i>Value at constant 2006 prices £m</i>	<i>Index of real value</i>
2001	1,449	698	37	1,612	970	47.4
2002	1,638	890	47	1,815	1,223	59.8
2003	1,615	1,024	54	1,770	1,316	64.4
2004	1,551	1,134	60	1,734	1,454	71.1
2005	1,783	1,533	81	1,771	1,607	78.6
2006 (estimate)	1,897	1,897	100	2,044	2,044	100.0
2007 (forecast)	2,402	2,699	142			

Source: Mintel, 2006, Figure 20.

- 2.9 The market has been growing significantly in real terms although the pace of growth from year to year is highly variable. Sales tend to be driven by the release of new consoles, particularly when they embody a new generation of technology (see paragraph 2.11). As keen gamers purchase the latest consoles, they purchase games to play on them. Ahead of the release of a new console, sales may drop off in anticipation of the launch. As the major manufacturers have tended to release new generation consoles at similar times, there have been sales cycles in the past. Mintel (2006) anticipates substantial growth in the market in 2007 because of the release of the latest generation consoles such as the Sony PlayStation 3, Nintendo Wii, and Microsoft Xbox 360. Mintel (2006) estimates that household penetration rates have

⁵Source: Entertainment and Leisure Software Publishers Association (ELSPA) website: www.askaboutgames.com/?c=/pages/factsFigures.jsp.

⁶IDG 'The PC and Video Game Markets', April 2007, p82.

⁷See, for example, *Verdict UK Video Games and Consoles Retailing 2006*—Retailers Set to Reap Rewards in Buoyant Sector, October 2006 (Verdict 2006) page 3.

⁸Mintel, Computer and Video Game Retailing, Retail Intelligence, September 2006.

been fairly static in recent years at 25 to 30 per cent, implying that gamers are upgrading their consoles and may own multiple consoles.

- 2.10 While many games are released each week, a few blockbusters can achieve very substantial sales. For example, Halo 3 (a game for the Xbox 360 published by Microsoft) realized sales of US\$300 million worldwide in its first week of release.
- 2.11 Video games consoles have generally become technologically more sophisticated. The most recent consoles (ie Sony PlayStation 3, Nintendo Wii, and Microsoft Xbox 360) are described as third or next generation consoles. The features introduced in this generation include using high-definition optical discs (Blu-Ray or HD DVD), and using the motion of the controller to interact with the game (particularly the Wii and, to a limited extent, the PS3). Some third generation consoles are backwards compatible, which allows games developed for earlier consoles to be played on them. They also have online connectivity allowing users to interact with other players over the Internet and to download games on to some form of storage, typically a hard disc or flash memory.
- 2.12 Consoles can also be self-contained, portable and of a size that can be held in a user's hands; these are hand-held consoles, such as the Nintendo DS and Sony PSP. More advanced models of hand-held consoles also have online connectivity capabilities.
- 2.13 Video games software is developed both by the console manufacturers (Nintendo, Microsoft and Sony) and by independent game developers and game publishers. Games developed by independent game developers or independent game publishers can be available on one or more platforms. Video games are of various genres, such as action games (eg first-person shooter games), adventure games, fighting games, role-playing games, simulation games (eg flight, economic simulation games, city-building games), sports games and strategy games. These may be played by one person at a time or by multiple players playing in person or online (multiplayer games).
- 2.14 Similar games to those played on consoles can also be played on PCs. PC games may require specialized hardware in the user's computer to optimize the performance of the game. Some game genres have had more success as PC games than as console games, such as some strategy or simulation games. Apart from differences in the types of games played, Mintel (2006, p24) argues that PC games are not a strong competitor to console games, for example because most family PCs are not sufficiently powerful to deliver high-quality graphics.
- 2.15 Some other hand-held devices with screens support games, eg mobile phones, PDAs, MP3 players. However, these games tend to be much simpler than modern console games.

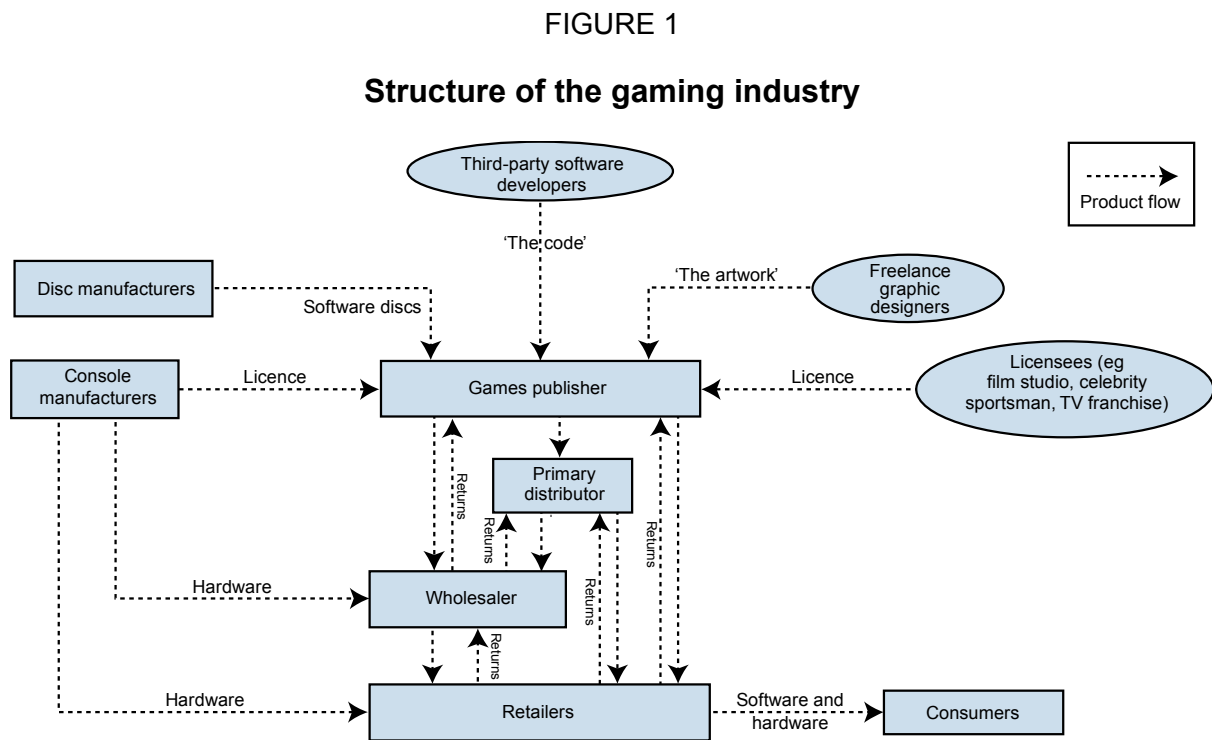
Structure of the gaming industry

- 2.16 The main participants in the gaming industry are:
 - console and accessories manufacturers;
 - game developers and publishers;⁹

⁹The console manufacturers also develop and publish some games.

- distributors; and
- retailers.

2.17 Figure 1 shows the structure of the gaming industry.



Source: GAME.

- 2.18 Game manufacturers, developers and publishers create the games. This process can vary in complexity with some games being created by a small number of programmers in under a year, and others taking two years or more to develop, Ubisoft Limited told us that the cost of developing a full game for a latest-generation console could be over US\$10 million but development costs for some games would be even higher. Some media commentators estimated that the cost of developing the Xbox 360 game Halo 3 could have been around US\$30 million.¹⁰ Game developers are usually divided into three categories: in-house studios (owned by a publisher), third-party developers (often bound to a single publisher) and independents (which sell to publishers).
- 2.19 Publishers select games titles and fund their development. They also act as project managers of the game development process and take responsibility for marketing, manufacturing and sometimes distribution.
- 2.20 Publishers can sell directly to retailers or use distributors. Distributors such as Entertainment UK (EUK) and Centersoft Ltd provide a range of services to their customers including category planning and management, merchandising and training services for store staff. Other distributors, such as Gem Distribution Ltd, Just

¹⁰For example, 'Development costs will probably be just above \$30 million, given an elite team of 300 full-time artists and programmers working for three years on the game at Bungie, the internal Microsoft studio that created the games, said Michael Pachter, an analyst at Wedbush Morgan Securities', *Los Angeles Times*, 24 September 2007.

Distribution Ltd, Koch Media Ltd and Pinnacle Software Limited also offer wholesale and distribution services to retailers.

2.21 Various retailers sell gaming products. These can be grouped into categories as follows:

- specialist gaming retailers (such as GAME, Gamestation, and various independent retailers);
- non-specialist entertainment retailers including music and video retailers (eg Blockbuster UK Limited (Blockbuster), HMV Group plc. (HMV), Zavvi Entertainment Group Limited (Zavvi, previously called Virgin Megastore));
- high street general retailers (eg Woolworths Group plc. (Woolworths), Argos Ltd (Argos), WH Smith PLC (WH Smith));
- supermarkets;
- electrical goods retailers (eg Comet Group plc (Comet), DSG Retail Limited (Currys and PC World); and
- online retailers (eg Internet retailers such as Amazon.co.uk Limited (Amazon) and Play.com, Internet operations for the bricks and mortar¹¹ retailers, and individuals or retailers selling through online auction sites).

Pre-owned and trade-in

2.22 As well as the sale of mint gaming products, there is an active market for pre-owned gaming software and hardware.¹² Consumers may complete a game or grow tired of it. Similarly, customers may wish to sell old hardware, for example if they are quitting gaming or are upgrading to a different console. Customers, therefore, may choose to swap or sell their pre-used games and hardware. There is some informal exchange (eg swapping with or selling to friends (often referred to as peer to peer, or P2P transactions)), sales through car boot sales, and through Internet auction sites or sales sites. Alternatively consumers can sell or trade-in their games and hardware to retailers, such as second-hand shops or games specialist retailers. GAME and Gamestation, along with many independent gaming specialist shops and Blockbuster, will purchase pre-owned games and hardware from customers in exchange for credit against a concurrent or future purchase from that retailer, or for cash. Cash prices paid are typically less than the trade-in credit. These retailers then use this stock to offer pre-owned products to the customer, which are sold at a discount to the price of mint product.

Gaming and online activities

2.23 As mentioned in paragraph 2.11, third generation consoles have Internet connectivity. Consumers can use this feature to:

¹¹The phrase 'bricks and mortar' retailers is used to describe all retailers with physical shops rather than Internet shops.

¹²Generally the resale of gaming products is accepted by suppliers and publishers, although some indicated their opposition to the operation of this business activity. For example, Sony Computer Entertainment UK Ltd and Sony Computer Entertainment Europe Ltd as format holder told us that they have never endorsed or licensed any party to undertake this activity, and they said that all their video games software is marked 'not for resale'. Some PC games are protected by electronic keys or similar technical devices that lock the software to a particular PC, which, in addition to licensing restrictions on transferring ownership, can make it more difficult to transfer the software between users. However, some PC games are transferable and Gamestation, but not GAME, deals in pre-owned PC games.

- play video games against other people anywhere in the world;
- play games online;
- buy games; and
- download video games and add-ons (eg additional characters or further games content).

2.24 PC gaming also includes Internet connectivity, offering the same options. Online gaming is more common on PCs than is currently the case on consoles.

2.25 While entire games can in principle be downloaded to newer consoles, in practice the size of most popular games is so large that this is not a viable option. Internet purchasing tends to be used for downloading small or retro video games¹³ or add-ons to video games, typically from the console manufacturer's website. However the proportion of software sales in the form of downloads remain very small. In 2006, digital downloads of PC games contributed £[x] million to the £[x] million European video and computer games market, while console downloads contributed £[x].¹⁴ Online gaming is a separate activity distinct from digital downloading. There are for example PC games whereby users pay a regular subscription to download games and play either online or offline. Some sites offer PC gamers tournaments that can be played online¹⁵ for a fee. Another type of PC game played online is the Massively Multiplayer Online Game (MMOG) (eg World of Warcraft). MMOGs usually require users to pay a subscription¹⁶ as well as an initial software purchase to get access to the game which is played online by thousands of people across continents.

The parties

2.26 We now briefly describe the parties involved in the merger. The details of the transaction, and the parties' stated rationale for the transaction, are discussed in the next section.

Game Group PLC

2.27 GAME is a specialist retailer of new and pre-owned video games (including new PC games), video games consoles and related accessories. In April 1999, Electronic Boutique plc acquired the GAME store chain, and in April 2002, Electronic Boutique plc was rebranded to GAME. On 2 May 2007, GAME acquired Gamestation.

2.28 GAME operated 817 stores as at 31 January 2007. Of these, 782 stores are operated directly: 395 in the UK, 12 in the Republic of Ireland, 359 in Europe and 16 in Australia. The remaining 35 are operated as franchises in Europe and Australia. GAME's UK stores are located in a variety of retail locations including high streets, shopping centres and out-of-town locations and are typically just over 120 sq metres (1,300 sq feet). GAME also operates a small number of concession stores in larger retail outlets such as Hamleys and Debenhams. In addition, GAME operates a mail

¹³Retro games refer to games which were originally created for old generation consoles. These tend to be far simpler and smaller in size than modern games. They may have been adapted to work on modern consoles. Retro consoles refer to old generation consoles which cannot read modern games software and need the original retro software to work.

¹⁴[x]

¹⁵Users do not need to install software on their computers to play these games online.

¹⁶Users usually also purchase the software to get access to the online game.

order service and has two websites serving the UK market, Game.co.uk and Gameplay.com, an online specialist it acquired for £2.3 million in July 2004.

- 2.29 The GAME Group had turnover of £801.3 million and an operating profit of £33.0 million in the year ended 31 January 2007. In the UK and Ireland it had turnover of £586.4 million and an operating profit of £26.8 million.¹⁷ A detailed analysis of the financial performance of GAME is included in Appendix B.

Games Station Limited

- 2.30 Gamestation is a specialist retailer of new and pre-owned PC and video games, video games consoles and related accessories operating stores in Great Britain only. It was founded in 1993 by two gamers in York. The business was acquired by Blockbuster in October 2002. Blockbuster's ultimate parent company is Blockbuster Inc. Gamestation operated as an independent, stand-alone company from Blockbuster Inc.
- 2.31 Gamestation, pre-merger, operated 217 stores in Great Britain and 34 franchises within Blockbuster stores. Gamestation's stores are located in a variety of retail locations but typically in shopping centres, and are a minimum of approximately 91 sq metres (1,000 sq feet). Gamestation told us that it typically sought secondary retail locations close to prime retail sites but without premium rents; it said that this strategy differed from that of GAME, which typically favoured prime locations with high levels of passing trade. In addition, Gamestation operates a website which sells both mint and pre-owned gaming products.
- 2.32 Gamestation had turnover of £229.2 million and an operating profit of £2.4 million in the year ended 31 December 2006 (including turnover generated through concession stores which were not acquired by GAME, excluding these 35 stores, Gamestation's sales were £203.5 million). A detailed analysis of the financial performance of GAME is included in Appendix B.

3. The merger

- 3.1 This section describes the transaction by which GAME acquired Gamestation, the other bids for Gamestation, the rationale for the merger and the parties' intentions for GAME's and Gamestation's activities post-merger.

Outline of merger situation

- 3.2 In [REDACTED], Blockbuster Inc conducted a review of its worldwide asset portfolio, which led to the decision to divest certain non-core assets, including Gamestation.
- 3.3 In November 2005, Blockbuster Inc made known its intention to divest Gamestation through several public announcements in the USA. Citigroup Inc. was appointed in [REDACTED] to market the business and produced an Information Memorandum in [REDACTED]. Blockbuster Inc received expressions of interest from a number of parties and indicative offers from [REDACTED]¹⁸ and [REDACTED], of around £[REDACTED].¹⁹ Blockbuster Inc also received an indicative offer from a UK private equity fund. However, this offer was below Blockbuster Inc's expectations and was not pursued.

¹⁷The published financial report does not split turnover between UK and Ireland (Source: The GAME group PLC annual report, year ended 31 January 2007, p52).

¹⁸[REDACTED]

¹⁹[REDACTED]

- 3.4 [REDACTED], Blockbuster entered into [REDACTED] with [REDACTED] based on a revised acquisition price of around £[REDACTED].²⁰ However, negotiations broke down at the end of February.²¹ On [REDACTED] GAME submitted a revised offer of £74 million.²² [REDACTED] and the sale and purchase agreement was signed on 2 May 2007.
- 3.5 The transaction included the entire share capital of Games Station Limited and its wholly-owned subsidiary Gamestation Limited. GAME acquired 217 operating UK stores and the head office/warehouse in York. The 34 Gamestation concessions within Blockbuster stores were not included in the transaction (these are now branded as Blockbuster but continue to operate as specialist gaming retailers).
- 3.6 [REDACTED]²³
- 3.7 [REDACTED]

The rationale for the merger

- 3.8 Blockbuster Inc regarded Gamestation as a non-core asset and used the majority of the proceeds from the sale to repay debt.
- 3.9 GAME indicated that the transaction would enable it to extend its customer reach given Gamestation's different focus on 'core' gamers; as such, Gamestation would remain a separate brand. GAME also viewed Gamestation's strong pre-owned business as offering the potential for improving its overall pre-owned offer across the merged entity.
- 3.10 In addition, GAME argued that the transaction would enable it to maintain its presence on the high street in the medium to long term.²⁴ In particular, the transaction would enable GAME to realize pre-tax synergies of approximately £[REDACTED] million a year by the second full year post-completion, mainly as a result of reduced overheads ([REDACTED]), improved use of distribution infrastructure, more efficient management of pre-owned product [REDACTED] and improved sourcing [REDACTED].
- 3.11 Third party observers commented that the transaction also had a defensive rationale, as it would allow GAME to defend its declining market share and prevent the potential takeover of Gamestation by GameStop or a private equity player, either of which it was felt was likely to put significant further pressure on GAME.²⁵
- 3.12 To assess the defensive element of the transaction, we considered whether the price GAME paid for Gamestation was indicative of a premium above what could be reasonably justified through cost synergies, ie whether GAME had paid a premium for Gamestation specifically to eliminate potential entrants from the UK market. It is, however, inherently difficult to assess whether a strategic premium has been paid in a merger due to the different methods of valuation, required returns, and the relative

²⁰[REDACTED]

²¹[REDACTED]

²²[REDACTED]

²³[REDACTED]

²⁴GAME cited a number of recent insolvencies in the retail entertainment sector including Silverscreen and Fopp Limited to illustrate the 'significant and ever growing pressure from...the supermarkets and online retailers'.

²⁵For example, following the completion of the merger, Oriel Securities Ltd. commented that the merger of Game and Gamestation would not only increase the UK store base by 50 per cent but it would also effectively close the UK market to the large US specialists who would hence think twice before entering the UK market organically against Game [Oriel securities report titled 'A commanding UK presence' dated 9 May 2007]. ABN AMRO Bank N.V. commented that the completed merger would improve the competitive position of Game as one of the main competitive threats was that a new entrant (ie GameStop) would use Gamestation as a platform to create a more substantial competitor to Game. (ABN-AMRO report titled *Station Games* dated 4 May 2007, p3.)

importance attributed by the bidding parties to elements such as potential synergies and brand value.

- 3.13 The evidence for the payment of a strategic premium by GAME is mixed. In response to Blockbuster's information memorandum in 2006, both GAME and [X] made similar offers for Gamestation. [X] included a number of Gamestation concessions within Blockbuster suggesting that their offer, all things being equal, should have been higher than GAME's. However, [X] faced additional costs arising from separating the Gamestation concessions from the Blockbuster stores, which it factored into its offer price. Both GAME and [X] expected to benefit from synergies as a result of the transaction, although the nature and extent of them were different for each. Both though calculated that their offer price allowed them to benefit from an acceptable level of these synergies. Both also assessed that the acquisition of Gamestation at the price offered, including retaining a proportion of the synergies created, would increase their respective earnings per share.
- 3.14 The evidence relating to the different offers, expected synergies and estimated increases in earnings per share set out above, mean that we cannot conclude that a strategic premium was paid by GAME.

Intentions for GAME and Gamestation post-merger

- 3.15 GAME said that it intended to continue to operate GAME and Gamestation as separate fascias post-merger, and said that it had no plans to align their separate pricing policies or other competitive elements in the two chains.
- 3.16 GAME said that no store closures were planned for either GAME or Gamestation; both the GAME and Gamestation fascias would be retained although at the margin a few stores could be changed between the two. GAME also said that it would continue to support Gamestation's programme of store openings in the immediate future.
- 3.17 In the longer term, it would be rational for any business to consider the interactions between its various activities in determining its optimal strategy. Therefore we will consider this further in addressing the effects of the merger, with regard to whether the merger could create incentives for the merged company to change its tactics and positioning for GAME and Gamestation and whether it could act on these incentives.

Undertakings

- 3.18 On 12 June 2007, GAME gave initial undertakings to the OFT under section 71 of the Act. When the merger was referred in August 2007, the CC adopted those undertakings. We considered whether any further changes were necessary to prevent pre-emptive action by the parties that might prejudice the reference or impede the application of effective remedies at the end of the inquiry. As a result, on 18 October 2007 the CC accepted interim undertakings given by GAME and Gamestation (see Appendix A).

Jurisdiction

- 3.19 Under our terms of reference (see Appendix A) we are required to decide whether a relevant merger situation has been created. A relevant merger situation is created where two or more enterprises have ceased to be distinct within the statutory period for reference and either the share of supply test or the turnover test specified in the Act is satisfied.

- 3.20 As a result of the transaction described in paragraphs 3.2 to 3.7, Gamestation has ceased to be distinct from enterprises carried on by GAME.
- 3.21 The UK turnover of Gamestation exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.
- 3.22 We therefore conclude that there is a relevant merger situation within the meaning of the Act. This conclusion has not been disputed by any party during the course of our inquiry.

4. Pre-merger competition in the market

- 4.1. We now address the nature and extent of competition in the retail supply of gaming products prior to the merger.

Structure of supply

- 4.2. The parties overlap in the retail of:
- (a) mint games software for video games consoles, hand-held consoles, and PCs;
 - (b) mint video games consoles and hand-held consoles;
 - (c) mint accessories and peripherals;
 - (d) pre-owned games software for video games consoles and hand-held consoles;
 - (e) pre-owned video games consoles and hand-held consoles;
 - (f) pre-owned accessories and peripherals;
 - (g) some 'other' games-related products such as t-shirts, magazines and game-related strategy books; and
 - (h) a trade-in service for software, consoles and peripherals to customers.
- 4.3. Because the 'other' product category (in paragraph 4.2(g)) is a very small part of turnover, and because books, magazines and clothing are available from a wide variety of unrelated retailers, we do not consider these further.

Retailers supplying gaming products in the UK

- 4.4. As noted in paragraph 2.21 there are several distinct types of retailers offering gaming products in the UK.
- 4.5. Specialist gaming retailers include GAME, Gamestation, and various smaller chains and independent retailers. Among the small chains, GameStop is the world's largest games specialist but has just two stores in Great Britain and four in Northern Ireland, Grainger Games Ltd (Grainger Games) is a chain of 12 stores in the North-East of England and Scotland, Chipsworld Limited (Chipsworld) has 11 company-owned stores and 20 franchise operations in the UK.
- 4.6. We estimate, after contacting likely retailers based on an initial list prepared by the parties, that there are some 455 specialist independent gaming retailers in the UK (excluding the parties but including small chains such as Grainger Games or

Chipsworld).²⁶ Most of these will sell mint and pre-owned products and accept trade-ins, although a few may be mint only or specialize in pre-owned. In general, depending on store size, specialist retailers are likely to stock an extensive range of titles including non-chart games.

4.7. Non-specialist entertainment retailers include Blockbuster, HMV, and Zavvi. The decline in the retail market for CDs means that entertainment specialists have increased their sales of gaming products:

- Blockbuster operates 720 high street stores (and in September 2007 acquired 59 further stores from ChoicesUK Limited (Choices UK)), with games sales and rental representing approximately [%] per cent of its total revenue. Blockbuster retails mint hardware, software and accessories, and also retails pre-owned product (with trade-in facilities) alongside sales of ex-rental games. The Gamestation concessions that were in Blockbuster stores prior to the sale of Gamestation by Blockbuster continue to offer a similar range and service as they did as Gamestation outlets. The number of lines stocked in Blockbuster stores varies with the size of stores; the largest have as many lines as a typical Gamestation but others are far smaller.
- HMV operates 223 stores across the UK, and has increased the share of store space dedicated to games in the last few years. Currently, approximately [%] per cent of HMV's total retail space is dedicated to its games business; a [%] per cent increase on the previous year. HMV offers a relatively wide range of bestsellers and back catalogue games for consoles and a range of PC-format titles. HMV has opened two gaming centres at stores in Edinburgh and London where customers can pay to play games on in-store consoles. HMV has in the past also trialed a pre-owned scheme from November 2004 to May/June 2005 in 34 stores. HMV decided that it was not economical to continue pre-owned game sales at the time. HMV's range varies across stores but is on average as wide or wider than the average for GAME and Gamestation.
- Zavvi, which has been rebranded from Virgin Megastore following a management buyout, operates 129 stores across the UK offering mint gaming products but no pre-owned products. The parties told us that recently Zavvi had launched a new price campaign in an attempt, to compete, in particular, with the online retailers and the other high street retailers.

4.8. General high street retailers include Argos, Woolworths, WH Smith and John Lewis Partnership plc:

- Argos operates 657 outlets. It has recently significantly increased the number of pages in its catalogue dedicated to gaming. It has increased its market shares and is particularly significant in the sale of hardware, but its range of mint software is 30 to 40 per cent that of the main parties.
- Woolworths sells mint games across 821 outlets. Woolworths Group plc also owns a UK distribution subsidiary, EUK, which supplies other large retailers. Woolworths offers a chart-focused mint range targeting the mass-market consumer. It has in the past trialed a pre-owned and trade-in scheme across its network of stores but has recently decided not to proceed with this scheme.

²⁶This number excludes Choices UK stores, which closed during the course of this inquiry. It also excludes CEX, which is a chain of 41 stores that specialize in trade-in and sale of pre-owned of a range of products; however, the purchase and sale of gaming products is a significant share of its activities.

Woolworths told us that it generally stocked the top-50 chart titles and a small range of budget games.

- 4.9. The large supermarket chains all sell mint gaming products. Tesco plc (Tesco) retails gaming products from [X] stores, Asda Group Ltd (Asda) sells them in 336 stores, and Wm Morrison Supermarkets PLC (Morrison's) sells them in around 380 outlets. J Sainsbury plc (Sainsbury's) sells mint gaming products in 418 outlets [X]. In August 2007, Sainsbury's announced that it has increased its store space committed to games by 50 per cent. However, the range of games typically sold in supermarkets is small and concentrates on chart games.
- 4.10. Electrical goods retailers include Comet, Currys and PC World. Dixons Group has reduced its involvement in gaming products, especially software, at its Currys stores but its PC World stores carry a substantial range of games and hardware for both consoles and PCs.
- 4.11. There are several online retailers of gaming products and many of the bricks and mortar retailers also sell through a website. As well as online retailers, Internet auction sites such as eBay are a potential source of gaming products. The two most significant Internet suppliers are Amazon and Play.com:
- Amazon offers a full selection of mint gaming hardware and software across all platforms. Users can also purchase mint products from other suppliers through Amazon Marketplace and these other suppliers or individuals can also sell pre-owned hardware and games via Amazon Marketplace.
 - Play.com also offers a full selection of hardware and software at price levels comparable to Amazon. Pre-owned products can be sold and purchased through the Playtrade facility on the website.
- 4.12. eBay is used as an auction site by both individuals and businesses to sell mint and pre-owned gaming products, and it can also be used to sell these at a fixed price. eBay's sales figures are shown in Table 8.

Pre-owned and trade-in as a competitive tool

- 4.13. Some retailers, including the parties, many of the independent retailers, Blockbuster, and some online retailers sell pre-owned gaming products. These generally retail at a discount to the mint product in the same store. Nevertheless, pre-owned products are typically functionally identical to the mint equivalent (at least in the case of software as this does not normally degrade over time), although there may be some cosmetic deterioration of the product or packaging.
- 4.14. Pre-owned products are generally sourced by buying games from customers, either as trade-in against a future purchase or as an outright cash sale. The parties told us that the great majority of their purchases from customers are as trade-ins rather than as cash purchases (see paragraph 7.48).²⁷ Thus a customer can take products to a store and will be offered either cash, or typically a higher trade-in value in the form of credit against a future purchase. In this way customers can reduce the net cost of their next purchase, and the retailer is able to offer a pre-owned product for sale.
- 4.15. The retailer needs to be able to assess that a traded-in product is of saleable quality (although some damaged hardware and scratched discs can be repaired). Typically,

²⁷In general we use the term 'trade-in' to refer to both trade-ins and cash purchases in the context of the parties' business.

shop staff visually inspect the product and then offer a trade-in price. At GAME and Gamestation staff can simply scan the product barcode and the till will display the centrally determined trade-in price. Thus there is no local price negotiation (although Gamestation offers a price-match guarantee on trade-ins). Older formats such as the original Playstation are not accepted for trade-in at GAME whereas Gamestation accepts many older products and 'retro' games. However, certain titles may not be accepted where there is excess stock or the products have little value.

- 4.16. In most cases, products are displayed for sale in the same stores where they are traded in. However, both GAME and Gamestation have facilities for products to be recalled to a central site and then reissued to other stores, for example if there is an imbalance of stocks between stores. The proportions of pre-owned stock redistributed in this way are relatively small. In the case of GAME, [X] per cent of traded-in games was recalled from stores in 2006. [X] per cent was recalled and redistributed immediately, and [X] per cent was redistributed following reclamation. [X] per cent was recalled and stored centrally for later redistribution or disposal, and [X] per cent was recalled and disposed of when the product could not be reclaimed. Gamestation currently redistributes about [X] per cent of its games. Repair facilities are also located centrally to deal with more complex problems that cannot be fixed in-store.
- 4.17. GAME told us that trade-in and pre-owned are used as part of its means of competing with other retailers on price, and that the pre-owned offer is attractive to price-sensitive customers. The proportion of GAME's hardware and software sales by value made up from pre-owned was [X] per cent in 2006, and the figure for Gamestation was considerably higher at [X] per cent (see Appendix B). The proportion of sales by volume was much higher. In 2006, pre-owned software accounted for [X] per cent of GAME's software sales by value, but [X] per cent by volume, and [X] per cent by value for Gamestation but [X] per cent by volume.

Trends in market share

- 4.18. The parties provided in Table 2 the estimates of their market shares based on 2006 sales values covering both mint and pre-owned sales. The merged entity would have by these estimates nearly [X] per cent of UK software sales, but a smaller percentage [X] per cent) of hardware sales and just over [X] per cent of peripheral sales. They estimated that their total share of all gaming products would be around [X] per cent.

TABLE 2 Market share estimates

Market		Parties' revenue £m	Market share estimate			
			Parties	Mintel	IDG	Verdict
Total market	Market size (£m)	)	)	1,897	1,914	2,044
	Game			29.3%	29.0%	27.2%
	Gamestation			10.7%	10.6%	9.9%
	Combined			20–25%	40.0%	39.6%	37.1%
Mint software	Market size (£m)	)	)	N/A	N/A	N/A
	Game			N/A	N/A	N/A
	Gamestation			N/A	N/A	N/A
	Combined			25–30%	N/A	N/A	N/A
P/O software	Market size (£m)	)	)	N/A	N/A	N/A
	Game			N/A	N/A	N/A
	Gamestation			N/A	N/A	N/A
	Combined			35–40%	N/A	N/A	N/A
Total software	Market size (£m)	)	)	1,219	1,200	1,288
	Game			27.9%	28.3%	26.4%
	Gamestation			10.8%	11.0%	10.3%
	Combined			25–30%	38.7%	39.3%	36.7%
Mint hardware	Market size (£m)	)	)	N/A	N/A	N/A
	Game			N/A	N/A	N/A
	Gamestation			N/A	N/A	N/A
	Combined			15–20%	N/A	N/A
P/O hardware	Market size (£m)	)	)	N/A	N/A	N/A
	Game			N/A	N/A	N/A
	Gamestation			N/A	N/A	N/A
	Combined			15–20%	N/A	N/A
Total hardware	Market size (£m)	)	)	564	714	756
	Game			30.3%	23.9%	22.6%
	Gamestation			10.3%	8.1%	7.7%
	Combined			15–20%	40.6%	32.1%	30.3%

Source: CC analysis of parties' estimates, market research reports by Mintel (2006), IDG (2007)* and Verdict (2006).

*IDG (2007).

Notes:

1. Market share estimates were determined on the basis of revenue data, market share estimates and market size estimates provided by the parties, as well as market size estimates as recorded in various market research reports. All figures are based on 2006, with the exception of the Mintel market size figures for 'Total software' and 'Total hardware', which are based on 2005.

2. Differences between the sum of the parties' hardware and software sales and their total sales are accounted for by sales of accessories and peripherals.

4.19. We also report for comparison some estimates drawn from independent market reports from Intel (2006), IDG (2007) and Verdict (2006). The market size estimates shown in Table 2 vary between different sources. These variations may arise for three reasons: (a) differences in base year; (b) inclusion/exclusion of certain market segments (particularly pre-owned products and online gaming); and (c) data collection methods.

4.20. The parties also provided estimates of their shares in mint and pre-owned peripherals and other products. For GAME they estimated its share of peripherals at [%] per cent (£[%] million) and for Gamestation [%] per cent (£[%] million), compared with total market sales estimated at £[%] million. For the 'other' category these shares were [%] and [%] per cent out of total market sales estimated at £[%] million.

4.21. The parties told us that their share of the market was under threat from other retailers. In particular, they argued that strong competitive pressures arose from the supermarkets and Internet retailers. The parties gave the estimates in Table 3 of

parties argue the coverage of data in these results are not as reliable as Chart Track.²⁸

- 4.25. It appears from the various separate data sources that the generalist retailers' share has declined substantially, and that the major beneficiaries have been Internet retailers and supermarkets. The parties estimate that Internet supply of hardware has increased substantially, and that of specialists and supermarkets slightly. Similarly, generalists have suffered the greatest reduction in share in hardware.
- 4.26. We were told that the supermarkets had increased their market share through offering chart games at discounted prices. This was partly attributed to their lower cost model although we were told that supermarkets would sometimes sell high-profile games at very low prices in order to attract shoppers into their stores. The growth of the Internet suppliers was attributed to their lower prices and also the wide range that they are able to stock. In contrast, the decline in other retailers' shares was attributed to a lack of distinctive offer such as lower prices, wider range or specialist advice. Mintel²⁹ argued that families, especially less keen gamers or those purchasing for children might find it more convenient to purchase games while doing their grocery shop rather than to visit high street generalist retailers. WH Smith and Currys (previously Dixons stores) are two retailers who have significantly scaled down their offer of gaming products.
- 4.27. The parties also provided estimates of their shares of supply for pre-owned software and hardware. No independently sourced data was available. For these pre-owned figures, the parties have used a 'bottom up' approach, adding up their estimates of each retailer's revenues in pre-owned gaming products. We used a similar approach, based on the actual revenue figures of the main retailers of pre-owned gaming software. Other differences between the parties' estimates and the CC's figures that account for the different market share estimates are the inclusion/exclusion of informal P2P trade and rentals, which we do not count as part of the relevant market, see paragraphs 6.70 to 6.73. The parties' estimates and the figures analysed by the CC in relation to pre-owned software are reported in Table 4. Insufficient historic data was available to conduct this analysis for earlier years.

²⁸Mintel (2006), p81. Verdict (2006), p8.

²⁹2006, p9.

TABLE 4 Pre-owned software 2006

CC estimates based on actual data where available		Parties' estimates*	
	Sales £m	Market share %	
GAME†	[]	20–25	[]
Gamestation†		25–30	
GAME and Gamestation		50–55	
Amazon‡		[]	
eBay§			
Blockbuster¶	100.0		
Independents#			
Total			

Source: The parties, CC.

*Revenue figures were calculated on the basis of the parties' market share estimates and the parties' own revenue data (which implies a segment total of £[] million).

†Game and Gamestation figures based on revenue data provided by the parties.

‡Amazon figure based on revenue data provided by Amazon. Includes sales via Amazon Marketplace only, Amazon itself is not a retailer of pre-owned gaming products.

§eBay figure based on revenue data provided by eBay. Figures were provided in US\$ and were converted to GBP using the exchange rate of 1 GBP = 1.843 US\$ (2006 annual average spot exchange rate as reported by the Bank of England).

¶Blockbuster figure based on revenue data provided by Blockbuster.

#Parties' estimate of Independents' combined revenue in pre-owned gaming software. No independent figures were available.

~Estimate from the parties based on customer survey evidence. Overall they claimed that informal P2P represented around [] per cent of the overall pre-owned segment.

4.28. The results show that the actual revenue figures for other suppliers are lower than the parties' estimates. We had insufficient data to verify the combined revenue from independents.³⁰

4.29. Adopting a similar approach, we analysed market shares in relation to pre-owned hardware and compared these to the parties' estimates. The results are reported in Table 5. Again the CC market share estimates for the parties are higher than the parties' estimates, for similar reasons as set out above.

³⁰As an example, if the combined revenue of Independents were £[] million, instead of £[] million, the parties' combined share would be around [] per cent, instead of [] per cent and the Independents' combined share would be around [] per cent, instead of [] per cent.

TABLE 5 Pre-owned hardware 2006

	CC estimates based on actual data where available		Parties' estimates*	
	Sales £m	Market share %	Sales £m	Market share %
GAME†	[]	15–20	[]	[]
Gamestation†		15–20		
GAME and Gamestation		30–35		
Amazon‡		[✂]		
eBay§		[✂]		
Blockbuster¶	[✂]	[✂]		
Independents#	[]	[]	[]	[]
Total	[]	100.0	[]	100.0

Source: The parties, CC.

*Revenue figures were calculated on the basis of the parties' market share estimates and the parties' own revenue data (which implies a segment total of £[✂] million).

†Game and Gamestation figures based on revenue data provided by the parties.

‡Amazon figure based on revenue data provided by Amazon. Includes sales via Amazon Marketplace only, Amazon itself is not a retailer of pre-owned gaming products.

§eBay figure based on revenue data provided by eBay. Figures were provided in US\$ and were converted to GBP using the exchange rate of 1 GBP = 1.843 US\$ (2006 annual average spot exchange rate as reported by the Bank of England).

¶Blockbuster figure based on revenue data provided by Blockbuster.

#Parties' estimate of Independents' combined revenue in pre-owned gaming hardware.

~Estimate from the parties based on customer survey evidence. Overall they claimed that informal P2P represented around [✂] per cent of the overall pre-owned segment.

4.30. It is difficult to arrive at precise market shares, given the dynamic nature of the market, differences in data collection and the lack of availability of data. Nevertheless, the above analyses suggest that the parties, particularly when considered in combination, have a substantial share of sales of both mint and pre-owned gaming products. Of course, while market shares can be indicative of firms' relative position in a market, where this is a result of product or service differentiation, market shares may over- or understate the actual position of competing firms, and should therefore be interpreted with caution.

Recent examples of entry

4.31. As video games are a relatively young product area, and the market for them has expanded greatly, there have been many examples of entry. The parties argued that the most significant of these were the supermarkets and online players. However, in the last ten years expansion of an existing offering has been more common than new entry. Retailers who have grown their games business significantly in the last few years include the supermarkets, Argos, HMV, Woolworths, and Internet retailers such as Amazon and Play.com.

4.32. Amazon and Play.com both allow other traders and individuals to sell both new and pre-owned gaming products through their websites. eBay also allows sales of mint and pre-owned products from individuals and businesses. Blockbuster also introduced trading-in and pre-owned activities in 2004. CeX Limited (CEX) as a second-hand exchange shop is another entrant into trading-in and the sale of pre-owned gaming products.

Consolidation and exit from the industry in recent years

- 4.33. The market has seen a number of retailer exits over the past ten years, primarily generalist retailers who have either downsized, stopped offering gaming products, or ceased trading:
- (a) Tempo Limited: retailed games from 32 stores ten years ago, concentrating mainly on hardware, but closed at the end of 2001.
 - (b) Our Price PLC: the entertainment specialist sold games in 162 stores ten years ago, albeit a limited range. The company was then acquired by Virgin and the brand has now ceased trading.
 - (c) MVC Entertainment Limited (MVC): once part of the Woolworths Group, this chain reached 82 stores, offering a small range of mint and pre-owned games. The business subsequently went into administration and certain of the chain's assets were sold on to Music Zone Limited (Music Zone).
 - (d) Music Zone: took on the MVC assets before itself going into liquidation in early 2007.
 - (e) Choices UK operated 162 stores throughout the UK selling music CDs, DVD and video games, and had a pre-owned offering. It went into administration in August 2007 and now has no retail stores. 59 stores have been acquired by Blockbuster.
 - (f) Dixons: stores have been rebranded as Currys Digital following a sharp decline in market share and now stores stock only a very small range of software products, preferring to concentrate on hardware.
 - (g) Future Zone/Electronics Boutique: these two specialist retailers were merged with GAME to form the basis of today's GAME group.

Pricing

- 4.34. We now consider pricing of gaming products.

Promotions

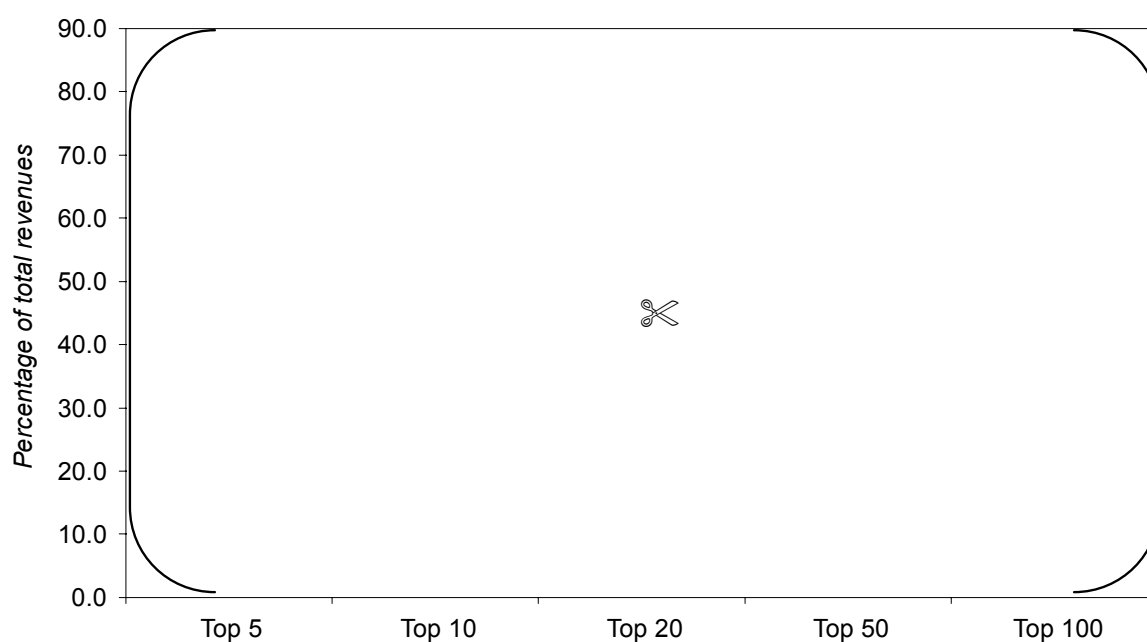
- 4.35. In considering pricing, we note that it is common for retailers to offer promotions on games, such as price reductions, multibuys (eg 'buy one get one half price'), and hardware is often bundled with games in promotional deals. Some promotions are linked to trade-ins, such as a discounted price on a game provided that certain qualifying games are traded-in. The parties told us that they use promotional tools extensively to enable them to compete more effectively on price with more aggressively priced supermarkets and online retailers, as well as with other high street retailers.
- 4.36. GAME estimated that between [x] and [x] per cent of its mint sales (equating to just under [x] per cent of mint sales by value) were made with some kind of promotional support, or were combined with a trade-in, such that the net price paid by the customer was less than the displayed shop price. Details of GAME's use of promotions are shown in Table 1 in Appendix C.

Price changes over time

- 4.37. The price of any one hardware or software stock-keeping unit (SKU)³¹ is not fixed indefinitely but tends to decline over time. For example, games tend to command a higher price on release than they can support after a few months, see Appendix C paragraphs 8 to 12.
- 4.38. For games software, demand tends to be centred on recent releases and chart games. The parties estimated that the top-20 chart products represent well over half (55 per cent) of mint software sales, and that nearly three-quarters (75 per cent) of sales are represented by the top 50 (see Figure 2). As demand falls over time, prices are reduced in steps.

FIGURE 2

Distribution of revenues



Source: CC reproduction of data provided by GAME.

Relative price levels

- 4.39. We looked at how prices varied between retailers. Because software titles typically decline in price over time, price comparisons between suppliers need to match identical products at the same point in time. However, the differences in range stocked by different suppliers means that full like-for-like comparisons are difficult.
- 4.40. The parties submitted two price comparisons. The first one, covering three different comparison exercises made in 2007, shown in Figure 3, used a 'static basket' of titles which was created using SKUs that were available across all retailers. Consequently, this basket is likely to capture only the popular chart titles that all these retailers stock.

³¹SKUs are different products where, for example, any different edition of the same game will count as a different SKU.

FIGURE 3

Comparison of mint and pre-owned software prices: GAME and Gamestation with various competitors (static basket)



Source: GAME.

4.41. Figure 3 suggests that, on average:

- for mint software, the parties' prices are higher than those of supermarkets and online retailers; and
- GAME and Gamestation's pre-owned prices are lower than the lowest mint prices.

4.42. The parties also carried out a similar exercise using a rolling basket approach which compared the price of all available SKUs for *each* retailer against the comparable mint SKUs at GAME (see Figure 4) on a pairwise basis. The number of SKUs in a basket differed by retailer because of varying stock availability of these SKUs at the pair of retailers. This approach allows a wider basket of SKUs to be compared.

FIGURE 4

Comparison of mint and pre-owned software prices: GAME and Gamestation with various competitors (rolling basket)



Source: GAME.

4.43. Figure 4 paints a broadly similar picture of comparative average price levels as Figure 3. The parties argued that the data in Figure 3 and Figure 4 support the concept of a 'mint price ceiling', ie that, in general, the parties' pre-owned prices are lower than the lowest mint prices by other retailers.

4.44. We have carried out an analysis of the data underlying Figure 4 to explore in more detail a pattern of pricing among different retailers (see Appendix D, Annex 2). We found that there is no strict ranking as to which retailers are always cheaper or more expensive than other retailers. The analysis also showed that pre-owned titles can often be sold at a higher price than the mint version of the same title at a different retailer. For example, approximately 50 per cent of titles offered by both GAME and Asda had a higher pre-owned price at GAME than their mint price at Asda. The parties acknowledged that the mint ceiling can be penetrated in relation to individual titles due to deep discounting on mint, typically by supermarkets and online retailers; this is discussed in paragraphs 6.32 and 6.33.

Mint

4.45. We now consider the pricing policies for mint software adopted by GAME and Gamestation.

4.46. When a new software title is released, it has a recommended retail price (RRP) or suggested retail price (SRP) set by the publisher. Retailers then decide what discount, if any, to offer to this price. The parties said that as well as taking account of the discount to RRP they receive from the publisher, and of internal factors such as margin targets, revenue forecasts etc, the size of this discount is informed by

trends in previous titles, competitors' marketing material, and (following release) competitor price checks.

- 4.47. GAME stated that the identity of competitors that inform its pricing decisions on newly released mint titles [REDACTED]. However, we saw evidence which suggested that GAME's pricing decisions might also be influenced by Gamestation, as well as high street retailers [REDACTED]. GAME also provided evidence that it monitored the price of mint games by some online retailers, [REDACTED]. The analysis appears to focus only on the price differential between each of GAME's two websites and the aforementioned websites and appears to have been used primarily to inform the separate prices for its Internet offers. GAME told us that the management responsible for its national pricing policy is responsible for both stores and online and so online monitoring also influences in-store pricing.
- 4.48. Gamestation claimed that it set prices taking account of 'a broad set of retailers, both high street and online', subject to local price adjustment as discussed in paragraph 4.62.
- 4.49. As noted above, product prices are reduced through the life cycle of the game and publishers told us that it was often their initiative to re-price the game or to issue budget editions. GAME stated that it continued to monitor prices of competitors for mint software throughout the product life cycle, with the comparator set comprising a wide set of bricks and mortar retailers including [REDACTED].
- 4.50. In contrast to software, for newly released mint hardware there are no list RRP prices. However, either estimated retail prices (ERPs) or SRPs are provided or guidance is implicitly provided via the manufacturer's advertising. GAME and Gamestation both claim to set prices 'in line with' these guidelines. They also claim that there are very narrow margins on consoles and that there is fierce competition between retailers.
- 4.51. A significant aspect of the pricing of mint hardware pricing is the practice of bundling: where (mint) software and/or peripherals are added to the hardware at no or limited increases in price.

Pre-owned

- 4.52. Both GAME and Gamestation stated that the sale prices of pre-owned versions of titles are set by a combination of:
- (a) the mint price of the product;
 - (b) demand and supply of pre-owned games and stock levels; and
 - (c) price monitoring of competitors.
- 4.53. The parties told us that pre-owned prices were primarily set by applying a discount to their own mint price of the product, typically £5 or £10 off the mint price; for example Gamestation provided the pricing matrices used for setting the pre-owned price relative to an equivalent mint price, see Appendix C.
- 4.54. Both parties told us that they monitored each other's pre-owned prices as well as the prices of other competitors, including [REDACTED]. However, both parties stated that their monitoring of pre-owned prices was not (primarily) undertaken on an SKU-by-SKU basis but rather to ensure that promotions, bundling and multibuy deals were successful, as these might include or apply to pre-owned stock.

- 4.55. The parties told us that changes in stock levels indicated whether their pre-owned prices were out of line with competitors. However, rather than changing pre-owned prices, both parties' first response to significant changes in stock levels (either a build-up of excessive stocks or a reduction in stock cover to very low levels), would be to make changes in the trade-in prices offered.

Purchase of trade-in

- 4.56. Both GAME and Gamestation initially set their prices at which trade-in products are purchased in relation to the pre-owned price using a specific matrix (where pre-owned prices are set at some discount to the mint price). For both parties the precise trade-in price offered depends on the absolute value of the pre-owned price and the platform to which the SKU relates.
- 4.57. GAME has [redacted] trade-in pricing matrices used in different stores—see paragraph 4.61. Gamestation's trade-in pricing matrix shows that the trade-in price averaged across all price points is around [redacted] per cent of the pre-owned retail price while GAME's average trade-in price is approximately [redacted] per cent of the pre-owned price. However, this difference between the two may partly be due to Gamestation's broader range of pre-owned categories (eg retro console games), as price comparisons for specific products indicate that Gamestation has tended to offer higher trade-in prices than GAME for particular products—see Table 4 in Appendix C.
- 4.58. The trade-in price received also depends on whether the customer wants credit or cash for the product. For GAME, if the customer opts to receive cash they will receive [redacted] of the 'standard' trade-in price. For Gamestation, a specific adjustment is made to the way in which the trade-in matrix is used; averaged across all pricing points on the matrix, the cash price offered is [redacted] per cent of the credit price.
- 4.59. Trade-in prices adjust over time with any decline in the retail price of pre-owned. They are also adjusted according to stock levels. If stocks of pre-owned had built up beyond some threshold, trade-in prices would be reduced in an attempt to cut back on recruitment of stock. Similarly a shortage of pre-owned stock would lead to an increase in trade-in prices. Both parties said that this policy of seeking to adjust trade-ins would be followed first, with selective changes to the pre-owned retail price only being enacted if this failed to resolve the stock imbalances. [redacted]

Local pricing

- 4.60. GAME told us that for each title, for both mint and pre-owned products, the same shelf price is charged throughout the country. However, there had been different local price schedules in use until 2005 and GAME used to offer a policy of matching local competitors' prices at a customer's request.
- 4.61. GAME offers different trade-in prices for some SKUs depending on location (see Appendix C). Stores are allocated into [redacted] zones. GAME said that the allocation depended on the relative demand for trade-ins in the local area, that is, whether other stores nearby were also seeking trade-ins such that it was necessary to offer a price incentive to recruit stock. GAME said that there was no precise rule or distance dictating this policy, but rather it reflected management's perception of local circumstances. GAME said that the trade-in prices offered in the [redacted] zones were usually the same and differed for only around [redacted].
- 4.62. Gamestation told us that its prices for mint, pre-owned and trade-in were set at a national level. However, stores could agree with area management to match specific

local competitors on a few high-profile mint chart or recent release items. In general, these are matched to GAME, but where certain stores do not face a GAME locally, they may have freedom to match other local stores which they judge to be their significant competitor, [§]. Gamestation stores offer a prominent price match guarantee as part of their offer against any other store within a 10-mile radius for mint products (and trade-ins) on customer request.

Customer behaviour

4.63. We now consider the ways in which retailers compete in the supply of gaming products, first looking at evidence of the factors that consumers rate as important.

Consumer rankings of purchasing criteria

4.64. Customer research by the parties suggests that price is one of the most important purchasing criteria. GAME's loyalty card customers were surveyed in 2006. In response to the question 'What is most important to you when choosing a store for gaming products?' where respondents were allowed to pick three answers from a list of ten, the results shown in Table 6 were identified. GAME argued that cheap prices and good promotions both indicate price sensitivity and that [§] per cent of customers indicated that these were important ([§] per cent of respondents rated neither cheap prices nor good promotions as important). Cheap prices were particularly stressed by low spenders. In contrast high spenders were more likely than medium and low spenders to stress products being in stock and a pleasant store environment, whereas low spenders were more concerned with the ability to buy and sell pre-owned.

TABLE 6 GAME survey results of relative importance of factors in choice of store

	Overall	High spenders n=187	Medium spenders n=326	Low spenders n=130
Large choice of games				
Cheap prices				
Good promotions				
Ability to buy and sell pre-owned products				
Convenience of location				
Knowledgeable staff				
Product I want is always in stock				
Easy to find products				
Pleasant store environment				
Ability to trial games in store				

Source: GAME consumer survey 2006 [§].

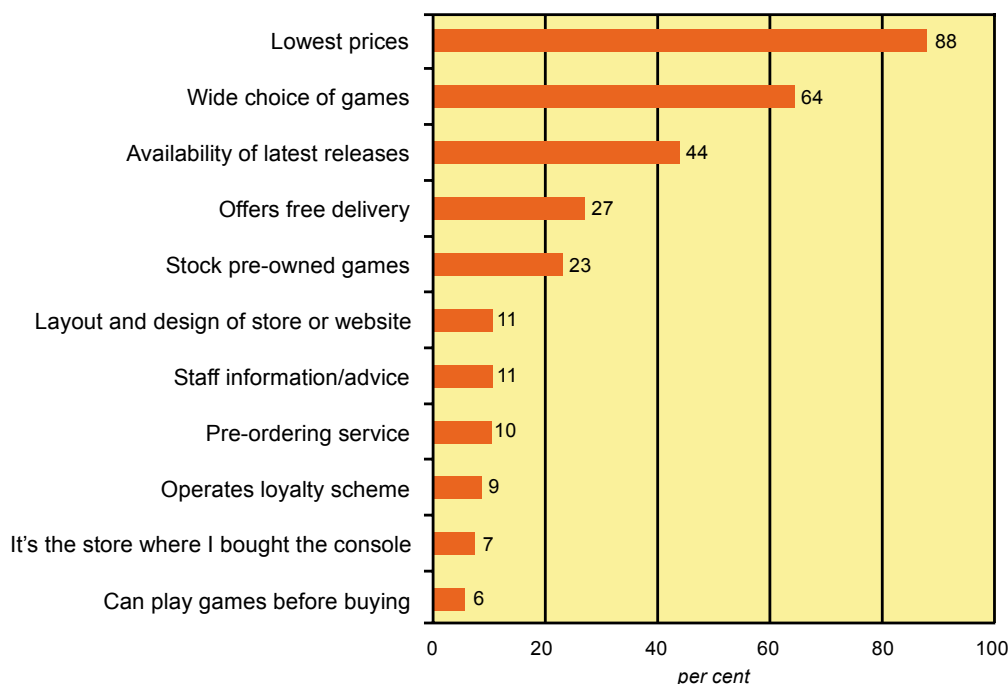
4.65. GfK conducted a random location omnibus survey (RLO)³² on behalf of the parties. The results of the RLO survey also indicate that price and promotions were considered an important purchasing criterion by respondents, as were stock availability and convenience. However, as the survey question asked people to pick their top three purchasing criteria, we cannot infer from these survey results which factor was considered most important—only which factor was mentioned most in respondents' top three.

³²The RLO survey is a regular (three or four times a month) face-to-face survey with UK adults in homes drawn from 175 areas randomly selected from the full list of UK Standard Regions, run by GfK.

4.66. The stated importance of price as a purchasing factor is also recognized in a market research report by Mintel: 88 per cent of 649 respondents chose the retailer they did on the basis that it offered the lowest prices and 65 per cent stated that they actively shopped around for the best deal when buying games.³³ These results are reproduced in Figure 5.

FIGURE 5

Most important purchasing criteria for buying gaming products



Source: Mintel (2006), Figure 35.

4.67. Further analysis by Mintel showed that 73 per cent of those buying from a store buy from only one store, and that 71 per cent of those buying from websites buy from only one website (although respondents could have used both a store and a website).³⁴ However, the same report reports that only 35 per cent of the same sample stated that they tend to stick to the same retailer or website to buy their games and 65 per cent shopped around (pages 85 and 86).

4.68. We asked BMRB Social Research (BMRB) to carry out a customer survey for us. BMRB interviewed 201 GAME loyalty card holders who had recently traded in gaming software at a GAME outlet and 433 respondents drawn from a general sample consisting of recent purchasers of pre-owned software and hardware from any source. Among other things, BMRB asked what the most important reason was for respondents to buy from the retailer from whom they had most recently bought a pre-owned game, rather than from other sellers of pre-owned games. 29 per cent of respondents said 'good prices/value for money', 12 per cent said 'convenient to use', 12 per cent said 'near where I live' and 7 per cent said 'good selection/wide range of games'. BMRB also asked respondents what the most important reason was for respondents to choose to trade-in with the retailer from whom they had most recently

³³Mintel, 2006, p70. Survey of 649 Internet users aged 15+ who purchased video game consoles or game software in the last 12 months, July 2006. Respondents were asked about their most important reasons for choosing the store or website they used to buy video computer games or consoles in the last 12 months.

³⁴Mintel (2006), p63.

bought a pre-owned game, rather than other buyers of pre-owned games. 31 per cent said 'good cash price (or credit) for trade-in', 22 per cent said 'convenience' and 8 per cent said 'I always trade-in here/habit'.

- 4.69. Although survey evidence suggests price is the most important purchasing criterion, given the price variation discussed in paragraphs 4.39 to 4.44, non-price factors must be an important feature of competition in the highly differentiated gaming retail market. Relevant non-price factors include product range/availability and customer service, including staff knowledge and in-store testing. We briefly discuss each of these.

Product range

- 4.70. GAME's survey of loyalty card holders (see Table 6) shows that product range is the single most important purchasing criterion for these customers. This is also recognized in market research reports, which highlight that having a wide choice of games is one of the key attractions of specialists.³⁵ The parties, as specialist retailers, offer a wide range of SKUs including both chart titles and 'backlist' titles, which are older and/or less popular games, whereas non-specialist stores tend to stock a narrower range. The parties also offer pre-owned games obtained through their trade-in service. Gamestation also offers a range of retro console games.
- 4.71. However, the parties argued that as the majority of sales by value are focused on newer releases and chart games (see paragraph 4.38), retailers with limited ranges are able to compete effectively. Moreover, online retailers tend to offer a wider range than the parties. GAME's estimate of the typical range of products stocked by various retailers is shown in Figure 6, drawn from a survey of stores. This shows that online retailers tend to have a far wider range than bricks and mortar stores, but GAME and Gamestation have among the widest ranges of the bricks and mortar retailers, whereas supermarkets tend to have relatively narrow ranges.

FIGURE 6

Mint software range per retailer, number of SKUs

[REDACTED]

Source: GAME.

Note: [REDACTED]

- 4.72. The range of SKUs stocked will vary between branches depending on the size of the store. A number of retailers gave details of how the number of SKUs varies across their stores, some of which differ from results shown in Figure 6:
- HMV told us that its average range was [REDACTED], with total SKUs ranging from [REDACTED] to [REDACTED] across its stores.
 - Woolworths told us that it generally stocked the top-50 chart titles and a small range of budget games, its total SKUs ranging from [REDACTED] to [REDACTED] across its stores.
 - Blockbuster told us that, excluding former Gamestation concession stores, its average range was [REDACTED] SKUs, varying between [REDACTED] and [REDACTED] in different branches.

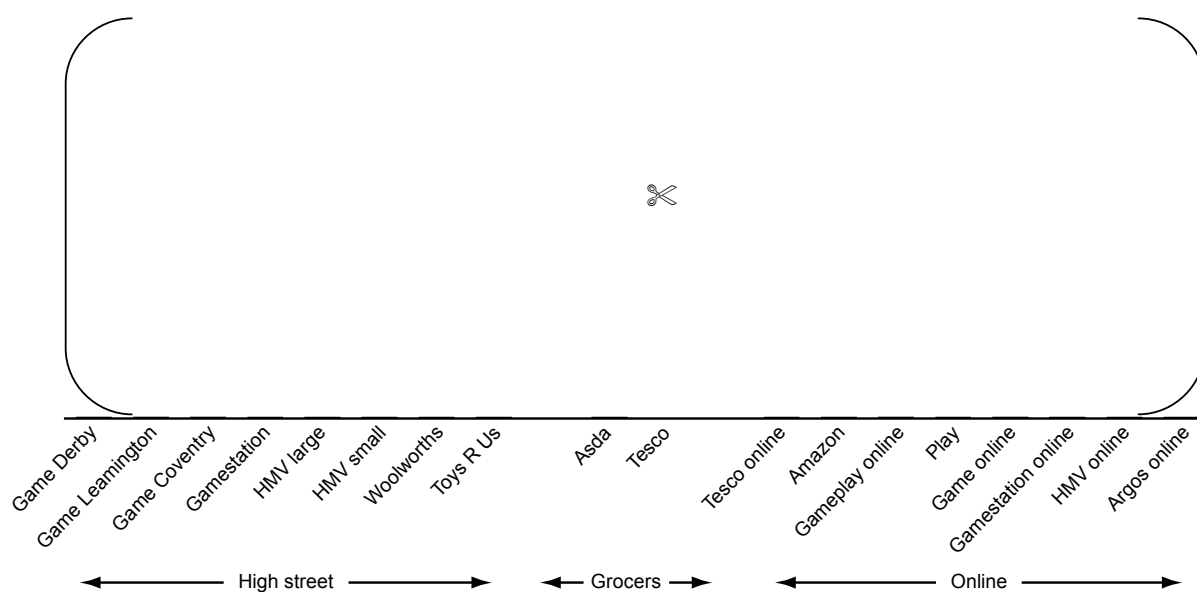
³⁵See, for example, Mintel (2006) p10 and p83.

- Argos told us that its range was approximately 30 per cent of GAME's range (in terms of SKUs) and 40 per cent of Gamestation's range.
- WH Smith told us that its average range was [X] SKUs, with total SKU range ranging from [X] to [X] across its stores.

4.73. GAME also provided specific range information (from analysis dated April 2006) in relation to mint Playstation 2 games, which is reproduced in Figure 7. This shows that Game, Gamestation and [X] stock similar sized ranges, which is wider than other bricks and mortar retailers but considerably behind online retailers.

FIGURE 7

PS2 mint software range per retailer, number of SKUs



Source: GAME.

Customer service

4.74. Another aspect of competition is customer service. GAME said that it relied on trained and knowledgeable staff to advise customers as a point of differentiation from supermarkets and online retailers. GAME also told us that there was no exceptional retail training for its staff, rather they tended to be enthusiasts for gaming. Customer survey results indicate that customer service from trained and knowledgeable staff was usually given low importance.

Number of retail outlets

4.75. The number of retail outlets also affects retailers' ability to compete nationally. The number of stores in the national chains is shown in Table 7. GAME said that store location was very important. GAME had actively pursued a strategy of achieving prime locations on the high street and in shopping centres. In this respect it was different from Gamestation, which said that it had tended to favour secondary shopping locations. Nevertheless our analysis has found that Gamestation stores are generally located close to a GAME store.

TABLE 7 Trends in outlet numbers for major retailers, 2003 to 2006

	2003	2004	2005	2006
Game	335	359	398	410
Gamestation	139	211	240	240
HMV	166	179	201	223
Zavvi/Virgin Megastore	150	150	119	129
Argos	540	556	592	657
Woolworths	825	820	823	821
WH Smith	673	677	669	671

Source: Mintel (2006), p80.

4.76. We looked at the extent to which areas where GAME and Gamestation stores were in close proximity also faced other competitors, to see if overlapping GAME and Gamestation stores would, as a result of the merger, face a reduction in the number of competitors on the local area, or whether there was a geographic separation between these two chains and other retailers. We looked first at the 179 Gamestation stores located within half a mile of a GAME store. In terms of the provision of mint products, every one of these overlapping stores faced alternative competitors. Two faced three alternative retailers, and eight faced four alternative retailers within half a mile, where alternative retailers include high street retailers, electronics specialists, supermarkets (known to stock gaming products), and specialists including independents and Blockbuster. All the other overlapping stores face more than four alternative retailers.

4.77. For pre-owned products and for trading-in, the presence of independent gaming specialists, second-hand stores, and Blockbuster varies between local areas. 84 per cent of Gamestation stores which overlapped with GAME stores also had another retailer of pre-owned within a half mile radius, and 92 per cent within one mile.

Supply issues

4.78. We now address the organization of the supply of products to retailers.

4.79. GAME told us that the commercial relationships with its suppliers of mint products (hardware and software) tended to be governed by one-year contracts, and that this was the common practice in the industry. [REDACTED].

4.80. GAME said that the discount it achieved relative to SRP varied by supplier [REDACTED].

4.81. GAME also said that hardware typically was significantly less discounted than software and accessories, and that the volume of an order could also be a factor in determining the level of discount the retailer received, with a higher discount being given to larger orders.

4.82. In addition to discounts off SRP, GAME receives from suppliers contributions towards marketing activity. [REDACTED].

4.83. Gamestation told us that it does not have long-term contracts with suppliers and that it renews its agreement with each supplier each year. Gamestation negotiates with suppliers with regards to discounts off the SRP. The level of discount varies by supplier and discounts on hardware tend to be much lower than discounts on software. Gamestation also negotiates promotional funding such as [REDACTED].

4.84. We received evidence from large and small suppliers of hardware and software on the level of discounts that they offer to different retailers. Hardware suppliers tend to

offer a standard level of discount to all their customers. The structure of the discount, however, might vary between suppliers; for example, Nintendo offers discounts linked to sales volume, marketing support and operational efficiencies, while Sony mainly offers a standard discount on the SRP. Discounts are usually much lower than for software.

- 4.85. In relation to software the most common type of discount is a discount off the SRP. The level of the discount can vary between retailers and ranges from [X] to [X] per cent. When there is variation in the level of the discount from the supplier, [X] and [X] are [X]. Gamestation typically receives the next highest level of discount to the SRP, with the difference between the discount given to GAME and Gamestation by the suppliers ranging from [X] to [X] percentage points. Amazon and Play.com generally receive the lowest level of discounts. Few software suppliers indicated that they chose to give their customers additional marketing contributions.
- 4.86. The information that we have on the discounts offered for hardware products suggests more limited differences than for software in the terms achieved by different retailers.

5. The counterfactual

- 5.1 In deciding whether the merger would be likely to give rise to an SLC, we need to compare the situation that we expect following the merger to that which would be expected to prevail had the merger not occurred (the counterfactual).³⁶ The counterfactual need not be the same as the existing, pre-merger conditions, for example if there are expected changes in the structure of the market or if alternative developments affecting the merging companies may be expected in the absence of the merger.³⁷
- 5.2 This section sets out the counterfactual for this merger. We considered the situations that might have applied to Gamestation and GAME.

Gamestation

- 5.3 Gamestation was predominantly a stand-alone entity within the Blockbuster group.³⁸ It was in a satisfactory financial position having recorded a profit before tax in 2006, 2004 and 2003 (see Appendix B). It was a cash generative business which would have continued to be viable either as part of, or separate from Blockbuster. Blockbuster Inc told us that in the absence of the transaction, it would have continued operating Gamestation as before, so as to maintain its value as a going concern. In addition it said that it would have continued to invest in the business, including financing the opening of further stores.
- 5.4 Nonetheless, Blockbuster Inc stated that the future strategy for Gamestation, if the sale to Game had not taken place, would have been to pursue a sale of the company because Gamestation would have remained a non-core asset.

³⁶The CC's Merger Guidelines state that: 'In applying the SLC test, the Commission will evaluate the competitive constraints on firms with the merger compared to the situation that would have been expected to prevail without the merger (sometimes referred to as the 'counterfactual'). The counterfactual will be that situation which the Commission expects to arise in the absence of the merger under consideration'. *Merger References—Competition Commission Guidelines, CC2*.

³⁷See, for example, paragraph 1.22 of CC2.

³⁸Gamestation shared services with the Blockbuster group, included legal, audit, property management and distribution services.

- 5.5 A number of opportunities for a sale would have been available, such as through reopening negotiations with [X] or with a private equity firm which had expressed an interest. It might also have been possible in time to stimulate interest from other potential purchasers or it might have looked at the possibility of a management buyout, although there is no evidence that this was seriously examined at the time.
- 5.6 We consider that Gamestation would have continued to operate as a competitor in the market, maintaining its market position and tactics and continuing to seek to expand its store portfolio.

GAME

- 5.7 We also considered whether, in the absence of the merger, the competitive position or policies of GAME would be expected to change from the pre-merger situation. We found no reason to believe that GAME would not have continued to develop its business model in the UK along the lines it had previously pursued.

Conclusion

- 5.8 We therefore conclude that in the absence of the merger, Gamestation would have remained as a viable competitor to GAME in the market. This might have occurred under different ownership, but if Blockbuster had been unable to reach satisfactory terms for the sale of Gamestation we are satisfied that Blockbuster would have continued to support and invest in Gamestation. In either case we expect that Gamestation would have continued to follow a policy of store opening, and would not have significantly changed its operating model or competitive positioning.

6. Market definition

- 6.1 The purpose of market definition in merger analysis is to provide a framework for the analysis of competitive effects. It identifies a collection of products, and an appropriate geographic area, that delineates the market within which the effects of the merger can be assessed. Market definition is not an end in itself, but can be a useful tool for analysing the competitive constraints faced by the parties to the merger from other firms supplying the market.³⁹
- 6.2 The framework for our analysis is the SSNIP approach,⁴⁰ which is a generally accepted conceptual approach to market definition. Accordingly, we take into account demand-side substitution and supply-side substitution.

³⁹Competition Commission, *Merger References: Competition Commission Guidelines*, June 2003, CC2, paragraph 2.2. The CC will adopt this concept wherever it is feasible to do so.

⁴⁰The SSNIP test (also known as the hypothetical monopolist test) typically starts by considering the narrowest possible definition of the products sold by each of the merging firms, and whether a hypothetical monopolist in that product could profitably increase its price by a small but significant non-transitory increase in price (SSNIP), usually 5 per cent. The approach takes into account both substitution away from the product by customers (demand-side substitution) and substitution into the product by suppliers (supply-side substitution). In practice, this means that we will infer, from the information that is available and has been collected, what the likely outcome of the SSNIP test would be. This can then be used to determine the relevant market(s).

Relevant product market(s)

- 6.3 The activities of the parties overlap in relation to the retail supply of mint and pre-owned gaming products, and the provision of trade-in services, allowing customers to trade-in previously bought gaming products in return for cash or store credits.
- 6.4 In terms of product market definition, the key questions are:
- whether mint and pre-owned gaming products are in the same market, ie whether they constrain each other;
 - whether there are separate markets for different types of retailer, for example whether online retailers constrain other retailers and so are part of the same market;
 - whether there are any product segments sufficiently distinct to constitute separate markets; and
 - whether trade-in is a separate market, and if not how the interaction of trade-in with pre-owned and mint sales should be treated.
- 6.5 After discussing trade-in services, we discuss each of these key questions in turn, considering both demand-side substitutability and, if necessary, supply-side substitutability.
- 6.6 The parties submitted that within the electronic gaming retail sector there are three distinct product markets: (a) gaming consoles, (b) software and (c) peripherals. We have adopted this distinction.
- 6.7 We considered whether the market could usefully be defined in terms of separate specific titles or products. However, consumers can and will choose between different titles on the basis of their attributes and price, and so we acknowledge that there is potential for substitution between games, and between consoles or peripherals in response to changes in their relative prices.
- 6.8 The parties submitted that both mint and pre-owned products should be considered to be in the same relevant product market for each of these three markets, and that there were no separate markets for different types of retailer or different product segments.

Trade-in

- 6.9 First, we consider the appropriate treatment of the role of trade-in purchases offered by the parties. The parties obtain their pre-owned gaming products from customers trading in their previously bought gaming products. The parties have argued that if trade-in is viewed just as an upstream market, no competition issues arise because, in their view, both publishers and individuals selling trade-ins are suppliers, and in which the parties themselves are buyers, and any reduction in trade-in prices represents an efficiency saving provided that it is passed on to the final consumer. However, trade-in is used as a tactical tool. The parties told us that trade-in allowed them to compete with other retailers who may offer lower prices, through reducing the net cost of a new purchase to a gamer who trades-in (possibly linked to promotions) and because the pre-owned stock so obtained could be offered at a discount to mint prices.

- 6.10 We therefore consider that it is appropriate to take trade-in into account in assessing the competitive effects of the merger in the markets for gaming products, rather than strictly defining a separate market for trade-in in which individuals are the suppliers.⁴¹

Mint and pre-owned gaming products

- 6.11 We next considered whether mint and pre-owned gaming products constitute separate markets or whether they are part of the same market.
- 6.12 Within this framework, the key questions are (a) whether a hypothetical monopolist of mint products would be able to raise prices by 5 per cent without losing a sufficient amount of sales to suppliers of pre-owned products to render the price rise unprofitable, and (b) whether a hypothetical monopolist of pre-owned products would be able to raise prices by 5 per cent without losing enough sales to suppliers of mint products to render the price rise unprofitable. We deal first with demand-side substitution and then with supply-side substitution.

Demand-side

- 6.13 The parties argued that there is easy substitutability for customers between mint and pre-owned because these are essentially the same product, sold at the same place and time from the same shops. While there may be a perceived quality differential, functionally pre-owned is the same as mint (and often the two are visually indistinguishable), and therefore customers should be responsive to any changes in relative price. In support of this they presented evidence showing that most customers purchased both mint and pre-owned, that the proportion who would switch between mint and pre-owned was responsive to the relative price differential, and that customers claimed to be highly price-sensitive.
- 6.14 When we consulted with various third parties on whether there was a competitive interaction between mint and pre-owned products, most told us that there was; for example, publishers expressed concern on the impact of sales of pre-owned on sales of mint games. None argued that these were distinct economic markets.
- 6.15 Various survey evidence indicated that many or most customers had recently purchased both mint and pre-owned games. This evidence is summarized in Appendix D, paragraphs 23 to 27.
- 6.16 The fact that customers are prepared to buy both new and pre-owned does not necessarily indicate high substitutability between mint and pre-owned games for a given title, if mint and pre-owned are purchased for different reasons.⁴² We therefore considered evidence concerning customers' willingness to switch between mint and pre-owned in response to changes in their relative price.
- 6.17 The parties presented an analysis of survey results on the proportion of customers who were likely to choose the pre-owned or mint version of the same title for a given price difference—see Appendix D, paragraphs 30 and 31 and Figure 3.

⁴¹Competition Commission, *Merger References: Competition Commission Guidelines*, CC2, June 2003, par. 2.36: 'Where there are upstream and/or downstream markets the Commission will have regard to their impact on market definition and competition more generally. As well as considering which aspects of the supply chain should be included in the definition of the relevant market, the Commission will consider the potential for upstream and downstream markets to impact on the relevant market, and vice versa, in its assessment of the competitive effects of the merger'.

⁴²For example, market research provided by Gamestation showed that when questioned as to why they bought pre-owned games, the most common response given by teenagers (83 per cent) was 'I wanted to get an older game that wasn't available new'. For adults, this was the second most common response (28 per cent).

- 6.18 These results suggest, for example, that at a mint game price of £39.99 and a pre-owned price of £34.99, a 5 per cent (ie £1.75) price increase in the pre-owned version would lead to [X] per cent of customers switching from pre-owned to mint. At a mint price of £34.99 and a pre-owned price of £24.99, a 5 per cent (ie £1.25) price increase in the pre-owned version price would lead to [X] per cent of customers switching from pre-owned to mint. However, because of the way that this data is recorded (in £2 intervals rather than continuously, and with ‘boundary values’ appearing in two categories⁴³), the suggested switching percentages are rather crude estimates.
- 6.19 The parties presented the results of interviews by GfK as part of the RLO survey. The RLO survey suggested to those who had bought used games in the previous year that an increase of £2 in the price of a pre-owned version of a game, retailing at £25, might make them more likely to consider purchasing the mint version of the game. [X] per cent of respondents agreed. However, the wording of this question is, we believe, rather leading.
- 6.20 Respondents were asked how much they thought a mint game would cost if a pre-owned game was priced at £25, and were then asked how a price increase to £27 for the pre-owned product would influence their decision on whether to buy a mint or a pre-owned game. Of those who were previously going to buy pre-owned, [X] per cent still would buy pre-owned, [X] per cent would be a little more likely to buy mint, [X] per cent much more likely, and [X] per cent would definitely change, see Appendix D paragraphs 36 to 39.
- 6.21 The parties pointed to survey evidence from the GfK exit and RLO surveys,⁴⁴ of customers who had purchased pre-owned choosing to do so because of relative prices, and that many customers considered the relative prices of pre-owned and mint products before deciding on which to purchase—see Appendix D, paragraphs 32 to 34.
- 6.22 In the BMRB survey, by far the most common reason for buying a pre-owned game rather than a mint game on this last occasion was because it was cheaper, which was mentioned by over three-quarters (78 per cent) of respondents.⁴⁵
- 6.23 Taken together, these results indicate that perceptions of relative price are for many customers an important factor in deciding whether to buy mint or pre-owned.
- 6.24 RBB Economics, on behalf of the parties, provided three pieces of analysis, which it said supported mint and pre-owned software being in the same market.⁴⁶ These were: estimates of correlation coefficients between trends in price levels for mint and pre-owned software; scatterplots showing the relationship between the mint/pre-owned price differential and the share of mint sales of a given set of titles; and a comparison of the trends in volume of specific pre-owned software titles and the trends in the prices of the same mint software titles. We look at each of these in turn.
- 6.25 RBB Economics pointed to a high degree of correlation between mint and pre-owned price levels of games over time (see paragraph 8 in Appendix D). Similar patterns of prices over time would be consistent with, but not conclusive of, mint and pre-owned software being in the same market, whilst different patterns would suggest mint and

⁴³Respondents could choose one of the following options: nothing at all, less than £2, £2–4, £4–6, £6–8, £8–10, £10–12, £12–14, £14–16, more than £16. Someone who was willing to pay £4 more may have answered ‘£2–4’ or ‘£4–6’.

⁴⁴The RLO survey is introduced in paragraph 4.65. The GfK exit survey was a separate survey of customers exiting GAME, Gamestation and independent games specialists in September 2007, see paragraph 32 in Appendix D.

⁴⁵See paragraph 29 in Appendix D

⁴⁶See paragraphs 8 to 15 in Appendix D.

pre-owned software are in different markets.⁴⁷ RBB Economics argued that this correlation arose because competition between the mint and pre-owned products forced the parties to maintain a reasonably consistent price differential between them. It pointed to the parties' product pricing rules for pre-owned which largely just apply a discount to the mint price for the same product.

- 6.26 However, a correlation between two price series would also be observed if both displayed a similar trend even if this arose for other reasons, for example because the demand for both mint and pre-owned was subject to similar declines over the games' life cycle. While RBB Economics acknowledged that this was theoretically possible, it argued that the pricing rules the parties followed represented a definite causal link in tying the two series together, and that competitive interaction between them was more likely to explain a close correlation than the possibility of their life cycle declines coinciding closely. Nonetheless, we found that the correlation between any pair of mint and pre-owned prices over time for any single game was often considerably lower than the pooled results presented by the parties.⁴⁸ Moreover, when expressed in first differences, ie the changes in price in each time period, the correlation between mint and pre-owned price changes was far lower.
- 6.27 RBB Economics provided scatterplots which show a negative relation between the mint/pre-owned price differential and the share of mint sales of the given set of titles. RBB Economics also compared trends in the volume of specific pre-owned software titles and the trends in the prices of the same mint software titles and found that the volume of pre-owned software sold fell when the price of the mint software fell, implying the two products are in the same market. However, as discussed in paragraphs 12 to 15 of Appendix D, we considered this evidence to have weaknesses.
- 6.28 We looked at changes in relative sales volumes of mint and pre-owned in reaction to relative price changes, for individual titles.⁴⁹ We found that mint and pre-owned volume sales move in opposite directions over time, implying that customers may substitute mint and pre-owned games of the same title. However, this was typically in response to very large relative price changes arising from promotions, which in some cases took the price of mint product below the price for pre-owned. These price changes tended to be much larger than 5 per cent (the SSNIP criterion), and therefore while the effects of these promotions in terms of sales volumes indicate substitution between mint and pre-owned titles, they cannot be interpreted directly as the response to a SSNIP.
- 6.29 The parties' internal documents did not tend to make explicit price or other comparisons with pre-owned gaming products when setting the price of mint. However, the parties claimed that this was because pre-owned prices were systematically set as a discount to competitively set mint prices.
- 6.30 The parties told us that the price comparisons between retailers shown in Figures 3 and 4 were indicative of the nature of the relationship between mint and pre-owned prices. Because mint is seen as being of superior quality to pre-owned, they argued

⁴⁷If mint and pre-owned software formed part of the same market and their relative prices diverged, customers would be likely to switch to the relatively lower priced option which, in turn, would be likely to contribute to the elimination of the divergence in prices. Consequently, similar price patterns over time are consistent with products being in the same market. See also Lindsay, A, *The EC Merger Regulation: Substantive Issues*, 2nd ed, Sweet & Maxwell 2006, p111, paragraph 3-014. However, similar price patterns over time may occur for reasons other than competition, eg if both are subject to similar trends without a causal link, hence such evidence is not conclusive of a causal link through competition.

⁴⁸The parties argued that pairwise correlations would be subject to noise from average selling prices reflecting differing incidence of hardware bundles and multibuys, whereas aggregated series tended to reduce this noise.

⁴⁹See paragraph 11 in Appendix D.

that their pre-owned prices were generally capped by a ceiling equal to the cheapest mint prices available from other retailers. While they acknowledged that this was a general guideline rather than a strictly followed rule, they argued that if pre-owned prices exceeded any rival's mint prices, then they would lose substantial sales.

- 6.31 We undertook a disaggregated analysis of the underlying data behind the price comparison shown in Figure 4—see Appendix D, Annex 2. The data is a cross section of prices across 196 software SKUs on various platforms, for mint and pre-owned, across various retailers. We compared the prices offered by the parties with the corresponding prices offered by each retailer for each SKU to determine the proportion of products where each retailer is cheaper, the same or more expensive than a competitor.
- 6.32 The average price levels indicate that pre-owned prices are set below those of the cheapest mint providers, and the parties argued that these mint prices effectively set a ceiling for pre-owned prices. However, we found that there was an overlap in the prices for mint and pre-owned between different retailers for some titles. For example, we found that [redacted] per cent of titles offered by both GAME and Asda had a higher pre-owned price at GAME than their mint price at Asda; and that [redacted] per cent of the titles sold by both Gamestation and Amazon.com had a higher pre-owned price at Gamestation than the mint price at Amazon. [redacted] per cent ([redacted] games) had a higher pre-owned price at GAME than the mint price at Tesco, and [redacted] per cent of pre-owned games were more than [redacted] per cent more expensive at GAME than mint at Tesco.⁵⁰ However, the parties' mint offer is sometimes cheaper than the pre-owned prices set by other retailers; [redacted] per cent of Gamestation's mint prices were lower than the prices for the equivalent pre-owned title offered by Amazon.
- 6.33 There are some weaknesses in this analysis: it only refers to one point in time and we do not have sales data to show how relative prices, and particularly changes in relative prices, affect relative sales. Further, it does not show how promotions (for example bundling discounts) impact on relative prices. Nonetheless, the data suggests that to some extent mint prices from other retailers do not set an absolute constraint on the parties (although the parties argued that were higher prices to be consistently charged for a pre-owned version of a game compared to a mint game it would reduce sales).

Supply-side

- 6.34 Having considered demand-side substitutability, we now turn to examine supply-side substitutability. We considered the feasibility and likelihood of alternative suppliers switching into the supply of mint (pre-owned) games in response to an increase in prices of mint (pre-owned) games by 5 per cent by a hypothetical monopolist. Supply-side substitution occurs when a price rise prompts other firms to start supplying, at short notice, an effective substitute to the product in question. Supply-side substitution occurs in the short run with little or no investment required, and if feasible and likely, will suggest a wide market.
- 6.35 It appears feasible for retail suppliers of pre-owned games to switch supply to mint games. There are no obvious impediments to obtaining mint supplies, although the responsiveness depends on the relative margins available in mint compared with the differences in costs associated with supplying pre-owned and mint games and how

⁵⁰Similarly, [redacted] per cent of GAME's pre-owned were more than [redacted] per cent more expensive than at Asda, and [redacted] per cent were more expensive than mint at Gamestation.

these would change in response to a 5 per cent price rise. In terms of percentage margins, [✂].

- 6.36 On the other hand, supply-side substitution from mint to pre-owned software may be more difficult. This is discussed in detail in Appendix D, paragraphs 46 to 51. Two large retailers who have recently tried to diversify from mint into pre-owned have not continued with this exercise, for a variety of reasons including difficulties in attracting sufficient trade-ins, costs in managing stock, determining appropriate pricing, investing in systems and staff training to handle trade-ins etc. It thus appears that supply-side substitution from pre-owned to mint games may be more feasible than vice versa.

Gaming hardware (consoles and peripherals)

- 6.37 We considered whether there were any differences to the above analysis that were applicable to consoles and peripherals—see Appendix D, paragraphs 52 to 61. In general there was no indication of different behaviour but hardware transactions differ from software transactions in the sense that, per customer, they occur less frequently and involve greater one-off monetary values. Customers may therefore be more price-sensitive in relation to hardware than in relation to software. It is therefore likely that customers will be at least as sensitive to the relative prices of mint and pre-owned for hardware as for software.

Conclusion on mint and pre-owned

- 6.38 There are some strong indications that mint and pre-owned are in the same market. The essential characteristics of the mint and pre-owned products are identical—while there may be a perceived quality differential, mint and pre-owned products are functionally and visually the same. There is a high degree of overlap—the same customers buy mint and pre-owned software from the same shops at the same time. There are no indications of barriers to switching.
- 6.39 Many customers see the relative prices of mint and pre-owned software as being an important factor in deciding whether to buy mint or pre-owned. We noted a wide dispersion of prices (for the same title) for both mint and pre-owned software. However, to some extent the reason why mint and pre-owned prices charged may differ between retailers arises from differences in service quality and other non-price factors; service quality differences may also allow specialist retailers to set pre-owned prices higher than mint prices from other retailers. We did not have any data on aggregate quantities sold at the different prices to indicate to what extent price difference impacted on relative sales; but we note that almost half the parties' mint sales occur with some kind of discount or promotion. No third party argued strongly that mint and pre-owned software were distinct economic markets, and there was no evidence put to us consistent with mint and pre-owned *not* being in the same market.
- 6.40 Therefore, based on the above, we expect sufficient switching to occur in response to a small change in relative prices, for us to conclude that mint and pre-owned are part of the same product market, and that this applies in each of the product markets for software, consoles and peripherals.

Distribution channel

- 6.41 We now consider whether the parties are, as specialist gaming retailers, in the same market as all other types of retailer, or whether there is a narrower and distinct market for only certain types of retailer or sales channel.

- 6.42 By considering the next closest competitive constraints on specialist retailers in a stepwise manner, as envisaged in a SSNIP test, we can determine the extent of the types of supplier who could be considered to be in the relevant market. Unfortunately, the necessary market data is not available. We therefore conceptually apply the SSNIP framework by making inferences about demand and supply-side substitutability from available evidence, such as whose prices the parties monitor and respond to, and customer survey evidence relevant to switching between retailers.
- 6.43 As discussed below, there is evidence that consumers shop using a variety of channels. The parties told us that they had lost combined market share and that this reflected the growth of shopping through supermarket and Internet channels.
- 6.44 Gamestation conducted a survey of 1,006 males aged 16 to 34 in October 2006 and found that on average they had used [X] stores for new games and [X] Internet sites in the previous year. Over two-thirds of respondents had used both stores and Internet sites to buy new games.
- 6.45 The parties' GfK survey showed the variety of stores and websites that had been used by respondents interviewed at GAME, Gamestation and independent retailers' stores for mint or pre-owned games, and for trade-in—see Appendix D, paragraphs 75 and 76. While these results show that GAME and Gamestation are the most popular channels for the purchase of mint and pre-owned games and for trading them in, they indicate that customers interviewed at GAME, Gamestation and independent specialist stores use a variety of retailers covering channels such as high street retailers, supermarkets and online retailers. For example, for mint purchasers, between [X] and [X] per cent of respondents used each of Amazon, Argos, Asda, HMV, Play, Tesco, and Woolworths. For pre-owned, the proportion of respondents using retailers other than GAME and Gamestation were lower than for mint but between [X] and [X] per cent of respondents used each of Amazon, Blockbuster, CEX, Chipsworld, Computer Exchange, eBay, and Play. For trade-in the outcome is similar to that for pre-owned: between [X] and [X] per cent of respondents used each of Blockbuster, CEX, Chipsworld, Computer Exchange, and eBay.
- 6.46 The BMRB survey found that 50 per cent of customers who had most recently purchased pre-owned games from GAME, and 53 per cent of those purchasing from Gamestation, had also in the last 12 months purchased pre-owned games from other bricks and mortar retailers (ie excluding Internet retailers and GAME and Gamestation), covering high street and supermarket retailers as well as specialists. Of the 35 per cent of customers who said they compared prices with other stores before their most recent purchase of a pre-owned game, 99 per cent of those who were GAME customers said that they had looked at other shops (excluding Gamestation), while 97 per cent of those who were Gamestation customers had looked at other shops (excluding GAME).
- 6.47 The parties told us that a recent survey of independent retailers commissioned by GAME was consistent with the importance of the existence of a wide range of competitors for specialist games retailers, including specialists, supermarkets, high street shops, entertainment specialists and Internet retailers or auction sites—see Appendix D, paragraph 74. The parties said that the independent retailers surveyed were typically specialist retailers and so were likely to have many customers in common with GAME and, in particular, Gamestation.
- 6.48 The parties told us that their price monitoring included online, supermarket and high street retailers, and their pricing responded directly to all types of retailers.

- 6.49 Among the bricks and mortar retailers, there appears to be no clear distinction between different groups of retailers that would suggest a lack of competition between them to such a degree that a stepwise SSNIP type test would find them to be in distinct markets.
- 6.50 We particularly considered whether there was any distinction between Internet suppliers and bricks and mortar retailers, and whether these differences may influence whether customers switch between them. Internet suppliers provide the same products but the delivery experience is different: there is no opportunity to browse in a shop, there is no opportunity to seek advice from staff, there is no immediate trade-in facility (although customers can sell used games online), and there is a delay before the product is delivered (although titles can be pre-ordered for delivery on the first day of release). Whilst some consumers may find the Internet difficult to use, or mistrust it, or may not have Internet access, and those without credit cards (including children) may face difficulties in making payment, many customers do not face these problems.
- 6.51 In general, mint gaming software appears to be lower priced online than in bricks and mortar stores, although there is overlap between different retailers and supermarket prices for chart games tend to be similar to those of Internet providers. Internet providers have a combined market share of some [] per cent based on the parties' estimates in Table 3, and this share has grown considerably since 2001, although this table also shows that this growth may have slowed since 2004.
- 6.52 We considered whether non-price factors such as service may prevent sufficient consumers from switching to online retailers in response to a 5 per cent price increase by a hypothetical bricks and mortar monopolist.
- 6.53 Survey evidence shows no significant perception of switching barriers between the bricks and mortar channel and the online channel. It also shows an already substantial customer overlap (ie customers buy from both types of retailer). The BMRB survey found that 38 per cent of customers who had most recently purchased pre-owned games from GAME, and 39 per cent of those from Gamestation, had also in the last 12 months purchased pre-owned from Internet suppliers. The parties have provided several survey results showing that the majority of customers shop at both bricks and mortar and Internet retailers (see Appendix D, paragraphs 72 and 73).
- 6.54 The fact that customers are prepared to use bricks and mortar retailers and the Internet does not necessarily indicate easy substitutability between them. We therefore considered evidence concerning customers' willingness to switch between them in response to changes in their relative price.
- 6.55 A variety of surveys showed differing proportions of customers who had compared prices before purchasing pre-owned games. The BMRB survey (see Appendix D, paragraph 79) asked respondents whether they had compared prices before they bought their last pre-owned game. 29 per cent of GAME users had compared prices and of these, 61 per cent had used the Internet. 39 per cent of Gamestation customers had compared prices and of these, 40 per cent had used the Internet and 30 per cent of customers of other bricks and mortar retailers had compared prices and of these, 64 per cent had used the Internet. Surveys presented by the parties⁵¹ indicated generally higher proportions who checked prices in other stores or online, at least sometimes, before deciding on a purchase.

⁵¹See Appendix D, paragraphs 80 and 81.

- 6.56 We considered evidence on whether customers perceived problems with purchasing over the Internet. The parties' RLO survey found that [redacted] per cent of respondents who had purchased pre-owned games had done so from eBay, and [redacted] per cent of these had experienced problems, such as the game was faulty, it was slow to arrive or failed to arrive, or the game was not genuine. Nonetheless, [redacted] per cent of past users said that they would use eBay again. Of pre-owned purchasers who had not used eBay, [redacted] per cent said that they would consider it in the future and [redacted] per cent said that they would not.
- 6.57 There was mixed evidence on whether the parties were monitoring Internet retailers with an eye on their own bricks and mortar business. GAME appears to monitor online retailers primarily to analyse the relative performance (in terms of price) of its own online channel, ie its websites Game.co.uk and Gameplay.co.uk. However, Gamestation submitted evidence that shows that it compares its performance across its store and Internet proposition with that of competitors, including online retailers such as [redacted].
- 6.58 Overall, the evidence suggests that a considerable proportion of customers can and do switch between Internet and bricks and mortar retailers. We also gained a strong impression from a variety of retailers that they believed that online suppliers offered substantial rivalry. Games are clearly defined, undifferentiated products, and so customers can easily search for the best deals online, if price differences offset any concerns about waiting for the delivery. Games are suitable for postal distribution and a significant number of gaming customers are likely to be comfortable with browsing and purchasing online.
- 6.59 We therefore think that Internet purchasing is likely to currently form a significant constraint on bricks and mortar retailers, as many customers will be willing to switch between online and bricks and mortar stores in response to small changes in relative prices.
- 6.60 We did not receive any indications that different conditions applied for software, consoles and peripherals. The parties also put to us that eBay was a particularly strong competitor in relation to the trade-in and sale of pre-owned hardware, and we note recent growth in Internet trading of consoles. The limited evidence may suggest a greater degree of substitution between bricks and mortar retailers and online retailers for hardware than for software, but is not conclusive of this.

PC games

- 6.61 Both parties sell mint PC games, but only Gamestation sells pre-owned PC games. According to a market research report by Mintel (2006), mint PC games make up approximately 17 per cent of all mint gaming software sales⁵² but according to a market research report by IDG (2007), revenue sales are falling as gamers switch away from PCs to video consoles.⁵³
- 6.62 Competition conditions may differ somewhat for PC games compared with video console games:

⁵²Based on 2005 figures. See Mintel (2006), p7.

⁵³See IDG (2007), p84.

- According to the Mintel report, margins on PC games would be thin in response to flat demand.⁵⁴
- PC games tend to be smaller, in terms of file size, and may therefore face a greater competitive constraint from the development of digital downloading.
- Certain other bricks and mortar retailers, including high street retailers such as Woolworths and supermarkets such as Tesco, appear to stock relatively few PC titles, seemingly focusing on video console games—though entertainment specialists such as HMV and computer specialists such as PC World do stock a wider range of games across all platforms, including PC.⁵⁵

6.63 As noted in paragraph 2.14, the degree of substitution between PC and console games may be lower than between different consoles. However, rather than considering PC games as a separate market, we will take the above differences into account to the extent necessary in the assessment of the competitive effects of the merger.

Online gaming

6.64 We considered whether online gaming was part of the same market as console games. Online gaming can include several possible activities. In this instance we are considering participation in games where, rather than purchasing software and loading it on to the user's own PC or console, the customer connects to a game hosted elsewhere.⁵⁶ However, the category is also used to refer to online interaction between console games and PC games where the customer has still had to purchase software for use on their own machine.

6.65 [X] per cent of respondents to the RLO survey said that they had played online games, of whom [X] per cent had paid some kind of fee for online gaming, such as for a subscription or a one-off upfront online fee, but also including the costs of buying a game in the first place in a store.

6.66 The parties argued⁵⁷ that online gaming offered similar functionality to boxed games, and was therefore directly substitutable. They argued that as gamers had a finite amount of time and funds for playing games, then any increased use of online gaming suggests that there will be less use of boxed games. The parties said that this was most likely to be observed for PC games, as it was first introduced and is more developed for PC games. They noted that PC games have grown more slowly in recent years than console games, which is consistent with this, although they believed this constraint would now become more relevant to consoles in the future given the online capabilities of latest generation consoles. They also argued that on the supply side publishers could be expected to promote online gaming as this would allow them to circumvent the need for retail sales and to sell direct to the consumer, thus improving their margins.

6.67 Some latest generation consoles have online connectivity which can support online gaming. However, players still have to buy the boxed video game to be able to use the online functionality and play the game online with one or more players. We do not believe that subscriptions to allow such online interaction are a substitute for the

⁵⁴See Mintel (2006), p22 and p7.

⁵⁵See Mintel (2006), p113.

⁵⁶We exclude downloading of games over the Internet here. This is considered in paragraphs 6.74 to 6.76.

⁵⁷RBB Economics, *Defining the relevant product market for mint and pre-owned software*, p15.

purchase of the necessary hardware and software in the first place, rather they are a complement that allow these items to be used.⁵⁸

- 6.68 To the extent that customers subscribe to online gaming where no physical purchase of software is required, we note that this provides an alternative to using retailers such as the parties, but we believe that such activities are rather different in nature from those typically undertaken by most console gamers or PC gamers relevant to the parties. For example, popular MMOGs like World of Warcraft still require players to purchase the game to load on their own PC. Although there were some 12.5 million MMOG subscribers worldwide in 2006, Mintel says, largely because of the time commitments required to effectively play an MMOG, 'the world of MMOG is a quite different market to mainstream recreational gaming and as such is less threatening to games retailers' (Mintel 2006, p56).
- 6.69 We therefore conclude that online gaming is not expected to form a constraint on the markets for gaming products and so exclude it from our determination of the relevant market.

Renting games

- 6.70 Certain retailers, such as Blockbuster, offer games for rent. Rental periods vary but on the whole they tend to be fairly short durations. The parties argued that for customers who trade-in games, renting may be a viable alternative in that they can use games for a short period of time before moving on to the next game, and the costs of rental may be in-line with purchasing and then trading-in a game.
- 6.71 However, this will only apply over short periods. While some customers trade-in their games after a couple of weeks, many will take considerably longer and many will not know in advance how difficult a game is, how much they enjoy it, and how long they will take to exhaust their interest in the game. We consider it much more likely that most customers rent games in order to try them out before deciding whether to purchase them. We would not expect small changes in relative prices to change this. We also note that none of the survey evidence reports rental as an alternative to the purchase of games. The value of rentals is much smaller than sales, suggesting that sales are more likely to be a constraint on rentals than vice versa.
- 6.72 We therefore conclude that rental should not be considered as part of the relevant market.

P2P

- 6.73 Apart from sales through formal channels, there may be some swapping, trading or sale of games between friends and colleagues, or through other informal channels like car boot sales. The evidence we have seen suggests that the use made of such channels is very limited. We also saw no evidence that retailers took account of this as a possible constraint in deciding their actions and pricing. While such trading undeniably occurs, we do not believe that it acts as a constraint on the parties and so would not be included in the relevant market in a SSNIP type test.

⁵⁸The parties argued that subscriptions for time spent playing online mean that gamers will be less inclined to trade-in games, and so is a substitute for the parties' pre-owned and traded-in business.

Downloading

- 6.74 Another factor which has been raised with us as a possible constraint on bricks and mortar retailers arises from downloading of console games. The parties said that potential for this was growing with the increasing availability of fast broadband Internet connections. To some extent the downloading of games is already established for PCs. The current extent of downloading is very small compared with the overall size of the market—see paragraph 2.25. However, modern console games tend to be extremely large. Even with high speed broadband connections the time taken to download such a game would be many hours. Although the speed of such connections may increase in the future, the expectation is also that games will continue to grow in size, and there are also constraints on the storage capacity of consoles to hold a library of downloaded games. The services that are likely to be purchased in this way are minor upgrades and supplements to games, or services that allow players to play against each other or otherwise interact online. The parties do not generally offer such products and they are in general unlikely to be seen as a substitute for boxed games, although there may be exceptions.⁵⁹ We also note that GAME's decision to purchase Gamestation would appear irrational if there were an expectation of a substantial shift to game downloading. We note that GameStop in the USA expressly indicated to investors in its most recent annual report that it did not think that such factors were a threat to it.
- 6.75 Sony told us that it expected that there would also be a slow building of digital distribution of software by publishers directly to consumers. This may take the form of full video game titles or simply additional content that enhance existing disc-based video game titles (for example, additional cars, tracks or costumes). Sony said that currently the percentage of such sales within the Sony Computer Entertainment Europe (SCEE) group was minimal. Whilst the SCEE group and others had plans to grow this business, it said that there were significant external barriers to growth. SCEE group began offering digital download content for Playstation 3 in March 2007.
- 6.76 We therefore conclude that technological developments and downloading are not expected to form a significant constraint on the merging parties in the next few years.

Other platforms

- 6.77 It was put to us that games could be played on alternative platforms, such as PDAs and mobile phones, and that this functionality was set to develop and extend. However, the nature of such games is far more limited than console games and we do not believe that gamers would view these as a potential substitute for console gaming.

Relevant geographic market

- 6.78 The approach to assessing the geographic market definition is conceptually the same as for the product market definition, ie to find the smallest area over which a hypothetical monopolist could profitably impose a SSNIP for each separate product market. In the context of this merger, the key question is whether the geographic markets are national or sub-national, ie local.

⁵⁹One exception suggested to us would be where an annual version of a game is released, it may be possible for players to upgrade an old version of the game rather than buying a new one.

- 6.79 The parties have claimed that the relevant geographic market for each of the product markets they have identified is national, on the basis that ‘the prices of the parties are set on a national level, as are their procurement and advertising strategies and those of all principal competitors’.
- 6.80 It does not necessarily follow that the geographic market is national because prices are set on a national basis. National pricing is not necessarily a permanent characteristic of gaming retailing, but a choice made by some retailers, which may, for example, reflect potential efficiencies, such as saving the administrative costs of operating different local retail offers.
- 6.81 If different prices could be sustained in different local areas—ie that a high retail price (or low trade-in price) in one area is not undermined by people travelling to another area where there are lower retail prices (or higher trade-in prices)—it suggests that there is a lack of price competition between these geographic areas.
- 6.82 Gamestation told us that while most of its mint prices were set nationally, to a limited extent stores could adjust prices to match particular local competitors on a limited number of products, mainly high-profile new releases or chart products. For most Gamestation stores, this would be with regard to matching a nearby GAME store, but those without a GAME nearby have freedom to match their most relevant local competitor. In addition Gamestation advertises a price-matching policy against mint prices or trade-in values from any store within ten miles.
- 6.83 GAME prices nationally for mint and pre-owned. It operates [X] different zones for trade-in prices (see Appendix C). It said that the different pricing matrices provide a rather crude attempt to deal with the issue that local supply and demand conditions may differ according to the number of stores in an area that sell pre-owned titles, ie the availability of pre-owned stock may vary between localities.
- 6.84 Therefore there are some differences in prices offered by the two merged parties, depending on local factors.
- 6.85 We undertook an econometric analysis of how average sale prices at Gamestation stores varied depending on the number and identity of competitors in the local area—see Appendix E. The results found a link between the identity of local competitors and mint prices two weeks after product launch⁶⁰ (and not for pre-owned or trade-in prices), as would be expected from Gamestation’s pricing policies, although the difference in average sale prices were small. Similar results were found looking at average sale prices (which may reflect different take-up of promotional discounts such as bundled deals), and also for solus sales, ie sales where only one item was bought in a particular transaction, so there were no bundling or multibuy discounts.
- 6.86 The parties’ internal documents show that new entry in a local area does lead to a response by GAME and Gamestation, primarily in the form of temporary marketing and promotional campaigns, ie local newspaper campaigns and bundled promotion offers in store. However, neither relies on a local pricing response—see Appendix C.
- 6.87 The pricing adjustments made by Gamestation for mint deals, and for GAME on trade-in, suggest a local element to competition.
- 6.88 However, we consider that the evidence for local markets is not strong. We note that GAME has abandoned local pricing for mint and pre-owned and the extent of price

⁶⁰A similar relationship was not found for the pricing of products 20 weeks after launch, suggesting these pricing differences between stores are manifested for recent releases only.

differences between GAME stores, and between Gamestation stores, is limited. Therefore it appears to us that local elements of competition which may have applied in the past are being or have been dropped.

Conclusions on geographic market definition

- 6.89 We consider that there are significant elements of competition applying nationally, in particular as noted in paragraphs 6.58 and 6.59 we find that Internet supply is a significant competitive constraint. We also note that many of the bricks and mortar retailers are themselves now offering gaming products through their own Internet sites. Because these effects will apply equally in all areas, we consider that the appropriate geographic market dimension is national.

Conclusions on market definition

- 6.90 We conclude that there are separate product markets for software, consoles and peripherals.
- 6.91 We do not find separate product markets for mint and pre-owned products, nor that there are separate markets for different types of distribution channel or classes of retailer. However, we do note evidence indicating factors that may impact on the intensity of competition between different types of retailer and we return to them in the context of the assessment of the competitive effects of the merger. PC games are treated as being part of the same market but we note that their effectiveness as a competitive constraint may vary as several different types of gaming can come under this heading.
- 6.92 We conclude that the appropriate geographic market is national because of the constraints now posed by Internet retailing leading to the local elements of competition that had been observed diminishing.

7. Assessment of the competitive effects of the merger

Introduction

- 7.1 The principal effect of the merger on the retail supply of gaming products has been to remove one of the two national chains of gaming specialist retailers as an independent competitor, and to increase concentration in the retail supply of gaming products. These effects are considered below.
- 7.2 There are three different but related aspects to the parties' activities: mint sales; pre-owned sales; and trade-in purchases of gaming products from customers in order to provide a supply of pre-owned stock. The interaction between these means that the parties face a difficult assessment in order to optimize their business performance. This assessment has to be made both before and after the merger. Post-merger, price-setting behaviour will reflect the fact that for both parties, some of the sales that would, prior to the merger, have been lost to another supplier following a price increase, will now accrue to the other party. Equally, some of the stock that would, pre-merger, have been lost to another purchaser if trade-in prices were reduced, will, post-merger, also be offered to the other party. We would expect these changes to encourage some increase in selling prices, and reduction in trade-in prices by the merged company. In this section, we consider whether the merger would in fact lead to such an outcome, given the competitive pressures to which the merged company would be subject.

- 7.3 In assessing whether a price increase following the merger might be rendered unprofitable by customers switching to other suppliers, it is not necessary for all customers to be well informed and willing to switch. If enough marginal customers are able to respond to changes in relative prices, then this can render a price increase unprofitable unless the supplier has some means to identify, directly or indirectly, the price-sensitive and non-price-sensitive groups and somehow discriminate between them.
- 7.4 One retailer, GameStop, told us that avid gamers were attracted to specialist retailers like GAME and Gamestation because of the ability to trade-in games, the larger range of products and the service available in their stores. However, while the parties acknowledged that customers could be grouped into different categories, they told us that there was no way that they could identify and discriminate between different customer segments and so the relevant behaviour was that of the marginal customer, regardless of which category they fell under. They also argued that they had no knowledge of their customers that would allow them to discriminate between them based on price-sensitivity or willingness to switch. We did not identify any process that would practicably allow them to do so.
- 7.5 The crucial question is therefore whether there are enough marginal customers who would switch to other providers of products and services defined in the relevant market to prevent the parties' ability to increase prices profitably (or similarly reduce service levels or other aspects of their offer). This depends on the closeness of the substitutability for these other products and services offered by other providers. Relevant aspects in assessing the closeness of substitutability include whether there are any barriers to switching, whether any differences in the nature of the offer made by different retailers might restrict switching, and whether any evidence from current market outcomes such as pricing might indicate a lack of substitutability. We also looked at whether there were indications of how price responsive customers were, and whether the companies' own pricing policies and other practices reflected a high degree of customer mobility and price sensitivity.
- 7.6 In this section we generally consider gaming software, consoles and peripherals together unless otherwise indicated, as the same factors apply to each.

Effects of the merger on competition in the supply of mint and pre-owned gaming products

- 7.7 We first consider the potential impact of the merger on competition in the supply of mint and pre-owned products. Whilst there is some differentiation between mint and pre-owned, we have concluded that these products are in the same market (due to the close substitutability between mint and pre-owned products). The availability of mint is itself a potential constraint on pre-owned. The range of competitive constraints applying to mint is therefore also relevant in the assessment of the impact of the merger on pre-owned products, and vice versa, although as differentiated products the constraint on mint pricing from mint products from other retailers is likely to be stronger than the constraint from pre-owned from other retailers, and vice versa. Whilst holding this linkage in mind, we first consider mint, and then pre-owned. As shown in Table 2, the parties' combined share of mint and pre-owned software sales in 2006 was [X] per cent based on the parties' estimates (and somewhat higher based on various market research reports), and was [X] per cent for hardware sales based on the parties' estimates.

Mint

- 7.8 The parties argued that there was very active competition in the provision of mint gaming products; in particular they pointed to the growth of the share of supermarkets and Internet suppliers. They argued that these had been primarily responsible for a reduction in GAME's share of mint software sales from [X] to [X] per cent between 2001 and 2006—see Table 3 (although GAME estimated its share of mint hardware sales had increased in the same period from [X] to [X] per cent). While Gamestation had increased its share in both software and hardware by [X] per cent over this same period, this had to be judged in the context of a large expansion in store numbers.
- 7.9 We looked at whether customers would be willing to use a variety of different retailers, whether there were any barriers to customers moving between different retailers, or whether any aspects of customer behaviour mean that customers are unlikely to be mobile between suppliers.
- 7.10 There is a great variety of retailers offering mint gaming products in the high street and on the Internet. As gaming products are identical between different retailers, and there are no apparent barriers stopping people from using different retailers, any barriers would have to be related to the services offered or customers' perception of different retailers. Some differences may be of significance. For example, Internet retailers cannot provide customers with instant supply, and customers may place importance on the ability to browse in-store or consult store staff. Supermarkets and some high street retailers may also hold a limited range of stock.
- 7.11 The parties argued that retailers competed by offering different combinations of range, service, pricing and promotions. They stated that although different retailers might be differentiated in what they offer, this does not indicate that there are any barriers to customers choosing a different offer in response to a change in relative prices. The specialists' average list price levels tended to exceed those of the supermarkets and Internet retailers, although we noted in the parties' evidence on relative pricing levels a high degree of dispersion in relative prices between different retailers for different games rather than a consistent relationship. The parties attributed differences in average price levels to differences in the service and store environment they offered. They also pointed to the extensive use of promotional offers by the parties such as multibuy, temporary price promotions and deals linked to trade-ins which (see Table 1 in Appendix C) apply to [X] per cent of their sales, which they said meant that simple list price comparisons were potentially misleading. They argued that the trade-in facility also provided an easy means for gamers to reduce the net cost of purchasing games, and that pre-owned games provided an alternative for price-sensitive customers.
- 7.12 Various customer survey evidence shows that many customers purchase gaming products from a variety of suppliers (see paragraphs 6.44 to 6.46), consistent with customers switching between different retailers and different types of supplier.
- 7.13 Survey respondents also indicate a variety of possibilities when asked what would be their next best alternative retailer if their current choice was unavailable.⁶¹ For example, the parties' exit survey conducted by GfK asked mint customers what their

⁶¹RBB considered that respondents to the BMRB survey, or the exit survey conducted by GfK for GAME, who were customers of GAME or Gamestation, would be more likely to consider Gamestation as an alternative to GAME than would other consumers, due to the selection of respondents. We disagreed: we did not consider that there was any reason for these survey respondents to be any more or less likely inclined to mention Gamestation as an alternative to GAME (or vice versa) than other customers of these retailers. However, we note that these survey samples are not intended to reflect all customers in the market in total.

next best alternative retailer would be if they were unable to use the one they had used most in the last 12 months, see paragraph 85 and Table 7 in Appendix D. GAME customers gave a variety of responses: Gamestation [X] per cent, HMV [X] per cent, Woolworths [X] per cent, Play.com [X] per cent, Tesco [X] per cent, Amazon [X] per cent, Asda [X] per cent, Argos [X] per cent, Zavvi/Virgin Megastore [X] per cent and others [X] per cent. Gamestation is, however, the most frequently named next best alternative. Similarly, [X] per cent of Gamestation customers named GAME as the next best alternative.

- 7.14 RBB Economics argued to us that diversion ratios are an important indicator of the closeness of competition between suppliers; it claimed that when firms are their closest competitors a rise in one firm's price diverts more consumers to the other than would be predicted by their market shares. Such considerations can be informative in showing whether customers perceive these suppliers to be close substitutes or not (although the key questions on evaluating the effects of the merger is to what extent customers would switch between the merging parties prior to the merger, and hence this constraint is internalized, or that they would switch to other suppliers). RBB Economics used apparent market shares, derived from survey shares, and noted that survey respondents reported Gamestation and GAME to be the next best alternative on fewer occasions than would be expected given their respective survey shares. However, we carried out a similar analysis on the basis of actual market share estimates for mint games (see Table 2) and pre-owned games (from Table 4), and found that the stated diversion by survey respondents exceeded the diversion that would be expected on the basis of actual market shares, suggesting that the parties are close competitors according to RBB's definition.
- 7.15 In the RLO survey (see Appendix D, paragraph 86) that GAME commissioned from GfK, customers were asked similar questions about alternatives for mint games and Gamestation or GAME was mentioned most often: [X] per cent of mint customers who had used GAME most in the last 12 months said that their next best alternative retailer would be Gamestation, and similarly [X] per cent of Gamestation customers thought GAME was the next best for mint games.
- 7.16 We then considered whether consumers could be expected to move to these different retailers of mint product in response to marginal changes in relative prices (the survey questions about next-best alternatives were based on the existing retailer of choice no longer being available, rather than asking whether a customer would actually be responsive to relative changes in price).
- 7.17 Various survey evidence shows that customers attribute the greatest importance in their purchase decisions to pricing (see paragraphs 4.64 to 4.69). While this does not necessarily mean that they will choose to purchase from the cheapest source, given the differences in the service offered by different retailers, it suggests that there is consumer sensitivity to changes in relative price. Prices on, particularly, latest releases and chart games tend to be promoted or advertised quite visibly. It is likely that many marginal customers will be aware of relative price changes because of advertising and promotional displays, information in gaming discussion websites, reviews in magazines, because prices can be researched on the Internet, and because many customers will have cause to shop at high street and supermarket retailers. We note that both GAME and Gamestation monitor competitors and that their pricing can be responsive to changes by significant bricks and mortar competitors such as [X].
- 7.18 For these reasons, it appears likely that a proportion of marginal customers will become aware of any increase in relative prices by the parties following the merger, and so will be able to switch to alternative retailers.

- 7.19 However, HMV told us about a pricing initiative in November and December 2006 where it dropped the price of the top-20 games for each of seven formats by £5 or £10 (implying a proportionate price reduction of up to 25 per cent). It found that it increased its market share by [X] to [X] per cent (ie a [X] to [X] per cent increase in sales in proportionate terms, but across all games, not just the top 20). This suggests that customers were not very highly price-elastic between retailers; however there were indications that rivals may have been reducing prices at the same time meaning that changes in relative prices were less than implied above. GAME told us that some of its promotions at this time were partly in reaction to HMV's price cuts, and other rivals would also have been promoting their products in the run up to Christmas.
- 7.20 Despite GAME and Gamestation being named as the next best alternative retailer for each other, we see that there are many alternative retailers open to customers. Therefore, even though the customers of one of the parties might switch by preference to the other, if the merged entity were to raise prices the customers would also be able to switch to a wide variety of other retailers, both bricks and mortar retailers, and Internet retailers who have advantages in terms of their range and prices.
- 7.21 There may also be a limited degree of substitution between console games and PC games.
- 7.22 Consequently we conclude that because of the ready availability of alternative retailers, the fact that customers already tend to use a variety of retailers, the growing use of non-specialist retailers and Internet retailers, and the lack of barriers to switching, we do not expect there to be potential for a sustained increases in the parties' prices for mint products post-merger.

Pre-owned

- 7.23 The number of alternative suppliers is more limited for pre-owned gaming products than for mint and the parties' market shares are higher, see Tables 4 and 5. Supermarkets, high street generalists and electrical specialists do not offer pre-owned products. Alternative suppliers are: independent gaming specialists; Blockbuster; sales by individuals and companies through Internet retailers; and auction sites such as via Amazon Marketplace and Play.com's PlayTrade, or via eBay. Pre-owned can also be obtained second hand or at exchange shops, and via informal routes such as car boot sales.
- 7.24 We considered the closeness of competition from these potential substitute suppliers, bearing in mind also customers' ability to switch to mint products. We looked at what customers said about their alternatives for pre-owned games, based on the GfK survey results. Among those interviewed in the GfK exit survey (see Table 8 in Appendix D) who bought pre-owned games mostly from GAME in the previous year, [X] per cent of respondents named Internet suppliers (including eBay and websites belonging to bricks and mortar retailers) and [X] per cent named bricks and mortar retailers other than the parties (ie independent stores). Gamestation customers expressed similar preferences, within the margins of error of the survey. No GAME customers mentioned informal routes such as car boot sales, and just [X] per cent of Gamestation customers did so. However, for both parties the primary alternative was each other; [X] per cent of customers who used Gamestation most for pre-owned would turn to GAME, and [X] per cent of GAME customers would turn to Gamestation. We also looked at the GfK RLO survey results (see paragraph 86 of Appendix D) and found that the pattern of alternatives was similar to that in the exit survey but the percentages were generally higher. The reason was that one-fifth of

those questioned in the exit survey did not give an answer, while in the RLO survey all gave an opinion. [X] per cent of customers who bought pre-owned games mostly from GAME would turn to another bricks and mortar store, [X] per cent named Internet suppliers, and [X] per cent mentioned informal sources. Similar percentages of Gamestation customers mentioned these alternatives, within the margins of error. Again, the most popular alternative for each of the parties was the other: [X] per cent of GAME customers saw Gamestation as the best alternative, and for [X] per cent of Gamestation customers it was GAME.

- 7.25 BMRB also asked about alternatives for pre-owned games and found that GAME customers were more likely to see the Internet as an alternative than were Gamestation customers but also found, as had GfK, that the most popular alternative retailer for each of the parties was the other. BMRB was told (see paragraph 83 of Appendix D) that if GAME stopped trading on the high street, 35 per cent of customers who last bought from GAME would buy from the Internet instead and 32 per cent would shop at Gamestation. Correspondingly, 24 per cent of Gamestation customers would turn to the Internet and 51 per cent would turn to GAME.
- 7.26 The largest single alternative bricks and mortar retailer of pre-owned products is Blockbuster; it has a national chain of shops offering pre-owned products, sourced either from trade-in or its ex-rental stock. The range of pre-owned games offered varies depending on the size of the shop. Blockbuster's 2006 sales of pre-owned products were considerably lower than the parties at £[X] million (pre-owned software sales were £[X] million) compared with £[X] million for Game and £[X] million for Gamestation (£[X] million and £[X] million respectively just for software). Blockbuster said that it had always sold ex-rental games and had introduced trade-in in 2004. It said that it had aspirations to continue growing these activities. [X]
- 7.27 We identified 487 independent retailers of pre-owned gaming products in the UK (excluding Choices UK, which ceased trading as a bricks and mortar retailer during the course of this inquiry).⁶² The great majority of these told us that they sold pre-owned gaming products, with many reporting over 50 per cent of their sales from pre-owned. The parties submitted a survey of 133 independent retailers conducted on their behalf by Kadence (UK) Ltd (Kadence) in September 2007. It similarly found that [X] per cent of all independents sold both mint and pre-owned, with [X] per cent of sales being generated by pre-owned.
- 7.28 Alternative sales routes are second-hand or exchange stores and informal trading via car boot sales, swaps etc. However, only [X] per cent of all purchasers of pre-owned games in the GfK exit survey, and [X] per cent in the RLO survey, named these as their next best alternatives. This suggests that while they are a potential substitute, few customers think of them as a viable alternative.
- 7.29 Pre-owned products are available through websites such as Amazon Marketplace, Playtrade and eBay. We note that sales through these channels have increased substantially, particularly sales of consoles between 2005 and the first half of 2007. For example, eBay sales of pre-owned games and consoles in 2006 were approximately £[X] million compared with approximately £[X] million in 2005—see Table 8 (this excludes sales of new products through eBay). First half sales in 2007 suggest accelerating growth in sales. It is possible that this growth has been driven

⁶²These retailers are comprised mostly of independent gaming specialists, but we include here some second-hand stores which tend to have a significant offer of gaming products, such as CEX.

by the release of new consoles, leading to customers seeking to upgrade their hardware, but this could equally apply to greater trade-in of hardware through bricks and mortar retailers. Software sales have also increased, albeit less rapidly.

TABLE 8 eBay UK sales of used gaming products, 2005 to 2007

	Sales value £'000			Sales quantity '000		
	2005	2006	2007H1	2005	2006	2007H1
Consoles and systems						
Games						

Source: eBay.

Note: Conversion rates: 2005 £1=US\$1.8189; 2006 £1=US\$1.8430; 2007H1 £1=US\$1.9703.

- 7.30 Again we considered whether consumers could be expected to move to these different retailers of pre-owned product in response to marginal changes in relative prices. Survey results indicate a substantial degree of potential switching between GAME and Gamestation, which might indicate that the effect of the merger could be to internalize some of the existing competitive constraints. However, there exist various alternative retailers selling pre-owned which could be used if both the parties increased their prices post-merger (as noted in paragraph 6.55, there is evidence of customers comparing prices before purchasing). Further, the choices of best alternative retailer detailed in paragraphs 7.24 and 7.25 refer only to suppliers of pre-owned products, but because the prices of mint games from the cheapest retailers (particularly Internet and supermarket retailers) are often similar to the parties' pre-owned prices, customers could also easily switch to mint games from those other retailers without having to pay more.
- 7.31 We looked for evidence on whether there was a customer perception of barriers to purchasing from the Internet which would limit their responsiveness to relative prices. However, we were not persuaded that so many customers continue to be reluctant to or lack the means to purchase from Internet suppliers as to mean that these do not act as a competitive constraint. We also note that Internet trading sites operate schemes to allow customers to reclaim their money for faulty or misdescribed products. Survey responses also indicate that a substantial number of customers would be prepared to use Internet retailers. With regard to Internet auction sites, as demonstrated in paragraph 6.56, the parties' RLO survey found that [redacted] per cent of past users said that they would use eBay again to purchase pre-owned games; and of pre-owned purchasers who had not used eBay, [redacted] per cent said that they would consider it in the future while [redacted] per cent said that they would not.
- 7.32 Internet retailers and auction sites confirmed to us that their sales have grown very significantly in recent years (eg see Table 8) as they have become more prominent and accepted, and their market shares have increased.
- 7.33 Because of the potential for demand-side substitution between mint and pre-owned product, because of the availability of alternative retailers of pre-owned product in the shape of Blockbuster, independent retailers and Internet retailers and auction sites, and because there are indications that customers are responsive to relative prices, we consider that it is likely that at the margin customers would be able to switch away from the parties in the event of a relative price rise for pre-owned.
- 7.34 However, this was a finely balanced conclusion in that the effect of the merger could be to internalize the constraint that previously existed arising from customers switching between the parties, and it is a matter of judgement taking account of the

range of evidence whether or not the factors discussed in paragraph 7.33 are sufficient to offset this—see paragraphs 7.113 to 7.130.

- 7.35 Possible effects of the merger on the trade-in of products are considered in paragraphs 7.47 to 7.75.

Vulnerable market segments for mint and pre-owned gaming products

- 7.36 We considered whether there could be a lessening of competition in any particular segments of the supply of mint and pre-owned gaming products. Two possibilities were considered: whether an adverse effect might be realized in the supply of non-chart mint products; and whether an adverse effect might occur for pre-owned products where mint equivalent products are not available. One retailer, GameStop, put it to us that, in both cases, the extent of competition could be less than for chart games.
- 7.37 Considering mint non-chart games, competition might be less intense because some of the competitors faced by the parties concentrate on supplying only mint chart games, including the supermarkets and some of the high-street retailers and electrical specialists. One retailer told us that it had observed that GAME's prices relative to the Internet providers were lower for mint chart games than non-chart games.
- 7.38 The parties argued that there was no potential for price rises in non-chart products because of the degree of competition provided by specialist and Internet suppliers, and those high street stores with a broad product range. They argued that customers could easily substitute between different game titles if the price of one segment were increased relative to others, ie that demand would shift to chart games.
- 7.39 The parties also argued that it would not be feasible to discriminate selectively in order to increase the prices of non-chart products. They argued that such products represented a small part of their sales, that there was no precise definition of what constituted a chart or non-chart product, and that it would be difficult to identify when products moved from chart to non-chart status. Further, because different editions of a game may be issued over its life cycle, and/or promotions offered on games, it is possible for older games to re-enter the charts. Publishers often take the initiative in cutting supply prices in return for retail price reductions. As the purpose of such promotions and new editions is to drive further sales volumes, attempts to maintain higher prices would be counterproductive.
- 7.40 We accept that it is likely that retailers who currently have a limited range of products could expand that range in the event of a relative price increase for non-chart products. In the case of multi-product retailers, their allocation of store space to different products is influenced by the anticipated profitability of different products—see Appendix F. An increase in the price of non-chart products will increase the margin available over current levels and so may well generate an incentive to expand the range stocked. This potential for range to be expanded in high street retailers and supermarkets will, we expect, act as a constraint on the ability to increase prices in these products.
- 7.41 Because of the potential for other retailers to expand their ranges of mint products, because these products are already available through other retailers, because of the potential for substitution with other products and also because of the limited feasibility of profitably implementing such a policy, we conclude that the merger is unlikely to create opportunities to increase selectively prices for non-chart games. For these reasons, we think that the broader range offered by GAME and Gamestation will not

of itself be sufficient to protect them from competition from other bricks and mortar retailers.

- 7.42 We also considered whether there was relatively less effective competition for pre-owned games with no mint equivalent. For those pre-owned games for which a mint equivalent no longer exists (because it is no longer published/stocked), by definition, there cannot be substitution for the same title. On the other hand the parties argued that because there is competition between different games for a gamer's attention, price increases could not be sustained for individual games.
- 7.43 As large-scale specialists, the parties offer an extensive range of pre-owned games. GAME offers [X] pre-owned software SKUs in total (though only [X] pre-owned software SKUs are available in each and every one of its stores), whilst Gamestation offers [X] pre-owned software SKUs ([X] of these SKUs are available across all its stores).
- 7.44 We received widely varying evidence as to the extent to which pre-owned sales have no mint equivalent available. GameStop told us that its pre-owned business probably consists of 60 to 70 per cent of titles stocked that are no longer being published or stocked new. However, GAME told us that for approximately [X] per cent of its pre-owned titles sold (by revenue) there was no mint equivalent available ([X] per cent in terms of number of SKUs), although this comparison considers mint products available in any one of its stores. Gamestation indicated that for approximately [X] per cent of pre-owned software sales per month, there existed no mint equivalent (approximately [X] per cent of SKUs).
- 7.45 The parties' evidence suggests that a mint version of a pre-owned title may not always be available in particular stores but there is limited opportunity for them to identify pre-owned SKUs without a mint version available. Just as for non-chart mint products, there may also be practical limitations on the parties' incentives and ability to increase prices. These product areas cover a small proportion of sales. The absence of a mint equivalent suggests that publishers no longer believe that the product has significant commercial prospects. Further, for some games such as retro-format games, only Gamestation, and not GAME, currently stocks these products.
- 7.46 Given these factors and the option customers have to substitute between games, we conclude that the parties' post-merger ability to increase prices selectively for these product segments, and the incentive to do so, are very limited.

Effects of the merger on competition in the trade-in of gaming products

- 7.47 Trade-in is a means of lowering the net price to customers. Where a customer trades-in to finance further purchases (which applies to the great majority of cases) then a reduction in trade-in values offered will increase the net cost to the customer of buying gaming products.
- 7.48 Retailers selling pre-owned products largely recruit their stock from trade-ins, the only obvious exception being ex-rental games. We considered the nature of existing competition in trade-in. We noted that Gamestation tended to offer higher trade-in prices and also had a much higher proportion of its business in trade-in than GAME. GAME told us that it paid cash, rather than credit against future purchases, for only a very small proportion of its trade-ins, around [X] per cent. The figure for Gamestation was around [X] per cent.

Pricing policies for trade-in

- 7.49 Both parties told us that adjustments to the trade-in prices that they offered varied largely mechanically with changes in the stock position on pre-owned products. Thus they said that they did not tend to monitor actively and respond to each other's trade-in prices (although they also said that they monitored prices on eBay). They argued that there was no need to do so, because if their pricing was unattractive relative to competitors then they would be unable to attract stocks, or if their offer was overly generous then excess stocks would quickly accumulate.
- 7.50 GAME and Gamestation provided examples of how trade-in prices had varied over time and how their stock levels had responded to these price variations. The results were consistent with a fairly high degree of price-sensitivity in the supply of trade-ins. We queried how this came about when in general (with the exception of certain promotional offers where discounted prices on new products are conditional on the trade-in of certain games) trade-in prices are not clearly advertised. The customer has to approach the store (eg by taking the product in, although indicative quotes can be given over the telephone) for the retailer to quote an offer price. However, GAME said that it published a customer leaflet listing trade-in prices, and that the trade-in element of its special offers were heavily advertised in store, while Gamestation said that it would display a list of 'most wanted' trade-ins in its stores.
- 7.51 The parties argued to us that the response to adjustments in the trade-in price arises largely because of changes in the aggregate supply of traded-in product. They considered that there was very little evidence of an impact between GAME and Gamestation of changes in their relative price for trade-in. The parties pointed to a trade-in promotion at GAME called 'Quids In' which offered a £1 across-the-board increase in trade-in offers over a three-week period from 5 February 2007. This showed a significant increase in trade-in volumes received, at least in the second half of the promotion period. However, trade-in volumes at Gamestation showed no noticeable reduction, and Gamestation told us that it had not reacted to the GAME promotion. We found it difficult to interpret this evidence because there was a high degree of volatility in the weekly sales for GAME and Gamestation; in particular Gamestation's sales increased much more than GAME's during half-term week while GAME's proportionate increase in sales over the previous year was higher in the last week of the promotion, making it difficult to isolate the effects of the price change, and to distinguish this from any concurrent promotional publicity.
- 7.52 RBB also undertook an analysis of the trade-ins by GAME customers at stores that did not have a Gamestation within five miles. They identified customers who had traded-in (in an 18-month period) at least one of the top-100 most traded in products in 2006 or 2007 within 180 days of the launch of that title. The lowest of the trade-in prices they had accepted was then plotted against the proportion of customers who had, cumulatively, accepted this price. This proportion increased linearly from around £[~~10~~] to £[~~15~~]. While this comparison does not show the minimum offer customers would have hypothetically traded-in for, RBB said that this comparison illustrated that the aggregate supply of product was sensitive to the trade-in price offered, even in the absence of drawing customers away from Gamestation (because these stores did not overlap with Gamestation stores). However, this illustration shows the supply to just one retailer rather than the industry, and does not demonstrate the extent to which the proximity of a Gamestation store might change behaviours.
- 7.53 The parties also referred to evidence suggesting that at least some customers were unlikely to shop around between retailers and that they would simply retain their old games if they could not easily trade them in at their preferred retailer. For example, store exit survey evidence (from the GfK store exit survey and based on analysis by

[redacted]) suggests that if GAME were not to offer a trade-in facility, [redacted] per cent of those questioned would not trade-in, while the corresponding figure for Gamestation was [redacted] per cent. However, the great majority would trade-in—see paragraph 7.57.

7.54 We are not persuaded that there was negligible competition between the parties on trade-in before the merger for three reasons:

- GAME's pricing policies for trade-in reflect the presence of competitors in a local area and the choice of pricing structure used appears to be responsive to the presence or absence of a Gamestation store (see paragraphs 7.56 and 7.57);
- customers have said that they see GAME and Gamestation as each other's closest alternative for trading-in (see paragraphs 7.58 and 7.59); and
- internal papers suggested that there was a perception that GAME and Gamestation were in competition (see paragraphs 7.60 and 7.61).

7.55 These are discussed in turn below.

Trade-in pricing and local competitors

7.56 Gamestation told us that it had consistent trade-in prices in all its stores, subject only to a guarantee to price-match competitors within a 10-mile radius where the customer requests it. GAME told us that its promotional trade-in offers were applied nationally. However, its stores operate on [redacted] trade-in pricing matrices, [redacted]. GAME said that the difference in trade-in price offered typically ranges from £[redacted]. GAME said that the difference in the [redacted], applying to some [redacted] per cent of SKUs (by number), arises because the [redacted] matrix is an attempt to take into account the possibility that in certain locations demand for pre-owned stock from other retailers will be relatively high. [redacted]

7.57 This suggests that the price that needs to be offered for trade-in depends on the number of local competitors offering trade-in, indicating that there is some competitive interaction with other retailers nearby. Our analysis indicated that the presence of a Gamestation is often a relevant factor; we looked at the extent to which GAME's [redacted] distinction corresponded to the presence of a Gamestation in the local area. [redacted] per cent of GAME stores that have no Gamestation stores within half a mile are [redacted], whereas [redacted] per cent of them are [redacted]. For GAME stores that have one Gamestation store within a half mile, [redacted] per cent are [redacted] and only [redacted] per cent are [redacted]. Similar patterns apply over wider areas, whereas no similar pattern was found with regard to the co-location of other retailers offering trade-in, [redacted].

Closeness of substitution between GAME and Gamestation

7.58 Survey evidence suggests that GAME and Gamestation are close competitors for trade-in—see paragraphs 7.24 and 7.25 and Appendix D. Responses to the parties' RLO survey revealed that in the previous year, [redacted] of those who traded in mostly with GAME had used Gamestation and [redacted] of those who mostly used Gamestation had traded in with GAME, [redacted]. Similarly, the BMRB survey evidence suggests that trade-in customers view GAME and Gamestation as the closest competitors to each other. Of the respondents who had traded-in products to GAME, 42 per cent said that the next best alternative to GAME (if it no longer accepted trade-ins) would be Gamestation (compared with 20 per cent for other retailers and 22 per cent for Internet retailers). For Gamestation customers, 52 per cent said GAME would be the next best alternative in that situation, compared with 16 per cent each for other

retailers and Internet. Similarly, in the GfK exit survey, [X] per cent of Gamestation customers said that they would trade-in at GAME if they were unable to use Gamestation, and [X] per cent of GAME customers named Gamestation. [X] per cent of Gamestation and [X] per cent of GAME customers would turn to Internet selling (including eBay and the websites of the parties) and [X] and [X] per cent respectively would turn to other retailers, such as Blockbuster, independent specialists and second-hand shops. [X] per cent for each would use informal channels.

- 7.59 The GfK RLO survey suggested a similar pattern of stated alternatives. There were [X] and [X] respondents who mostly traded-in with GAME and Gamestation, respectively. These are small samples and so the results are indicative rather than precise. Bearing this in mind, over [X] per cent of those who mostly sold to Gamestation said that they would trade-in at GAME if they were unable to use Gamestation, and [X] per cent of those who mostly sold to GAME named Gamestation. All forms of Internet selling were mentioned by around [X] per cent while around [X] per cent mentioned other high-street retailers.

Internal papers

- 7.60 Another indication of the interaction between GAME and Gamestation arises from a review undertaken on behalf of GAME by [X] in 2006. While this is not itself a statement of GAME's policy or view of the market, it discusses the need for 'more competitive trade-in pricing' with reference to the pattern of pricing shown in Table 4 of Appendix C, stating: [X]
- 7.61 This suggests that there was seen to be actual or potential competition between the parties on trade-in prices pre-merger. However, GAME stated that its management had not necessarily endorsed the report's findings and that no policy changes regarding trade-in had been enacted as a result.

Competition with alternative retailers for trade-in

- 7.62 We now consider the extent to which customers are willing to switch to alternative retailers for trading in games, or switching to other channels to sell them.
- 7.63 Paragraph 6.45 lists various retailers named in the GfK survey as means of selling or trading-in used games; a variety of retailers and channels is used although GAME and Gamestation are the main ones. The RLO survey shows similar results: [X] per cent named GAME, and [X] per cent named Gamestation. eBay was quoted by [X] per cent, Blockbuster by [X] per cent, [X] per cent responded with various other high street retailers, and [X] per cent responded with other website traders. Multiple responses were allowed; for the most commonly used source, [X] per cent named GAME, and [X] per cent named Gamestation. eBay was quoted by [X] per cent, Blockbuster by [X] per cent and [X] per cent responded with various other high street retailers, and [X] per cent with other website traders.
- 7.64 The BMRB survey (see Appendix D, paragraph 78) also asked respondents who had recently traded-in software whether they had traded in software with any other retailer in the last 12 months. 28 per cent of those who said GAME was their most recent choice of retailer, and 42 per cent of those who named Gamestation, said they had also traded in with alternative retailers or otherwise sold gaming software in a different way. As a proportion of the 28 per cent of GAME customers who had traded-in or sold elsewhere, 52 per cent had traded-in at Gamestation, 54 per cent at other retailers and 9 per cent via Internet channels. As a proportion of the 42 per cent

of Gamestation customers who had traded-in or sold elsewhere, 76 per cent had traded in at GAME, 34 per cent at other retailers and 8 per cent via the Internet.⁶³

- 7.65 The parties' RLO survey asked respondents when trading-in pre-owned games, whether they first compared prices with high street stores and/or online retailers. Among the respondents who traded-in mostly with GAME and Gamestation, [X] per cent said that they compared prices in other high street stores, [X] per cent online, [X] per cent made comparisons at both, but [X] per cent made no comparisons. This suggests that around half of customers decide where to trade-in with reference to alternative pricing offers.
- 7.66 This indicates that there could be sensitivity at the margin to relative prices offered for trade-ins by bricks and mortar retailers.
- 7.67 We also looked at whether there were indications that sellers would be willing to switch from trading-in at a bricks and mortar store to selling on the Internet. There are advantages to the customer in trading-in at a bricks and mortar games retailer rather than selling products via online channels, because the transaction is generally immediate, and provides instant credit which can be used against a subsequent purchase. It is therefore a useful way for keen gamers to finance their hobby. In contrast, selling via an Internet channel may involve setting up an account, waiting for a sale to be realized, and then packing and sending the product before receiving payment.
- 7.68 The BMRB survey addressed whether customers would be willing to sell products on the Internet, rather than trading-in at Game or Gamestation, by asking them whether, if they could get the same price by selling on eBay or trading in at GAME or Gamestation, which was the best choice, or was there no difference. Customers who had traded-in with particular channels tended to name that channel as the best choice. However, of those who had traded-in at GAME, 6 per cent said that eBay would be their best choice and 25 per cent said there was no difference. For those who had traded-in at Gamestation, 11 per cent said eBay would be the best choice and 27 per cent said there was no difference.
- 7.69 While this is a hypothetical question, it suggests that a considerable proportion of respondents who had traded-in with the parties would be prepared to sell their old gaming products via eBay.
- 7.70 The RLO survey found that [X] per cent of respondents who had sold or traded-in games in the last year had used eBay, with [X] per cent saying it was the means they used most. [X] per cent of past users said they would use eBay again to sell games. When prompted, [X] per cent of those who had not sold through eBay said that they would consider doing so in the future.
- 7.71 Respondents to the BMRB survey who had traded-in with a bricks and mortar retailer rather than selling over the Internet were asked why they would not want to sell via the Internet (see BMRB figure 5.9). Various reasons were given: that it was too risky (16 per cent), don't want the hassle of having to post (12 per cent), too much trouble or too complicated (9 per cent), don't have Internet (5 per cent), never tried/don't know how to (3 per cent), and wanted it immediately/post takes too long (2 per cent). However, 44 per cent of respondents did not give a reason for not wanting to sell on the Internet. In the RLO survey, [X] per cent of respondents who had sold games on

⁶³The proportions of respondents who had made use of other retailers for trading-in hardware was much lower than for software. However, this may reflect that the frequency of trading-in hardware is likely to be much less than the frequency of trading-in games.

eBay said they had not experienced problems using it. Of those who had not sold games on eBay but knew they could, when asked why they had not done so, [X] per cent said convenience, [X] per cent because of trust in the buyer, [X] per cent because of security of purchasing, and [X] per cent because they could not trade-in for a new game.

- 7.72 The range of survey evidence, combined with the evidence on the growth of Internet auction sales and the market share of other Internet platforms, suggests that although GAME and Gamestation are seen by customers as each other's closest competitors for trading-in, there is nevertheless some willingness on the part of consumers to switch to these Internet alternatives.

Incentives regarding the interaction of trade-in and sales of pre-owned

- 7.73 The parties submitted that it would be against their interests to cut trade-in prices, because that would restrict their recruitment of traded-in stock, which was essential to allow them to offer pre-owned products to customers. They stated that competition for mint products forced them to offer pre-owned products so as to have a price competitive offer against other retailers. Thus they argued that any saving on the purchase costs of trade-in would be offset by a loss of the opportunity to sell pre-owned. Further, the parties argued that lower trade-in prices would imply a lower discount on mint and pre-owned sales which are partly financed by trade-ins, reducing the attractiveness of their prices, and that it would reduce the availability of their pre-owned stock.

- 7.74 Because we have concluded that there is little or no opportunity for the parties to increase the price of pre-owned given the constraints that will apply in the market post-merger, if the parties recruit fewer trade-ins, but are unable to increase the sale price of pre-owned, it implies that their stock of pre-owned products will run down over time to the point where they will lose some sales that would otherwise have been profitable. The merged firm may gain additional margins from internalization but such gains will be reduced by switching away from the merged parties. A reduction in sales volumes is not necessarily unprofitable if the effect of reduced volumes is more than offset by increased margins on remaining sales. However, although switching opportunities for trade-in are more limited, and although the parties could therefore have some scope to reduce the trade-in prices they offer post-merger, we considered that there would be enough customers for mint and pre-owned gaming products who would face an effective price increase (because they would receive less trade-in credit) who would be willing and able to switch to other retailers for the parties not to have an incentive to increase prices in this way post-merger.

- 7.75 For these reasons, because of the need to retain a balance in recruiting trade-in stock and because of the potential for customers to switch elsewhere for trade-in and the purchase of mint and pre-owned products, we conclude the ability to profitably decrease trade-in values will be constrained. Again, just as with the scope for switching in mint and pre-owned, this was a finely balanced decision, and this is discussed further in paragraphs 7.113 to 7.130.

Entry and expansion as a constraint

- 7.76 We felt that it was desirable to cover the extent to which entry and expansion would be a constraint to the merged parties increasing prices or worsening service quality, in addition to constraints from other retailers. One potential constraint on the ability of the parties to increase prices or reduce service levels post-merger would be if entrants were attracted into the market on a significant scale because of any

increased margins available, or alternatively if existing suppliers could consequently expand so as to constrain the parties effectively. We therefore looked at whether there were barriers to entry and/or expansion to the market and whether such entry or expansion could be expected to occur in response to an increase in available margins. Possible barriers to entry and expansion are considered in more detail in Appendix F.

- 7.77 With regard to mint products, there is evidence of a wide variety of suitable retail premises being available, there are no barriers to obtaining supplies of gaming products (other than where certain items of hardware are generally in short supply), and retail staff can easily be recruited. Staff will need appropriate training but such requirements will be typical of entry into retailing. A small-scale entrant will be disadvantaged relative to larger entities by somewhat worse purchase terms, and it will be easier for existing retailers, particularly those already operating on a substantial scale, to expand than for a new entrant to pick up sales. However, in general we do not see that barriers to entry and expansion in the supply of mint gaming products are prohibitive. In particular, were margins on mint gaming products to improve, general retailers and supermarkets would be likely to review the allocation of space in their stores as compared with other products. We note that many of the large supermarket chains told us they had expanded their space allocation for gaming products in their stores, or increased the number of stores stocking these products, in the past year.
- 7.78 One retailer, GameStop, told us that new entry was particularly problematic in this industry because small-scale entry would see the entrant at a disadvantage to the merged parties in terms of its purchasing terms, and because it would be less well known and so less attractive to customers. It also said that large-scale entry would be extremely difficult, as these same problems would also apply to some extent and it would be very difficult and costly to find and develop a large number of stores simultaneously, yet without this scale a new entrant would be unable to compete against the merged parties. It felt that there was insufficient headroom in the UK market for a new entrant to achieve the scale necessary to be an effective competitor.
- 7.79 We were not persuaded that these arguments amounted to an effective barrier to entry. The markets for gaming products have been expanding and we expect them to continue to do so. This therefore should present some headroom within which an entrant could establish itself. We did not see that the parties attracted terms substantially better than other competitors (see paragraphs 7.95 to 7.98) or preferential allocation of stock, especially in comparison with large and established retailers. We also do not agree that suitable retail premises are unavailable, as there are examples of certain retail chains either through administration or otherwise wishing to downsize, selling off existing networks of stores. We therefore consider that entry into mint retailing is possible, and do not accept that the effect of the merger is to increase barriers to any further entry.
- 7.80 We considered whether different entry or expansion barriers applied to pre-owned and trade-in activities. Trade-in and pre-owned are necessary parts of the same model as trade-in provides the pre-owned stock (with the exception of ex-rental stock). However, gaming specialists in most cases choose to combine both a pre-owned and mint offer.
- 7.81 The parties argued that entry would not be difficult, because they believed that retailers of mint games could easily expand into pre-owned. However, we heard that various parties had found expansion into pre-owned difficult, and had found it difficult to attract a sufficient volume of trade-in stock. We heard that it was difficult for non-

specialists to determine appropriate pricing for trade-ins and pre-owned, and that staff found it difficult to assess the suitability of traded-in products (eg checking whether products were damaged or the discs matched the product described on the cases). GameStop also put it to us that customers would be cautious about buying pre-owned hardware from a retail chain with which they were not familiar.

- 7.82 The parties argued that there were no special skills required to offer pre-owned/trade-in and that many independent retailers successfully offered these services. They said that staff did not need special training as the price offered for a product was determined simply by scanning the bar code and reading a price off the till display, while product checks were limited to examining the disc for scratches. The parties said that although they had central facilities that could recall, repair and reallocate stock between stores, this was not a requisite for entry into the industry as many retailers, including GAME's concession stores, operated independently and in any case, the cost of such a facility was not high. Both GAME and Gamestation said that a relatively small proportion of their trade-in stock was sent for repair or re-distribution—see paragraph 4.16.
- 7.83 The parties argued that certain retailers involved in trade-in/pre-owned retailing were already expanding through opening new franchises; they pointed to Chipsworld, an independent specialist, which has some 20 franchises, and CEX, a second-hand specialist, which has four franchises out of around 40 outlets, both of which are advertising for new franchises. Further, Blockbuster had in the last few years entered the market and was growing its trade-in and pre-owned business, although its current market share is small. The parties also argued that Internet entry would be possible.
- 7.84 The parties suggested that large retailers such as HMV and Woolworths, who had experimented with the pre-owned/trade-in business, could easily re-enter if there were an increase in the margins available. In an article from *MCV* magazine (2 November 2007), Woolworths implied that they could re-enter the pre-owned market [✂].
- 7.85 While small-scale entry and expansion has occurred, the two large retailers who have experimented with pre-owned trials have decided not to go ahead even though both would appear to be ideally placed to expand into pre-owned. They already have a large level of business in mint products, are well known, and should have no particular disadvantages in organization, management skills, or labour skills. Taken together, the barriers faced appear to raise problems even if none, individually, are insurmountable. It would require a substantial increase in the profitability of pre-owned to create incentives for them to re-enter this activity; we think that a small increase in profitability might prove insufficient.
- 7.86 These factors inhibiting entry into pre-owned are likely to apply to a new entrant integrated into the retail of both mint and pre-owned, as they do to an existing mint retailer diversifying into pre-owned.
- 7.87 However, the retailing of mint gaming products acts as a constraint on the retail prices of pre-owned gaming products, given the substitutability between mint and pre-owned, and so ease of entry in mint is still relevant to competition affecting pre-owned.

Supply-side issues

- 7.88 The merger could affect the relationship between the parties and their suppliers, and may also impact on the relative position of the parties compared with their retail competitors. We consider these two aspects in turn.

Impact on suppliers

- 7.89 It was put to us that the merger would increase buying power, leading to a possible detriment to suppliers. We considered it likely that the larger size of the merged entity would be likely to allow it to negotiate better terms with suppliers. In so far as these better terms are then passed on to consumers as a result of active downstream competition, these would normally be regarded as a beneficial effect of a merger. In this case we looked for evidence that the effect of the increased buying power could adversely impact on competition in the supply of gaming products.
- 7.90 We note that many of the suppliers of gaming products are large international companies. Most notably, consoles and many of the accompanying games are supplied by just three companies, Microsoft, Nintendo and Sony, and [X]. These consoles and games are regarded as 'must stock' products by retailers. Relative to their world business, the share accounted for by the merged entity is small. Under these circumstances we believe that the balance of negotiating power rests with the suppliers.
- 7.91 To a lesser extent, the same considerations apply to many software publishers. These also tend to be large international companies. A concern was expressed that although their major titles may be 'must stock' products, they are also likely to offer a range of less successful titles and retailers could use the potential to refuse to stock these as a tool to demand better terms. It was argued that this threat was more significant when there was only one national chain of specialist gaming shops which would normally stock less popular titles. It was put to us that smaller publishers, particularly those focused on the UK, would be particularly at risk from the threat to de-list their products.
- 7.92 However, there appeared to be very few publishers in this position and we received little evidence of concern from them. There seemed to be very little development of products specifically for the UK market rather than for international customers, and so we were not persuaded that there would be a detriment in terms of innovation or supply to the UK, as the UK tends to form only a small part of the total customer base for these products.

Impact on competition among retailers

- 7.93 We considered whether the strengthened buying power of the merged entity could leave it in a position where other retailers would by comparison be greatly disadvantaged in their ability to compete, with particular regard to the allocation of scarce games and consoles by suppliers, the allocation of special edition and exclusive games, and about the purchase terms that would be achieved.
- 7.94 In many cases, for a period around and after the launch of a new console, there is a scarcity of supply in the market and retailers are unable to get as many stocks as they would wish. Occasionally, this may apply for a sustained period, for example, the Nintendo Wii was in short supply through the run up to Christmas 2007, over a year after it was launched (consequently Wiis sold at a premium through eBay and many retailers sold Wiis bundled with packages of games and accessories). The same situation very occasionally applies to games but this is much rarer, as games are easier to mass produce at short notice.
- 7.95 We considered whether the merged entity may be able to demand a disproportionate share of the allocation of consoles, which would realize benefits to it in console sales, and accompanying and subsequent software and peripheral sales. GAME told us that at present it was subject to shortages of supply so its current size did not afford it

preferential allocation. The console manufacturers did not regard the gain in market power of the merged entity as significant. Rather, they felt they were able to choose how to allocate consoles in such circumstances and that as a new console release had to be stocked, the parties would be unable to exert any increased market power. Generally, they sought to allocate consoles in proportion to recent overall market share, although this may be adapted to favour slightly some of the high street shops which achieve proportionately better sales of hardware than software. The console manufacturers did not anticipate that the merger would change this.

- 7.96 We also considered special edition games. Some independent retailers complained that the parties were already able to secure a preferential allocation of such games, which may come in special boxes, be accompanied by related accessories, toys or mementos, or whose software may contain extra features. However, the software suppliers did not express any concern that their ability to distribute these as they saw fit would be compromised, and it appeared to us that such products were of very limited overall significance in the market.
- 7.97 The same applies to exclusive games. While some retailers do sell games to which they have been granted exclusive rights, we were told in the main that publishers would seek as wide a distribution base as possible for any games that they anticipated would be successful. Exclusives are rare (GAME told us that exclusive products accounted for [redacted] per cent of its sales since 2004) and are unlikely to involve games with significant sales.
- 7.98 It was also suggested that the parties would be able to negotiate much better buying terms than competitors, which would give them a marked cost advantage allowing them to undercut competitors and acting as a disincentive to entry and expansion. However, while some suppliers do offer volume-linked pricing, the typical terms we observed were not exceptional in this industry compared with others. Moreover, for some large suppliers, including the three console manufacturers, either the parties were already on the best terms that the suppliers were willing to concede or standard pricing terms applied regardless of volume.
- 7.99 We therefore conclude that the merger is unlikely to significantly impact on competition in retailing through the impact on the parties' relative buying terms.

Conclusions on the competitive effects of the merger

- 7.100 For the reasons discussed in paragraph 7.22, we do not expect that the parties will be able to profitably maintain an increase in prices for mint gaming products as a result of the merger. The same factors apply in the markets for mint software, consoles and peripherals and so we consider that this conclusion applies to all three of these product markets.
- 7.101 Similarly, we consider that the evidence suggests that at the margin, enough customers are likely to seek to switch to alternative retailers for pre-owned products in response to an increase in prices by the merged parties. The options open to customers and the ease of switching are not as attractive as for mint products. However, in conjunction with the constraint posed by the interaction between mint and pre-owned prices (ie that customers will switch to mint titles sold in other retailers in response to an increase in pre-owned prices because the price differential is no longer seen to justify the purchase of a product perceived as inferior), we conclude that the parties' ability to increase prices for pre-owned following the merger will be limited. We have seen no reason to conclude that there will be any differences in this regard between software, consoles and peripherals.

- 7.102 We note that the margin that can be achieved on the sale of pre-owned is a function both of the retail price of pre-owned, and the cost price of purchasing the traded-in product from customers. We therefore also need to consider their interaction with trade-in.
- 7.103 The evidence relating to trade-in is mixed. On the one hand the parties have by far the largest share of trade-in, and for each, it appears that their customers consider the other one to be the closest potential alternative for trading-in or selling old products. This suggests that the amount of business that would be lost to other channels and retailers in the event of a price increase would be limited, and this would impact on the parties' incentives in setting trade-in prices.
- 7.104 We also note evidence of pre-merger competition between the parties, particularly the choice of which trade-in pricing schedule to use by GAME in particular stores appears to heavily influence whether there is a Gamestation store in close proximity, suggesting that the two are in competition to attract trade-ins.
- 7.105 However, alternative retailers are available to customers: Blockbuster is expanding its pre-owned/trade-in activities and there are many local independent gaming specialists or second-hand stores available. We also observe recent growth in Internet activity for pre-owned suggesting more consumers are selling via these channels. Survey results indicate that in principle a sufficient proportion of customers would be willing to switch to selling via Internet channels to make a price increase unprofitable.
- 7.106 We note that if the parties restricted trade-in prices and traded-in volumes fell, the reduction in supply would imply that stocks of pre-owned product would run down over time meaning that the parties would be unable to maintain their pre-owned offer. In order to balance this, the appropriate response would be to increase prices in the pre-owned market. We have found that the ability to increase prices in pre-owned is restricted. Consequently a reduction in trade-in prices is likely to lead to missed opportunities for sales of pre-owned by the parties. We also acknowledge that the parties have been making use of trade-in and pre-owned as a competitive tool to compete against lower-priced competitors.
- 7.107 Given the conflicting evidence and incentives applying to the parties, our conclusion has to take account of all the evidence in the round. The incentives and evidence are finely balanced. However, taking account of the existence of alternative retailers for trading-in and channels to sell unwanted products, the growing use of Internet sales and increasing willingness among customers to use these channels, and because the interaction between mint, pre-owned and trade-in means that each is likely to restrict the other but there is effective competition between retailers in at least part of this chain, we conclude that the merger is unlikely to generate a reduction in trade-in prices.
- 7.108 Similar considerations apply to consoles and peripherals as well although trading in such products is likely to be less frequent than for software.

Conclusions on the SLC test

- 7.109 In answer to the questions in section 35 of the Act, in paragraph 3.22 we concluded that the completed merger of Gamestation by GAME is a relevant merger situation under section 23 of the Act, and that we therefore have jurisdiction to consider the competitive consequences of the merger.

- 7.110 For the reasons set out in paragraphs 7.100 to 7.108, and in comparison with the situation expected to prevail in the absence of the merger, set out in paragraph 5.8, we conclude that the merger has not resulted, and may not be expected to result in an SLC in the markets for the supply of gaming software, consoles, and peripherals to consumers in the UK.
- 7.111 Two of the four members of the Group, Alexander Johnston and Ian Jones, took a different view, concluding that the evidence in this inquiry supported an adverse finding in relation to the sale and trade-in of pre-owned software. Because the Group was evenly divided as to the conclusion to be drawn from the available evidence concerning pre-owned software, the Chairman exercised her casting vote⁶⁴ in favour of the finding that the facts found in this inquiry did not support an anti-competitive outcome.
- 7.112 The reasons why Alexander Johnston and Ian Jones disagreed with the conclusions of the rest of the Group are expressed in a note of dissent in paragraphs 7.113 to 7.130.

Note of dissent

Introduction

- 7.113 We agree with our colleagues that the merger is unlikely to result in an SLC in the supply of mint game products (software, consoles and peripherals), and of pre-owned consoles and peripherals. However, we believe, on balance, that the merger is likely to cause an SLC in the supply of pre-owned software, which currently accounts for 15 to 20 per cent⁶⁵ of the combined UK sales of the parties. Also, unlike our colleagues, we do not believe that the available evidence supports a conclusion that there are national markets for either mint or pre-owned software.
- 7.114 The SLC that we anticipate in the supply of pre-owned software, will, we believe, enable the parties to increase the margin that they currently earn between the purchase price and sale price of pre-owned stock. This will be achieved by a combination of an increase in the average selling price of pre-owned product, and a reduction in the average price at which pre-owned products are purchased from consumers. The parties have a clear incentive to attempt to engage in such behaviour for the reasons set out in paragraph 7.2.
- 7.115 The parties argued that any attempt by the merged company to improve profitability by raising the price of pre-owned games and/or reducing trade-in prices would be unsuccessful.
- 7.116 They suggest, first, that the own-price elasticity of demand for pre-owned products faced by the merged company will be very high. In effect, they argue that there is a 'mint ceiling' constraining prices of pre-owned products. Their argument was supported with data showing that the average price of mint products sold by supermarkets and Internet retailers was only slightly higher than the average price of pre-owned products set by the parties. They claimed that, given the quality differential between mint and pre-owned products, any attempt by the parties to increase pre-owned prices would be rendered unprofitable as consumers switched to

⁶⁴Competition Act 1998, Schedule 7, paragraph 21. It should be noted that the Act (Schedule 7, paragraph 20(2)) requires that at least two-thirds of the members of the Group conclude that there would be an anti-competitive outcome for there to be an SLC finding.

⁶⁵The sum of their sales of pre-owned software as a proportion of their combined sales of all mint and pre-owned products, year to end December 2006 or end January 2007.

buying mint products sold by low-cost retailers, notably supermarkets and Internet sales channels. Consumers could also switch to pre-owned products sold either by other bricks and mortar retailers, such as Blockbuster and the independents, or through Internet channels.

- 7.117 In relation to the purchase of pre-owned product, the parties contend that the companies did not, in fact, compete for pre-owned product prior to the merger, so that the supply elasticity facing the merged company would be no different from that facing each of the parties prior to the merger. There would therefore be no change in the incentives facing the merged company that might encourage it to reduce the trade-in prices it offered.
- 7.118 We consider pre-owned prices first and then the purchase of pre-owned stock (trade-in prices).

Increasing pre-owned prices

- 7.119 A unilateral increase in the prices of pre-owned products by the merged parties would be unprofitable if sufficient consumers switched either to purchasing mint products from other suppliers of mint products or to purchasing pre-owned products from other suppliers of pre-owned products.
- 7.120 As reported in paragraphs 6.13 to 6.33, the parties produced several pieces of evidence in support of their argument for a strong demand-side constraint on the level of pre-owned prices set by the merged company. We agree with our colleagues that none of the evidence relating directly to market outcomes stood up to close scrutiny as an indication of how demand would respond to a unilateral small increase in the price of pre-owned products. Unlike our colleagues, we do not accept that the evidence derived from consumer surveys, demonstrating that many individual consumers purchased both pre-owned and mint software, and that GAME and Gamestation customers purchased pre-owned products from other bricks and mortar retailers or from Internet sites, is at all conclusive about consumers' propensity to switch in response to quite small relative price changes. Nor do we find the somewhat mixed evidence from consumer surveys relating to consumers' awareness of the selling prices offered by different retailers indicative of a high degree of price-sensitivity.
- 7.121 We considered several other pieces of evidence bearing on the likely market responses to an increase in pre-owned prices by the parties post merger. First, as shown in Appendix D, Annex 2, whilst the average prices of pre-owned products sold by the parties may indeed be close to the average price of comparable mint products sold by supermarkets and Internet retailers, these averages disguise the fact that there is currently a very wide range of price relativities between the pre-owned price set by each of the parties and the mint prices charged by the supermarkets and the leading Internet sites for individual titles. This wide variation in price relativities, and the fact that a significant proportion of pre-owned titles are priced 10 per cent or more above the 'competitive' mint price, seems to us to undermine the parties' argument that there is a 'mint ceiling' constraining pre-owned prices. We think that retailers will set the prices for individual pre-owned titles taking account of several factors, including their own price for the mint version of the title concerned, the mint price set by low cost retailers, and the price of the pre-owned version of the title set by other retailers of pre-owned products. In this way, conditions of competition between the set of retailers selling pre-owned products will affect the level of pre-owned products. This could imply that there are separate markets for mint and pre-owned software, which in our view is plausible. However, we do not need to take a view on whether or not there are separate markets for mint and pre-owned software, as the significant

lessening of competition that we anticipate will manifest itself in a combination of higher selling prices and reductions in the prices at which pre-owned products are purchased from consumers. And the probability of market entry needs to be assessed in relation to a possible increase in the gross margin earned on pre-owned products, which also depends upon both the selling and trade-in prices.

- 7.122 In considering the conditions of competition for pre-owned stock, we note that the set of suppliers for pre-owned products is very much more limited than for mint products, and the parties have a much larger share of pre-owned sales than they do of mint sales. On the CC's estimates, GAME, with around [§<] per cent and Gamestation, with around [§<] per cent, together currently account for between 50 and 55 per cent of pre-owned software sales nationally.⁶⁶ The parties' combined market share in those local markets where they currently overlap, which, we believe, is the relevant context in which to assess the degree of competitive interaction, is likely to be significantly higher even than this. The parties are by far each other's closest competitors, as shown by the survey results reported in paragraphs 7.25 and 7.26 that identify the next best alternative if a particular supplier was not available. The fact that GAME and Gamestation set identical prices for around one-third of their pre-owned titles is, we believe, indicative of close competition between the two companies in the supply of pre-owned products.
- 7.123 Finally, the parties' ability to engage in multibuy and other promotions for pre-owned (as well as for mint products) also acts to reduce pricing transparency. This would tend to soften competition and reduce demand response to any unilateral price increases the parties sought to impose in pre-owned products.
- 7.124 We conclude that, on balance, the merged company would have some ability profitably to increase pre-owned prices.

Purchase of pre-owned stock

- 7.125 As noted in paragraphs 7.51 and 7.52, the parties presented evidence which they claimed supported their contention that they did not compete for supplies of pre-owned stock. For the reasons given in paragraph 7.54 we did not find the evidence persuasive.
- 7.126 However, even if the supply elasticity facing the merged company may indeed be somewhat lower than that facing each of the pre-merger companies, it may also still be sufficiently high as to discourage any attempt by the merged firm to increase margins by reducing trade-in prices. Consumer survey results indicate that whilst GAME and Gamestation are by far each other's closest competitors, a significant proportion of their customers would be prepared to trade-in pre-owned software either with other bricks and mortar suppliers or on Internet auction sites, notably eBay.
- 7.127 As noted above, such evidence tells us nothing about willingness to switch in response to a small price reduction. Instead, in assessing the likelihood of switching, we put weight on two factors. First, the trade-in prices offered by the parties are far from transparent. Unlike the selling prices of mint and pre-owned stock, they are not advertised on either companies' website. This means that customers must actually contact retailers to find out about trade-in prices. This does not preclude search activity, but suggests to us that to the extent that it happens, it is most likely to be confined to well known retailers offering a trade-in service. Consumer survey

⁶⁶See Table 4.

evidence indicates that, in many cases, these will be either a GAME or a Gamestation store. Second, as with the sale of pre-owned stock, the parties have the ability to engage in bundling or special multibuy offers, thereby reducing price transparency, softening the degree of price competition, and reducing the likely degree of switching away in response to any reduction in trade-in prices offered by the parties.

7.128 We therefore conclude that the merged company would be able profitably to reduce the trade-in price offered on pre-owned product.

Market entry

7.129 Given the experience of other major retailers discussed in paragraph 7.81, we believe that a significant increase in the margin on pre-owned stock would be required to attract entry into the supply of pre-owned products on a sufficiently wide scale as to constrain the conduct of the merged company. We would therefore expect the merged company to be aware of this possibility, and to increase margins materially but not so much as to attract new entry.

Conclusions of the note of dissent

7.130 We therefore conclude that the merger would result in an SLC such that the merged company would be able profitably to widen the margin on its sales of pre-owned stock by some combination of an increase in the selling price of pre-owned games and by a reduction in the trade-in price.