

# Anticipated acquisition by Microsoft Corporation of Activision Blizzard, Inc.

## SUMMARY

### Overview of the decision

1. The Competition and Markets Authority (**CMA**) conducted a phase 1 investigation into the anticipated acquisition of Activision Blizzard, Inc. (**ABK**) by Microsoft Corporation (**Microsoft**) (the **Merger**). After examining a range of evidence, the CMA believes that the Merger meets the threshold for reference to an in-depth phase 2 investigation, giving rise to a realistic prospect of a substantial lessening of competition (**SLC**) in gaming consoles, multi-game subscription services, and cloud gaming services.
2. As a result of the initial concerns found in the phase 1 investigation, the CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (the **Act**). Microsoft and ABK have until 8 September 2022 to offer an undertaking that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger for an in-depth phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act. This would enable the CMA to investigate these concerns in more detail before reaching a final decision on whether or not the Merger gives rise to an SLC.

### About the gaming industry

#### ***The same three companies have been the only major suppliers in the console gaming market for the past 20 years***

3. The gaming industry is the UK's largest revenue-generating form of entertainment. It is bigger than pay TV, home video (including streaming), cinema, music, or books. In 2021, it generated approximately £7 billion in revenue in the UK.
4. For the past twenty years, the same three companies have been the only significant suppliers of console gaming – Microsoft (Xbox), Sony (PlayStation) and Nintendo (Switch being the current generation console), with little or no entry from new rivals. As part of its investigation, the CMA sought to ensure that the Merger would not substantially reduce either current or future potential competition.

5. Part of the difficulty in entering and expanding in the console gaming market is the existence of strong network effects. Console providers such as Microsoft compete to attract users who want to play high-quality games, often with friends, as well as high-quality content from game developers, who want to make games for consoles with a large user base. Consoles with a lot of gamers attract better content, which in turn attracts more gamers to that console, which in turn attract better content, and so on. This self-reinforcing mechanism makes it more difficult for new entrants without a large user base or good pre-existing gaming content to enter and grow in the market.
6. In addition to consoles, people play games on personal computers (**PCs**) and mobile devices. Consoles and PCs can usually process larger and more complex games (such as *Call of Duty*). Mobile devices currently lack the technical capabilities to play most console games, and most people use them to play more casual games (such as *Candy Crush*).

### ***Subscription services and cloud gaming are growing***

7. The CMA believes the gaming industry is in a transitional phase. Over the past several years, gamers have typically accessed games by paying an up-front fee and downloading the relevant games from a digital storefront (such as the Xbox Store) to their console or device (such as a PC or mobile). For consoles this 'buy-to-play' model, whereby the gamer pays for the game in full and then accesses the software locally on their device, remains the primary mode of delivering games.
8. In recent years, two important and closely related disruptions have started to emerge in the gaming industry. The first is the development of cloud gaming services, a technology that allows complex games to be accessed on remote servers and streamed directly to a device. Since games are executed remotely, gamers can play using a range of devices that can be less powerful, and are often cheaper, than consoles (such as mobile phones or tablets). There have been several recent entrants into the gaming industry using this disruptive technology, including Amazon Luna, Netflix, Google Stadia, Blacknut, NVIDIA GeForce Now, as well as publishers like Ubisoft. Many industry experts predict that cloud gaming will continue to grow significantly in the coming years.
9. The second important development is the emergence of multi-game subscription services. Unlike the traditional buy-to-play model, these services allow gamers to access a catalogue of games for a fixed, often monthly, fee. Some subscription services currently offer games that must be downloaded and played on consoles, with a smaller selection of games that can be streamed from cloud infrastructure (such as Xbox Game Pass), and other subscription services offer gaming libraries that are entirely cloud-based (such as Amazon Luna and Google Stadia). While most of the revenue in the industry continues to be generated from the purchase of

individual games, multi-game subscription services are rapidly growing and have attracted a range of new entrants, including Microsoft, Sony, Nintendo, Amazon, Apple, Electronic Arts, Ubisoft, NVIDIA, Netflix, Utomik, Blacknut, and Google.

10. Although the console gaming market is highly concentrated, the CMA believes that the shift to cloud gaming services and multi-game subscription services is opening a window of opportunity for new entrants. To succeed, these new entrants will need to offer a strong gaming catalogue that will attract users. Cloud gaming service providers will also need access to cloud infrastructure and an operating system (OS) license (especially Windows OS, which is the operating system for which most PC games are designed).

## **About the businesses and the transaction**

### ***Microsoft has a strong gaming ecosystem***

11. Microsoft is a global technology company offering a wide range of products and services, with a global turnover of nearly £125 billion in FY2021. Since 2001, it has released several generations of Xbox gaming consoles. Xbox is one of the three major consoles in the market alongside Sony PlayStation and Nintendo Switch. Gamers typically download digital copies of the games they want to play on Xbox from Microsoft's Xbox Store. Microsoft also offers a multi-game subscription service, Xbox Game Pass, where gamers pay a monthly fee to gain access to a library of downloadable and cloud-based gaming content.
12. Microsoft is also a game publisher and currently owns 24 game development studios, several of which it acquired in recent years. These studios make games such as *Minecraft*, *Forza*, *Elder Scrolls*, and *Halo* for Xbox and other consoles, PC, and mobile devices. Some of this content is available exclusively on Xbox and some is licensed to rival console providers.
13. Microsoft has other business areas that are relevant to gaming. One is Azure, a leading cloud platform (ie a network of data centres and cloud computing infrastructure) that offers a wide range of services across several industries, including gaming. Another is Windows, the leading PC operating system. Many people play games on a PC rather than a console, and the vast majority of them use Windows OS. Because of its popularity, game developers generally make games that are designed and optimised for Windows OS.

### ***ABK creates some of the most popular gaming content***

14. ABK is a game developer and publisher with global turnover of £6.3 billion in FY2021. It develops gaming content for consoles, PC, and mobile. ABK's three most popular franchises—*Call of Duty*, *World of Warcraft* and *Candy Crush*—account for most of its revenue.

15. *Call of Duty*, in particular, is widely regarded as one of the most successful gaming franchises of all time. For more than a decade, its releases have ranked in the top games available on console and are expected to continue to do so.

### ***Microsoft's acquisition of ABK is a significant transaction***

16. Microsoft announced in January 2022 that it has agreed to acquire ABK for a purchase price of USD 68.7 billion. The Merger is conditional on receiving merger control clearance from a number of global competition agencies, including the CMA.

### **The CMA's assessment**

#### ***Why is the CMA looking at the merger?***

17. The CMA's primary duty is to seek to promote competition, both within and outside the UK, for the benefit of consumers. It has a duty to investigate mergers that could raise competition concerns in the UK, provided it has jurisdiction to do so.
18. The CMA believes that it has jurisdiction to review this Merger: the CMA believes it is or may be the case that each of Microsoft and ABK is an enterprise and that they will cease to be distinct as a result of the Merger, and that the turnover test is met given ABK generated more than £70 million turnover in the UK in FY2021. Accordingly, arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

#### ***How did the CMA investigate the merger?***

19. At phase 1, the CMA needs to establish whether there is a *realistic prospect* of an SLC which merits a reference to an in-depth phase 2 investigation. This is a lower threshold than that used during a phase 2 investigation, which requires the CMA to conclude that a merger is *likely* to result in an SLC in order to prohibit a transaction.
20. To understand the implications of the Merger on competition, the CMA gathered information from a wide variety of sources, including by using the CMA's statutory information gathering powers to ensure that the CMA has as complete a picture as possible under the constraints of the statutory timetable.
21. As part of its phase 1 investigation, the CMA gathered data and reviewed over one thousand internal documents from Microsoft and ABK to understand their businesses, their future strategies, and the gaming industry as a whole. The CMA also gathered evidence from other market participants, such as game developers and competitors across console, cloud, PC, and mobile gaming, which included both written and oral submissions as well as their internal documents.
22. This evidence shows that the Merger could impact competition in several ways. In investigating the Merger, and consistent with the CMA's strict legal time constraints

at phase 1, the CMA focused on the most important ways in which the Merger could potentially harm competition, both now and in the future. These ‘theories of harm’ assess the harm to competition that could arise from:

- (a) Microsoft withholding or degrading ABK’s content—including popular games such as *Call of Duty*—from other consoles or multi-game subscription services; and
- (b) Microsoft leveraging its broader ecosystem together with ABK’s game catalogue to strengthen network effects, raise barriers to entry and ultimately foreclose rivals in cloud gaming services.

### **A game-changing merger**

- 23. Microsoft already holds a strong position in the gaming industry through its established Xbox console, which has a large user base and a strong catalogue of gaming content. Microsoft has been steadily strengthening its gaming ecosystem in line with the evolution of the gaming industry, including by acquiring independent gaming studios (such as Bethesda in 2021), expanding Game Pass (its market-leading multi-game subscription service), and developing its cloud infrastructure to better support its gaming activities.
- 24. Acquiring ABK would significantly expand Microsoft’s own gaming library, adding some of the world’s best-selling and most recognisable franchises, including *Call of Duty*, *World of Warcraft*, and *Candy Crush*. The CMA is concerned that having full control over this powerful catalogue, especially in light of Microsoft’s already strong position in gaming consoles, operating systems, and cloud infrastructure, could result in Microsoft harming consumers by impairing Sony’s—Microsoft’s closest gaming rival—ability to compete as well as that of other existing rivals and potential new entrants who could otherwise bring healthy competition through innovative multi-game subscriptions and cloud gaming services.

### ***What could be the impact of the merger on gaming consoles and subscription services?***

- 25. The CMA gathered substantial evidence from Microsoft, ABK, and third parties to assess the significance of ABK’s gaming portfolio. This evidence consistently pointed towards ABK’s content, especially *Call of Duty*, as being important and capable of making a material difference to the success of rivals’ gaming platforms. ABK invests significant time and capital in creating regular *Call of Duty* releases, which consistently rank as some of the most popular games. These titles require thousands of game developers and several years to complete, and there are very few other games of similar calibre or popularity.

26. The CMA believes the Merger could allow Microsoft to make ABK content, including *Call of Duty*, exclusive to Xbox or Game Pass, or otherwise degrade its rivals' access to ABK content, such as by delaying releases or imposing licensing price increases. This type of concern is known as 'input foreclosure', where a firm uses its control of an important input to harm its rivals.
27. The CMA examined internal documents and economic analyses to assess whether Microsoft would have an incentive to use ABK's content to foreclose rivals. The CMA did not limit its analysis to an assessment of the short-term or 'static' costs and benefits to Microsoft of engaging in these strategies. Rather, the CMA considered Microsoft's broader strategies, as evidenced by its internal documents and historical course of dealing following similar transactions in the past. The CMA found that the potential strategic benefits to Microsoft of using ABK's content to foreclose rivals—such as expanding the Game Pass user base and strengthening network effects in its gaming ecosystem—could outweigh any immediate losses in terms of licensing revenues. The CMA notes that Microsoft has followed this approach in several past acquisitions of gaming studios, where it made future game releases from those studios exclusive in consoles to Xbox (such as the upcoming *Starfield* and, based on Microsoft's public statements, *Elder Scrolls VI* from Bethesda, a studio Microsoft acquired as part of its USD 7.5 billion acquisition of ZeniMax in 2021).
28. The CMA believes that in the short- to medium-term, the main rival that could be affected by this conduct would be Sony. Evidence suggests that Microsoft and Sony compete closely with each other in terms of content, target audience, and console technology. Nintendo, on the other hand, competes less closely with either of Sony or Microsoft, generally offering games that focus more on 'family fun' and innovative ways of playing (eg the Wii Fit board) and does not currently offer any *Call of Duty* games on the Nintendo Switch.
29. PlayStation currently has a larger share of the console gaming market than Xbox, but the CMA considers that *Call of Duty* is sufficiently important that losing access to it (or losing access on competitive terms) could significantly impact Sony's revenues and user base. This impact is likely to be felt especially at the launch of the next generation of consoles, where gamers make fresh decisions about which console to buy. The CMA believes that the Merger could, therefore, significantly weaken Microsoft's closest rival, to the detriment of overall competition in console gaming.
30. As the market for multi-game subscription gaming services grows, Microsoft could use its control over ABK content to foreclose rivals, including recent and future entrants into gaming as well as more established players such as Sony. Absent the Merger, ABK games would in principle be available to any multi-game subscription service. The CMA recognises that ABK's newest games are not currently available on any subscription service on the day of release but considers that this may change as subscription services continue to grow. After the Merger, Microsoft would

gain control of this important input and could use it to harm the competitiveness of its rivals. As the multi-game subscription market is still in its infancy, the effect of the Merger could be to tip or significantly increase concentration in the market in Microsoft's favour before future rivals have a chance to develop. The CMA therefore believes that the Merger gives rise to significant competition concerns in multi-game subscription services (including cloud gaming services, to the extent these are distributed through multi-game subscription services).

***What could be the impact of the merger on cloud gaming services?***

31. In the longer term, many market participants expect cloud gaming to grow and for gamers to shift from console gaming to cloud gaming on a range of devices. This market is growing rapidly and has seen several new entrants that were previously not active in console gaming, including cloud platform providers, such as Google and Amazon, and game developers such as Ubisoft.
32. Microsoft already has a combination of assets that is difficult for other cloud gaming service providers to match. By having a large and well-distributed cloud infrastructure, Microsoft will be able to host games on its servers on preferential terms and reach gamers throughout the world without having to pay a fee to third-party cloud platforms. By having Windows, the OS where the vast majority of PC games are played, Microsoft can stream games from Windows servers without having to pay an expensive Windows licensing fee and may be able to design and test games made for Windows more effectively than rivals. And by having an existing console ecosystem, Microsoft has an existing user base of gamers to which it can promote its cloud gaming services, as well as a range of popular games that it can offer.
33. The Merger would, therefore, bring together the company in a uniquely strong position to offer cloud gaming services with one of the industry's strongest gaming catalogues. The CMA is concerned that, by leveraging ABK's content and Microsoft's wider ecosystem, Microsoft will have an unparalleled advantage over current and potential cloud gaming service providers. This could result in increased concentration in cloud gaming services or the market 'tipping' to Microsoft, and ultimately deny consumers the benefits of competition between new and emerging providers vying to succeed in cloud gaming. The CMA recognises that, if Microsoft were to significantly increase its market power in cloud gaming services, this could have knock-on effects on independent game developers and publishers who compete against Microsoft's own gaming portfolio, and who could be disadvantaged in a number of ways, such as by having to pay higher fees or by being demoted on Microsoft's gaming ecosystem.
34. The CMA therefore believes the Merger could substantially reduce competition in cloud gaming services.

## **What happens next?**

35. As a result of these concerns, the CMA believes that the Merger gives rise to a realistic prospect of an SLC in gaming consoles (together with their digital storefronts), multi-game subscription services, and cloud gaming services. The CMA is therefore considering whether to accept undertakings under section 73 of the Act. Microsoft and ABK have until 8 September 2022 to offer an undertaking which might be accepted by the CMA. If no such undertaking is offered, or the CMA decides that any undertaking offered is insufficient to remedy its concerns to the phase 1 standard, then the CMA will refer the Merger for an in-depth phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act. Following such a further detailed investigation, the CMA would reach a final decision as to whether or not the Merger gives rise to an SLC.