# Barriers to entry

1. Where entry is easy, an SLC as a result of a merger is unlikely, provided that such entry is sustainable and likely to have a timely impact on the potential for existing firms to exercise market power.[1] This appendix contains our detailed consideration of the evidence on entry into the supply of football pools in support of the conclusions reached in paragraphs 7.26 to 7.28 of our report.

## Parties' views

2. The parties consider that barriers to entry as a football pools operator are insignificant, but that entry is nonetheless unlikely due to the decline in the popularity of football pools. Sportech in particular suggested that if its business could be turned around successfully this would attract entry, and that potential entrants were waiting to see how Sportech's growth strategy would fare.[2]

## Past entry

3. No entry has occurred in the recent past. Rather, the market is characterized by a gradual, at times dramatic, decline in the number of operators.[3]

## Expansion

4. The number of football pools operators remaining in the UK today is very small. Besides Vernons and Sportech, the only other known pools operator is Brittens.[4] Brittens is small compared with the parties (less than 1 per cent market share of football pools by revenue in 2004). It is currently not exerting any appreciable competitive pressure on Vernons and Sportech and would need to expand considerably to do so—we are not aware of such expansion plans.

## Barriers to entry

5. Potential barriers to entry in the operation of football pools fall into three categories: regulatory barriers, the economics of the pools (including the network externality) which might require entrants to be of a certain scale, and the nature of the customer base.

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[1] See *Merger Guidelines, CC2*, paragraph 3.45, p34.
[2] In particular, Sportech told us that for major international gaming operators, any cost-related barriers to entry would be insignificant, given the scale of their business, marketing activities and their large customer base. Evidence from Gala Coral supports this view.
[3] David Forrest's paper *The Past and Future of the British Football Pools* mentions that the number of operators dropped from 231 in 1948 to 42 in 1950 and just 5 in 1974. See the first footnote to paragraph 5 of Appendix C.
[4] We are aware that at least one football club, Celtic, also runs a small-scale pools competition. However, this game differs from the other pools in that players do not choose teams or attempt to forecast results. In addition, such pools are very small and their target market limited to the club's supporters. It is therefore doubtful that they compete directly, let alone effectively, with the bigger pools.

### *Regulatory barriers*[5]

6. Regulatory barriers to entry are low. Compliance with the relevant legislation is required, but the burden of compliance is not onerous.

7. Under the Gambling Act 2005, which came into force in September 2007, pools operators require a 'pool betting operating licence' from the recently-established Gambling Commission. There are two types of activity that can be specified in an application for a pool betting operating licence: non-remote pool betting and remote pool betting. Non-remote betting is carried out in person, while remote pool betting refers to betting via the telephone or Internet.

8. The fee payable to the Gambling Commission depends on whether remote betting is offered, as well as on the pool's gross annual gambling yield, classed into three bands: *(a)* anything up to £5 million; *(b)* between £5 million and £100 million; and *(c)* over £100 million. By way of example, a pools betting operator in band *(a),* offering both remote and non-remote betting, will have to pay (i) a non-remote application fee of £659 plus an annual fee of £2,121; and (ii) a remote application fee of £659 plus an annual fee of £1,500 with effect from September 2007. Overall, the new Gambling Act makes operating a pools business more expensive than was previously the case (prior to September 2007, a pools promoter's annual registration fee was only £464).

### *The economics of the pools—network effects*

9. Network effects arise when the value of a product to a customer increases with the number of other customers. This constitutes a barrier to entry, as an entrant needs to acquire a customer base of sufficient size in order to compete effectively.

10. In the case of the football pools, the number of customers—together with the payout ratio—determines the size of prize fund and hence the magnitude of potential winnings. Since large top prizes for small stakes are the key attraction of the product, a viable pools business would have to enter on a certain scale, to ensure that its initial jackpots were large enough to be seen as a substitute for the existing pools.[6]

11. In addition to the size requirements arising from the network effect, the scale necessary to support an effective business operation in the pools market is not insignificant. Necessary investments include IT systems, call centre resources, and facilities to process entries, which can be substantial (and prohibitive for small firms).

12. It is uncertain how large an entrant would have to be to be successful. According to Sportech, existing providers of other gambling products (eg online gambling companies) would find it easy to enter on a sufficient scale. Ladbrokes, on the other hand, believes that generating customer interest in a new pool would be very difficult. At present, there is no indication that any company has plans to enter the supply of football pools on a large scale.

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[5]A fuller description of the regulatory regime applying to football pools is in Appendix D.

[6]Since the prize fund is a function of revenues and the payout ratio, an entrant could in theory offer top prizes on the same level as Sportech and Vernons without the need for an equal number of customers, simply by offering a higher payout ratio. Offering insurance-backed top prizes is another potential alternative. However, such a strategy would be costly for the entrant, requiring a higher initial investment and reducing profitability.

### *Marketing to attract new customers*

13. Attracting a sufficient number of customers is likely to be the main challenge for an entrant. The current target demographic of the pools market seems to be well understood by potential competitors.[7] Lists of prospective customers for soft gambling products, including football pools, which facilitate targeted marketing as currently conducted by Vernons and Sportech, are available commercially. An entrant would have access to the same data.

14. However, evidence from the parties suggests that promotions on the basis of perceived quality differences is effective to some extent in retaining existing customers, but much less so with respect to the recruitment of new players.[8] Vernons, which for a long time has used comparisons with the Littlewoods product in its mailings to attract new customers, is [✂].

15. The budget for the marketing campaigns run by Vernons and Sportech in 2007 was £[✂] and £[✂] respectively.[9] Entry on a large scale is likely to require considerably higher amounts in initial marketing expenses. Since such costs would be sunk in the event of an unsuccessful entry, they could represent an added deterrent for potential entrants.

16. Moreover, evidence on the considerable inertia of pools customers casts doubt on the prospect of marketing campaigns attracting a large number of customers quickly (see paragraph 18). Evidence from Ladbrokes suggests that the response rate of recruitment campaigns is modest for existing pools providers—a new entrant would be likely to need to spend a multiple of the parties' marketing expenditure to gain a sufficient customer base.

17. Three third parties argued, in response to our provisional findings, that Vernons' marketing efforts had been successful in winning large numbers of new customers from Littlewoods over the period 1999 to 2007. Our discussion of this evidence is in Section 8. Our conclusion, that relatively few customers switch in this way (at most [1 to 3] per cent of Sportech customers a year—see paragraph 8.10), is consistent with our view here that the need to recruit a critical mass of customers for a new pools operation to be viable constitutes a substantial barrier to new entry.

### *Customer inertia*

18. Evidence of the high degree of inertia among pools customers is very strong. Our customer survey shows that the most frequently-given reason why people play the pools with one company rather than another is that it is the one they always played with. This would make it difficult for a new provider to attract customers from incumbent firms.

19. In view of the difficulties experienced by Sportech and Vernons with the recruitment of new customers, winning over existing ones is likely to be crucial for an entrant trying to build up its customer base. Their inertia thus represents an important barrier to entry.

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[7]This was the impression given by Camelot, for example.
[8]See Appendix C, paragraphs 15 to 28, for a discussion of the marketing activities of Sportech and Vernons.
[9]The figure for Sportech [✂].

### *Distribution channels*

20. Potential entrants would need to think carefully about their strategy regarding distribution channels. Postal distribution, the most widely-used distribution channel currently offered, works along the lines of a generic subscription business and would probably be easy to replicate. The success of online distribution, potentially the most cost-effective and easy-to-enter way to provide a pools product, has so far been very limited. Entering pools distribution via a collector network is potentially more difficult, but Vernons' experience suggests that a collector network is not a prerequisite for a profitable pools business.

## Prospects for entry

21. A company based on the Isle of Man submitted that it was planning to introduce a purely Internet-based pools competition later this year, under the name Pools4All. In so far as this game, which seems to have a greater skill element, is in the same market as the existing pools, the extent to which it would pose a serious challenge to Littlewoods and Vernons depends on the company's success in enticing players to use the online distribution channel. Given that the online business represents only about 5 per cent of turnover for Littlewoods and Vernons, this could prove difficult.[10] We do not expect Pools4All.com Limited, which does not see itself as a direct competitor to the existing pools, or other potential online pools suppliers to pose a sufficient constraint to the merged entity in the next two to three years.

22. Other potential competitive challenges for the pools companies might arise from the possibility that football-based games could be offered by gambling operators outside the pool betting sector. This possibility has not yet led to any concrete steps towards launching such products. Still, the emergence of other football-related games in the future cannot be ruled out, particularly if Sportech is successful in reinvigorating the pools business.

## Summary

23. The existence of a network effect that makes an entrant's effectiveness as a competitor dependent on its ability to attract a customer base of a size similar to that of Littlewoods and Vernons may represent a considerable barrier to entry. The barrier is reinforced by the high degree of inertia seen in current pools customers and the apparent difficulty in attracting new customers, as illustrated by the response rates of the parties' marketing campaigns. The demographic profile of the pools' current player base further contributes to our view that future expansion, which could attract entry, is not to be expected. On the basis of the evidence set out above and under current market conditions, we consider it unlikely that the football pools will attract entry on a scale large enough to constrain the conduct of Vernons and Sportech in the near future.

[10] Vernons thought that customer recruitment over the Internet was 'not very successful' and noted that most of the customers who played on the Internet simply transferred from an existing telephone or a postal way of entering the pools. Sportech, however, seems to be more hopeful about the opportunities offered by online distribution. Pools revenues from the Internet are, however, growing quickly—see Appendix B, Table 1.