OFFICE OF FAIR TRADING

Anticipated acquisition by Future plc of Highbury House plc

The OFT's decision on reference under section 33 given on 14 April 2005. Full text of decision published 21 April 2005

PARTIES

1. **Future plc (Future)** is an international publishing group primarily active in consumer magazines, with over 100 regular monthly magazines produced worldwide. For the last financial year, Future's turnover was approximately £190.4 million.

2. **Highbury House plc (Highbury)** publishes over 90 consumer magazines predominantly in the UK, in addition to business magazines. For the last financial year, Highbury's UK turnover was approximately £95.6 million.

TRANSACTION

3. On 14 February 2005, Future announced that it had made an offer to acquire the entire share capital of Highbury for approximately £97 million. The statutory deadline, extended from 14 April, is 19 April 2005.

JURISDICTION

4. As a result of this transaction Future and Highbury will cease to be distinct. The UK turnover of Highbury exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

Product market

5. The parties overlap in the publication of special interest consumer magazines (magazines sold via newsstand or subscription which cater for niche interests) in the UK and in publishing customer magazines (magazines published for third parties, e.g. in-store magazines).

6. In relation to customer magazine publishing, the parties' position would change little as a result of the merger, customers have a number of strong alternative publishers and we have received no substantive concerns about this sector from third parties. Accordingly we do not believe that the merger will substantially affect competition in customer publishing and so it is not considered further.

7. Special interest consumer magazine publishers receive revenues from advertisers, who buy advertising space, and the purchasers of magazines.

8. The parties submit that the appropriate product frame of reference is no narrower than all special interest consumer magazine publishing. However, as an initial starting point in its assessment the OFT has used the industry defined categorisation of consumer magazines used by ABC[1], which the parties adopted for convenience in their submissions. ABC divides magazines into segments according to broad subject topic (e.g. women's interests, computing, leisure interests), and further sub-segments (e.g. women's interests could be divided into craft, hair & beauty, and needlecraft). The size of each segment and sub-segment varies case by case.

Demand side substitution

9. For the magazine purchaser, the parties submit that there is a prevailing pattern of 'portfolio purchasing', whereby readers buy a range of titles and readjust their purchases when faced with a price increase or a decline in quality. Although there is some evidence to support this, there will undoubtedly be many readers for whom there is little substitution between magazines in different ABC segments and sub-segments (e.g. a computing magazine not being substitutable for a women's interest magazine). There is also likely to be little demand-side substitution for product customers between different media sources of information (e.g. magazine, book, Internet) for a given segment. The specific characteristics of each product imply that the alternatives may be primarily complementary in nature.

10. For the advertising customer, the key purpose of advertising is to ensure its message reaches its target audience as economically as possible. Hence, for some advertisers there may be some substitutability across different segments of magazine publishing, and across different media types of a given segment. However, differences in costs and audience profiles suggest that that these alternatives may be generally complements, rather than substitutes.

[1] Audited Bureau of Circulation

Supply side substitution

11. The parties submit that it is common for existing publishers to launch both into segments where they are not present and into sub-segments within segments where they are, in addition to re-positioning new titles. Accordingly, there are two levels of supply side substitutability to be considered: substitution between sub-segments within a single segment and substitution across segments.

12. There is evidence to support the notion that at least within certain segments, such as motoring and motorcycling, magazine publishers can easily switch sub-segments[2], due to the mobility of staff, the existence of a relevant advertising client base, and established reputation and expertise.

13. The evidence provided by the parties as to the ease of substitution across segments, where publishers would only be able to extract very limited benefit from existing advertising contacts and expertise, is less clear and third parties provide a mixed picture of past attempts at such supply-side substitution.

14. Given the mixed and inconclusive nature of the evidence regarding supply side substitution, and as this sector is characterised by a high level of product differentiation, it is considered appropriate to take a cautious view and analyse the impact of this transaction on competition on both a broad basis and on a narrow basis, which focuses on the areas where the parties' products appear to closely constrain each other.

Geographic market

15. Magazine publishing houses active in the UK make most of their sales and distribute within this area. Accordingly, the relevant frame of reference for assessment is the UK.

HORIZONTAL ISSUES

Market shares

16. As regards competition for overall readership, the merged firm would be the third largest consumer magazine publisher, with a combined share of supply of 8 per cent (increment 2.3 per cent), and the second largest special interest consumer magazine publisher, with a combined share of supply of 14.2 per cent (increment 3.8 per cent).[3] The parties estimate

[2] For example, motoring general sub-segment to motorcycling general sub-segment.
[3] Audited circulation by retail sales value in 2004.

that the merged firm would have a combined share of [less than 10 per cent] (increment [less than 5 per cent] of total advertising revenue from consumer magazines.[4]

17. At a narrower level, the parties overlap in a number of segments[5] and sub-segments therein. Where differentiated products are concerned, adoption of an overly rigid frame of reference – whether too broad or too narrow – might not necessarily reflect the competitive impact of a merger. As discussed above, our approach at the narrow level to the competition analysis focuses on the parties' products which might closely constrain each other. With this in mind the analysis concentrated on the sub-segment where the parties' position is strongest and which generated all of the third party concerns, namely computer games magazines. Other segments showed combined shares which were also relatively high in some cases, but in the absence of third party concerns, are not considered further at this stage.

Computer games

18. The most concentrated area of overlap between the parties relates to the computer games sub-segment, and various sub-divisions therein (multi-format console, Sony and Xbox[6]). The sub-segment as a whole is estimated by the parties to generate [tens of millions of pounds] revenue per annum for computer games magazine publishers.[7]

19. The merged firm would account for 95 per cent (increment 21 per cent) of computer games magazines.[8] Future, which currently publishes the official Xbox and Playstation2 titles on behalf of Microsoft and Sony, has maintained a consistently strong presence over at least the last five years. Highbury, too, has maintained a consistently significant share of computer games magazines sales.

20. Aside from the parties, only three other players have achieved and maintained a share exceeding 6 per cent in one or more of the sub-divisions of the computer games sub-segment over the last five years.[9] Two of these (Computec and Dennis Publishing) subsequently exited as their titles were acquired by Future. The remaining player, Emap, is only

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[4] The actual figures, based on Periodical Publishers Association (PPA) 2003 estimates, have been replaced by ranges at the request of the parties.
[5] Computing, leisure interests, cycling sports, home interests, women's interests, motoring and motorcycling, and music.
[6] The remaining sub-division in the computer games sub-segment is Nintendo.
[7] Information excised at the request of the parties for reasons of commercial confidentiality.
[8] Audited circulation in 2004.
[9] Computec (Sony); Dennis (PC Games, multi-format console); Emap (Nintendo).

active in one sub-division (Nintendo, for which it has held the official licence since 1992), and its share has steadily declined over time.

21. It would appear, therefore, that the parties may well be each other's closest competitors in computer games magazine publishing and that an important competitive constraint would be lost post-merger. This is supported by internal documentation provided by the parties, which indicates that the main issue for the merged firm is considered to be managing internal competition, rather than any external competitive threat of entry (i.e. ensuring that the merged entity's portfolio of titles do not compete actively with each other).

COMPUTER GAMES PUBLISHING - ADVERTISERS/READERS

Advertisers

22. Some third party advertisers confirm that they have played Future and Highbury off against each other in negotiations with one of the parties. They also describe the parties as being the sole providers of certain 'must have' computer games titles, which are considered essential advertising outlets for advertisers of so-called 'hardcore' computer gamer products to 'hardcore' gamers.[10] These advertisers may be prepared to pay more for advertising space in certain of the parties' specialist titles than they currently spend (i.e. they have inelastic demand). The parties claim that currently they do not discriminate between hardcore and mainstream titles in advertisers' portfolios. However, post-merger, the merged firm may have the ability and incentive to distinguish between these 'hardcore' advertising customers and customers with more elastic demand, and so increase prices to them from the levels they would have been without the merger.

23. Advertising only accounts for [less than a quarter] of the parties' revenues derived from computer games magazines, and hardcore games revenues will represent a fraction of this.[11] The parties argue that non-print media (such as TV), together with general consumer magazines (such as men's lifestyle magazines) and the Internet, provide credible alternatives to advertisers of computer games products, including hardcore products. The extent to which this can be shown to be true for hardcore products is unclear. Media buyers, used by advertisers, generally represent a range of customers with a range of products. As such, media buyers may possess power to constrain prices through their ability to switch to other magazines

[10] 'Hardcore' appears to be an industry term, relating to games that would not appeal to readers of less niche magazines, although it is not clear where the exact boundaries between mainstream and hardcore games would fall.
[11] Information excised at the request of the parties for reasons of commercial confidentiality.

and other media in the case of mainstream computer games products, and through the threat of a possible adjustment to their total advertising budget with the merged firm in the case of hardcore products. On this basis, whilst the merger may lessen competition, the OFT does not believe that it will do so substantially in relation to advertisers in computer games magazines.

Readers

24. Post-merger, there is unlikely to be sufficient actual competition to the merged firm in computer games magazine publishing to constrain the merged firm's ability to raise some or all of its titles' cover prices higher than they would have been absent the merger. Alternatively, the merged firm could supply magazines of a lesser quality which would be a reduction in value for money and (although cover price may not necessarily be higher than now) constitute an implied price increase. This is because, for the reasons explained below, the OFT does not believe that there is sufficient constraint from the threat of entry or expansion by potential competitors in this sub-segment and nor do consumers exert buyer power.

25. The parties submit that this sector is characterised by low barriers to entry, and, although failure rates for new titles have been estimated as high as 80 per cent for all special interest consumer magazine titles, the constant threat of competing launches by existing publishers and start-up companies (set up by small teams of individuals with sector knowledge and expertise) would constrain their post-merger behaviour.

26. Evidence provided by the parties suggests that launch costs are relatively low, although they can vary across titles depending on a variety of factors (e.g. editorial costs, advertising revenues, production values). The cost of computer games magazines does not seem to deviate significantly from other segments. The main exception to this is in relation to the procurement of official games magazine licences, where large one-off fees are incurred which could act to deter smaller publishers. Similarly one third party felt that cover-mount discs were required to gain any significant share and that small publishers had difficulties in obtaining these as the larger publishers negotiated exclusive deals with the main games producers. However, the significant and stable position of Highbury's and Computec's unofficial magazines, which rarely carried cover-mount discs, suggest this is not a prerequisite to being an effective competitor in the computer games magazine segment.

27. Third party views on barriers to entry in the special interest consumer magazine sector were varied. One third party raised a concern about the

difficulty of achieving retail shelf space for launch titles, especially for smaller publishers. This is a concern that may be emphasised in relation to computer games magazines given the wide range of the parties' existing titles. Others commented that barriers to entry within segments are lower than entry across segments, due to sector knowledge and contacts being of key importance for successful entry. It was generally agreed that entry/expansion by acquisition is the preferred modus operandi.

28. The above factors tend to indicate that barriers to entry into new segments, including the computer games sub-segment, are not insurmountable, especially for an existing or large publisher.

29. However, we have not seen sufficient evidence of the likelihood of entry in practice on a scale sufficient to place a sufficiently strong competitive constraint on the merged firm's ability and incentive to raise price post-merger. None of the competitors contacted by the OFT expressed any intention or inclination to enter the computer games magazine sub-segment to compete closely with the parties. This lack of inclination to enter is consistent with the recent entry history into computer games. There are no examples of successful new entrants (defined as the achievement of a stable share exceeding 5 per cent) in the last five years, apart from one (Computec) which entered the Sony sub-division in 2000 and was subsequently bought by Future in 2003. Furthermore, internal documents from the parties notably failed to identify new entry as a potential competitive threat. Finally, the parties have been unable to provide analogous examples of broad segments where there have been only one or two publishers over a period of time but new entrants were able to enter successfully and gain at least a 5 per cent share.

30. The parties submit that the introduction of a number of new generation consoles over the next two years will provide not only the incentive and opportunity for new entry, but also a level playing field for new entrants to compete with established players. In this respect, the OFT notes that upon previous introduction of new consoles (e.g. Playstation2 in 2000 and subsequently Xbox) such entry was not precipitated (other than the Computec exception noted above). This evidence leads the OFT to consider that entry into the computer games magazines sub-segment does not appear sufficiently likely in the short to medium term to offset the competition concerns identified above.

31. Individual purchasers of magazines are unlikely to have buyer power.

OFFICIAL COMPUTER GAMES MAGAZINES LICENSORS

32. The parties have bid against one other at least once in the past for the official magazine licence of a games manufacturer. One third party raised a concern that the number of (credible) alternative publishers available to take part in such bids will be reduced post-merger to two.

33. Although the countervailing buyer power which manufacturers have pre-merger will be lessened by the merger, the OFT considers that they have viable alternative options, as suggested by a third party, to either sponsor new entry from other existing magazine publishers active in related segments or bring the publishing of official magazines in-house. For these reasons, it is not considered that the merger will substantially lessen competition in relation to manufacturers.

VERTICAL ISSUES

34. No vertical concerns are raised as a result of this merger.

THIRD PARTY VIEWS

35. Third party views were mixed. Most concerns related to the computer games magazines sub-segment and the potential for an increase in price or a reduction in product quality as described above.

ASSESSMENT

36. The parties appear to be each other's closest substitute in the publication of special interest computer games consumer magazines.

37. Although the merged firm may be able to discriminate to charge higher rates to advertisers of certain hardcore computer games products, this possibility would appear to be limited in scope due to the buyer power of media buyers which negotiate advertising rates for their customers across a wide range of titles. In relation to readers, on the basis of the information provided, the OFT does not believe that there would be sufficient actual rivalry to constrain the merged entity from exercising market power and lowering quality and/or raising cover price on some or all of its titles from the levels they would have been without the merger. In light of third party comments and the history of lack of new entry, the likelihood of new entry into the computer games sub-segment may not be sufficient to allay the above concerns. Readers of computer games magazines do not appear to have buyer power vis-à-vis publishers.

38. In relation to computer games manufacturers, it has been suggested that the merger would appear to lead to the removal of one of three main credible alternative bidders for official licences to be the 'official' publication for the manufacturer's products. However, the OFT believes that this concern can be discounted on the basis that the manufacturers could sponsor an existing publisher in a related segment to enter, or even set up their own 'official' publication.

39. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

UNDERTAKINGS IN LIEU

40. Undertakings in lieu are intended to remedy, mitigate or prevent the competition concerns identified as a result of the merger. While it does not believe that the merger does give rise to a substantial lessening of competition, Future has offered a behavioural remedy to address any potential competition concerns that might be considered by the OFT to arise.

41. Future offered to undertake to cap cover price increases at RPI for existing ABC audited computer games titles for a period of two years after completion of the merger with Highbury.

42. This undertaking is not satisfactory for three reasons. First, the OFT will only exceptionally find that price effects arising from a substantial lessening in intensity in the process of competition can be adequately replaced by a price-cap remedy. This is not an exceptional case. Second, the remedy would not appear to be sufficient to address the competition concerns identified above in relation to the possibility of an implied price increase through a reduction in quality of the publications supplied by the merged entity. Lastly, the time limitation of two years means that, in order to accept a behavioural remedy of such a limited duration, the OFT would need to be confident that after that period of time conditions of competition would become such that no substantial lessening of competition may then be expected to arise absent the undertaking. In light of the OFT's competitive analysis above, it cannot be said that the required degree of confidence exists.

43. For the above reasons, Future's offer of undertakings is not considered a clear-cut remedy addressing the substantial lessening of competition identified by the OFT and the OFT therefore rejects it.

DECISION

This merger will therefore **be referred** to the Competition Commission under section 33(1) of the Act.