
ANTICIPATED ACQUISITION BY GAMESTEC LESURE LIMITED OF RANK LEISURE MACHINE SERVICES LIMITED

The OFT's Decision on reference under section 33 given on 5 January 2004

PARTIES

1. **Gamestec**, a subsidiary of Kunick Limited, is active in the operation and rental of amusement and gaming machines.
2. **Kunick Limited** also holds a 40 per cent interest in each of Bell-Fruit Games Limited and Mazooma Games Limited, which design and manufacture gaming machines.
3. **Rank Leisure Machine Services Limited (RLMS)** is a wholly owned subsidiary of the **Rank Group plc** and is primarily active in the operation and rental of amusement and gaming machines. RLMS is also active in the wholesale distribution in the UK of amusement and gaming machines manufactured by other companies. RSAL, a subsidiary of RLMS, operates a seasonal arcade business at various locations in the UK. Certain assets of **Pleasurama Property Investments Ltd** (also a wholly owned subsidiary of the Rank Group) are also included in the transaction.

TRANSACTION

4. The acquisition is an asset sale under which Gamestec will acquire the assets of RLMS and RSAL (and assets currently held by Pleasurama Property Investments Ltd).
5. The parties submitted a merger notice on 5 November 2003. On 10 December 2003 the merger notice was withdrawn by the parties and the OFT continued to consider the merger under the procedure for informal submissions. The administrative 40-working day timetable expires on 5 January 2004.

JURISDICTION

6. As a result of this transaction Gamestec and RLMS will cease to be distinct. The parties overlap in the supply of gaming and amusement machines and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met when segmented by type of customer. The transaction would lead to a combined share of supply of 25 per cent or above for motorway services ([35-

45] per cent, increment of [less than 5 per cent]¹ (see note 1)) and Licensed Betting Offices, excluding Fixed Odd Betting Terminals (FOBTs) ([25–30] per cent, increment of [less than 5 per cent] (see note 1)). Moreover, it would appear likely that if the gaming and amusement machine sector were segmented by national and regional customers, the proposed transaction would give rise to a share of supply of greater than 25 per cent with respect to national contracts. The OFT therefore believes that it is or may be the case that a relevant merger situation will be created.

RELEVANT MARKET

7. The parties overlap in the operation and rental of amusement and gaming machines in the UK.

Product market

8. A recent decision of the European Commission in *Candover/Cinven/Gala*² found that the operation of gaming machines could be a relevant product market, but concluded that it did not need to define the market more narrowly for the purposes of that assessment. When considering whether a narrower frame of reference may be appropriate, it is possible to segment the gaming machines sector by type of machine or by customer.

Type of machine

9. Operators of gaming machines require a licence under Section 27 of the Gaming Act 1968 that enables them to rent and operate all types of gaming machine. Non-gaming amusement machines (such as juke boxes, video equipment etc) do not require a gaming licence (see note 3). However, it appears that very few operators specialise in the operation of non-gaming amusement machines. Generally, most operators hold a Section 27 licence thereby allowing them to supply, maintain and operate a full range of gaming and amusement machines (both licensed and non-licensed).

Customer type

10. There are several different types of customer for amusement and gaming machines: licensed betting offices (LBOs), bingo halls, casinos, pubs, clubs, motorway service operators, inland and seaside amusement centres and other smaller customers. However, third parties indicated that there are not significant differences in supplying different types of customers and that operators generally supply the same machines on very similar terms to all types of customer. A customer's needs are not generally unique – although 'adult' venues would tend to favour machines aimed at adults – and most require a 'mix' of machines which most suppliers with a relevant licence would be able to provide. In addition, on average, there are no significant price differences between types of customer. Price depends more on the type and age of the machine, and the service level required by the individual customer.

¹ (see note 2)

² Case Comp/M.3109 *Candover/Cinven/Gala*, 14 March 2003.

11. It may also be possible to differentiate between operators serving national or regional customers. Third party responses indicated that regional players were, individually, unable to supply large national customers and some customers declared a preference for an operator with national coverage. National contracts account for less than [20-30] per cent (see note 1) of the parties' total turnover. However, not all large, national customers purchase on a national basis; for example, several of the large tenanted pub companies operate lists of up to 45 'approved' operators from which their tenants can select. In addition, it appears unlikely that there are significant barriers to national customers switching from a single national contract to several regional contracts.
12. For the purposes of most of this assessment, we have therefore considered the appropriate frame of reference for the product market to be the supply of gaming and amusement machines to customers generally.
13. However, some third party customers put to us views suggesting that regional players might not be able to compete fully effectively with national players to serve the needs of national customers. Having regard to the CAT's judgement of 3 December 2003 in *IBA Health Ltd v OFT* [2003] CAT 27 we have given careful consideration to the question of whether these views amount to a credible view that the merger might substantially lessen competition – see in particular paragraphs 20 to 32 below.

Geographic market

14. In *Candover/Cinven/Gala* the European Commission concluded that the geographic scope of the gaming machine segment was most likely to be national, since “the gaming machines are placed at different sites spread widely across the country”³.
15. Customers tend to use a mix of regional and national operators in the UK. There is no legal, economic or other impediment that prevents an operator in a particular local area developing or expanding business in another part of the UK and no regional area within the UK could be considered as operating in a different way to other regions. In addition, the parties' price data did not point to consistent price differentials between regions.
16. Some third parties commented that it is becoming increasingly important for certain customers to serve the whole of the UK. In response to this, certain smaller operators have joined the Independent Operators Association (IOA), which provides a network for them to compete for larger, national contracts.

HORIZONTAL ISSUES

Shares of supply

17. Post-merger, the combined entity will have a [10-15] per cent (see note 1) share of UK supply of all amusement and gaming machines. In addition, there is a plethora of smaller regional players which account for approximately 60 per cent

³ *Candover/Cinven/Gala*, paragraph 21.

of the supply of gaming and amusement machines in the UK. However, shares of supply of the top two operators (Leisure Link and the combined Gamestec/RLMS) will be nearly three times the size of their next largest competitor.

18. The parties also provided estimates of the pre- and post-merger Herfindahl-Hirschman Index (HHI) figures, which are given in the table below.

Table 1: Estimated HHIs in the UK market for the operation and rental of amusement and gaming machines based on volume of machines in 2003.

All operators	Pre-merger	Post-merger	Change in HHI
Average(a)	438	540	102
Maximum(b)	504	606	102

Notes (a) Assumes an average number of machines for the estimated 600 'other' smaller operators.

(b) Assumes that there are as many 'other' operators as possible with 5,000 machines, which equates to approximately 49 'other' operators. This estimate ignores the fact that there are an estimated 600 operators in the sector, and is therefore likely to be an over-estimate.

19. The parties were unable to provide regional share of supply figures. Best estimates based on overall 'amusement with prizes' (AWP) machine numbers and estimated number of pubs in the area from published government figures suggest the parties would not have a combined share of supply of more than 25 per cent in any region. The highest estimated share was [] (see note 2) in [] (see note 2).
20. It was submitted by some third parties that regional operators were unable to service larger national contracts. In particular, one third party submitted that the merged entity, together with Leisure Link, would account for a very large proportion of 'prime' national estates including many managed pub estates such as Spirit, S&N, Laurel; LBO chains such as Coral, Ladbrokes and William Hill; and bingo clubs such as Gala and Mecca.
21. Typically, contracts are entered into on either a national or regional basis and the parties estimated that the majority of supply by value (approximately 70-80 per cent) is via regional contracts, while national accounts represent the remaining 20-30 per cent of turnover. Including the parties, there are currently at least five operators capable of providing national coverage (the others being Leisure Link, Crown and the IOA), and a significant number of regional operators compete with these national operators for regional contracts. As a result of the merger, the number of operators currently capable of providing national coverage will reduce from five to four.
22. However, not all large national retailers choose to have national contracts. For example, a number of the tenanted pub groups do not purchase on a national basis as they operate lists of approved machine operators, from which their pub tenants can then select. The formation of the IOA also demonstrates the ability of these smaller regional players to join together to compete for national contracts.

23. The parties also estimated that managed pub groups that purchase on a national basis account for only 10.3 per cent of the total number of pubs. Other national pub owners are tenanted operators, which offer a wide choice of machine suppliers to their tenants (for example, one third party has a list of 45 approved operators). Further, the parties consider that there has been a general change in the UK pub market moving largely away from managed estates to tenanted estates. The other main type of customer which currently contracts on a national basis are the national bookmakers William Hill, Ladbrokes, Coral, Stanley Racing and the Tote, which together represent 63 per cent of LBOs. However, the parties note that LBOs account for less than 4 per cent of the overall number of machines⁴ and they face increasing competition in the LBO segment following the introduction of FOBTs, which are being supplied by a number of new entrants.
24. Bidding data for the past three years was submitted by the parties⁵ which indicated that many of the larger contracts (of over 100 machines), particularly for pub estates, are split between up to three suppliers. Where contracts are split, suppliers typically include a mixture of Gamestec, Leisure Link, RLMS, Crown and IOA. However, in a number of cases, smaller players such as Sceptre, Claremont, Kossway and a range of regional players have parts of split contracts.
25. Based on their data, the parties estimated the following average number of bidders and suppliers for various types of customers:

Type	No. of bidders	No. of suppliers
National pub retailers	7.7	6.2
National tenanted retailers	35.3	33.0
Regional pub retailers	5.3	4.3
National LBOs	5.2	3.8
Others	3.8	3.3

26. The parties and some customers have therefore commented there is nothing to prevent national customers from switching to multiple regional operators. This would not involve major capital costs but would involve some administrative costs. In addition, as demonstrated in the above table, most customers already tend to split contracts between one or more operators and there would not appear to be any significant incentives to use a single supplier.

⁴ It should be noted that the Gaming Board estimated that LBOs accounted for 6 per cent of the market. It is unclear why this difference arises, but it may be due to amusement machines not being included in the Gaming Board's estimates.

⁵ The parties have provided bidding data based on their own commercial intelligence on who they believe to have participated in the bids. They have no means of confirming exactly which other operators did in fact participate.

27. However, other customers are less convinced that they could switch so easily, citing additional staffing costs to manage more than one supplier. The parties estimate that if a national retailer with some 1,000 locations and some 4,000 machines required an additional senior machine person at an estimated maximum annual cost of £50,000, this would equate to only an additional 24 pence per machine per week. This estimate appears reasonable. Given that the average AWP rental price is around £45-55 per week⁶, prices would not have to rise much for larger contracts before it would be worthwhile hiring an extra full time member of staff to cover multiple regional operators. In addition, the parties note that certain customers operating on a national basis already employ smaller regional operators to operate machines other than gaming machines, for example pool machines. They submit that it would therefore be very easy for those customers to switch their gaming machines to those smaller regional operators (provided they had a Section 27 Gaming certificate). Therefore, while certain customers currently declare a preference for national coverage from an operator, it would appear that they would be able to switch to multiple regional players at relatively small cost in response to a price increase.
28. Some third parties have submitted that a price differential between the nationals and the regional players already exists, suggesting that some difficulties face regional players seeking to compete with national suppliers for large contracts.
29. The OFT has investigated whether such a price differential exists. Few third parties were prepared to share their bidding data with the OFT and the data which were made available conflicted. Some customers also commented that because they have not gone out to tender for a number of years, they did not know what current prices were available. One data set showed that while bids did vary by about 12 per cent between the highest and lowest bid, there was no systematic difference in price between regional and national players. Another showed that there was difference in price between regional and national players, but it was clear that suppliers were not chosen solely on the basis of price. In this respect, it is important to note that differences in price can be an indication of differing levels of service (e.g. frequency of machine rotation and collection of takings) and therefore may not be directly comparable.
30. Overall, those third parties raising concerns related to price differentials between national and regional operators were not able to substantiate their concerns. Nor was the evidence we gathered supportive of this as a credible view. Comments from some other third parties indicated that price differentials did not exist and evidence submitted by the parties regarding contracts lost to regional players did not support the likelihood that regional players were charging significantly higher prices. If the price differential between regional and national operators was significant it might be expected that the national operators would have accounted for a larger share of the total market; the five national operators together account for only 40 per cent of the total market.
31. The parties submitted that although there are differences in some of the central costs, there are no substantial economies of scale from which national operators benefit such that smaller regional operators could not compete. Expected

⁶ Mintel, March 2002, Gaming Machines - UK.

economies of scale enjoyed by the national operators in relation to some management and administration costs must be weighed against the fact that the national operators incur additional other central costs and the expense in testing new machines brought into the market for all customers. In addition, there are no material differences in the cost of equipment to smaller regional operators, nor in the costs for employing engineers and for collection of machines. This view was generally supported by competing operators. (We would also note that efficiency gains resulting from economies of scale are generally to be welcomed.)

32. Finally, certain third parties and the trade press have speculated that prices might rise as a result of this merger. Some operators have commented that price rises would be welcomed, as at present margins are so low that there are fears that others might be forced to exit the market. Based on available public information and supporting filed accounts, margins in the industry would appear, on average, to range between 4-12 per cent. [] (see note 2) More generally, any view that this merger would lead to higher prices lacks adequate substantiation to amount to a credible view.

Barriers to entry and expansion

33. Barriers to entry/expansion appear to be low. Fees for a Section 27 Certificate are £5,920 and the Gaming Board aims to issue certificates within 3 months of an application. The parties submitted, and third parties confirmed, that these are not difficult to obtain. In 2002/03, there were 22 new Section 27 Certificates issued with 11 applications for a new certificate outstanding as at 31 March 2003.⁷ While this fee would not be recoverable, the parties submitted that most other costs would be. Contracts are regularly up for tender and there are limited costs for entry, most of which can be recovered to a large extent on exit. Although there have been no recent new entrants to the sector, Gamestec also expects that there will be many new entrants into the market following the proposed changes in gaming regulations that are expected to result in a greatly expanded casino market.
34. Operators have indicated that they could easily start supplying customer types that they do not currently supply. However, smaller players have indicated that they would find it difficult to service large contracts. The parties estimate that the costs of expanding to gain a 5 per cent share of supply in the UK (approximately 20,000 machines) would be between £1 million and £2 million⁸. It should be noted that a share of supply of 5 per cent would make this hypothetical new entrant the third or fourth largest operator in the UK.
35. The evidence provided indicates an absence of significant barriers to entry. Despite this, other than the IOA, there are no recent examples of entry or

⁷ The Gaming Board's Report at paragraphs 5.14 to 5.19

⁸ Gamestec estimates that up to approx £[]m (see note 2) would be spent on equipping a head office and 6 regional offices with fixtures and fittings and computer systems, even though the properties themselves would be leased. In addition, stocks of spares, machine components, uniforms and compact discs might cost a further £[]m (see note 2). It is assumed that all other relevant costs are financed and excludes the leasing costs of property and motor vehicles.

expansion on a significant scale. Smaller operators indicated that with current margins they would not be willing to expand to supply national contracts. However, with few impediments to expansion, any attempt to raise prices would result in higher margins and thus be likely to prompt expansion by smaller players in response. The parties argue that entry on a small scale (i.e. less than 20,000 machines) provides viable and effective competition.

Buyer power

36. There appears to be considerable buyer power in the hands of larger customers such as pub groups. Third party operators have commented that larger customers have been able to squeeze margins considerably, and have suggested that the balance of power lies with them in negotiating prices. The tendering process also affords buyers some power. Large customers have confirmed that they have a degree of negotiating power and can switch suppliers fairly easily (subject to contracts). Bidding data supplied by the parties indicated that [] (see note 2) due to the high level of competition from both national and regional operators.

VERTICAL ISSUES

Manufacturing and wholesale

37. Gamestec has a 40 per cent interest in Bell Fruit Games Limited (BFG) and Mazooma Games Limited, which are companies active in the upstream markets of the design and manufacture of amusement and gaming machines. One third party has raised concerns about the vertical links between Gamestec and BFG/Mazooma Games. It was concerned that Gamestec tends to bias its purchases in-house, by restricting the opportunities for third-parties to test products and buying a third party product only when it is clearly superior to the in-house supply. It was suggested that a combined Gamestec/RLMS might be able to stifle access to market for new innovations that are not developed in-house, thereby restricting consumer choice.
38. However, this vertical link is unlikely to raise competition issues. First, the merged entity will not be large enough in relation to the market as a whole for concerns over anti-competitive foreclosure to be credible. Second, new machines sales fluctuate between the different manufacturers and games developers year on year, depending on which companies have the most popular new games. The parties estimate that BFG/Mazooma Games held around [less than 40] per cent (see note 1) of supply of new AWP machines sold in the UK in 2002 while Leisure Link held around [less than 20] per cent (see note 1). [] (see note 2).
39. New games are introduced on a fairly quick and continuous basis and installation and purchase of particular amusement and gaming machines is primarily driven by customer preferences and needs. Therefore shares of supply are constantly changing depending on which machine is the latest 'must-have' new game. This is demonstrated by the fact that Leisure Link (which has a 100 per cent subsidiary Maygay active in games development and manufacture) represented [less than 40] per cent (see note 2) of BFG/Mazooma's overall machine sales in

2003. Gamestec's own purchases of BFG/Mazooma machines broadly reflect the market position of BFG/Mazooma.⁹

40. In view of these considerations there is no reason to expect that the merger would have anti-competitive effects with respect to Gamestec's related companies in manufacturing or development.

Distribution

41. RLMS operates as a wholesale distributor of amusement and gaming machines, but is not active in the design or manufacture of amusement and gaming machines. It purchases machines from the manufacturers of amusement and gaming machines and sells these onward to operators of amusement and gaming machines. RLMS's sales of gaming machines is estimated to represent less than [10] per cent (see note 1) of the sale of new gaming machines and there are several other competitors active in the wholesale distribution of amusement and gaming machines.

THIRD PARTY VIEWS

42. Competitors are unconcerned about the transaction. Some hope that prices might rise following the merger, which they believe would be justified as buyer power means that current margins are very low. Most customers are not concerned, believing the transaction will not adversely impact the competitive nature of the industry. However, some customers commented that a reduction in the number of national suppliers could restrict choice and that Gamestec and Leisure Link would enjoy high shares of supply with respect to national customers.

ASSESSMENT

43. The parties overlap in the operation and rental of amusement and gaming machines in the UK. The post-merger HHI is estimated at between 540 and 606, representing an increment of 102. As a result of the merger the number of operators currently capable of providing national coverage will reduce from five to four.
44. Barriers to entry/expansion appear to be low, and the formation of the IOA demonstrates the ability for regional players to form a consortium to bid for national contracts. National customers also appear able to use a number of regional suppliers. Buyer power amongst the large national customers also appears to be reasonably strong.
45. Therefore, the OFT does not therefore believe that there is a significant prospect that the merger would substantially lessen competition.

⁹ Over the past five years, the percentage of AWP machines that Gamestec has sourced from BFG/Mazooma (by turnover) has been broadly in line with the BFG/Mazooma's estimated share of supply of machines (by turnover).

46. We have gone on to consider whether there exists a credible alternative view. In particular, in view of concerns put to us by some customers, we have considered whether regional players are not able to compete effectively with national players to serve the needs of national customers. The result of our assessment is that there are not sufficient grounds to give credibility to a view that the merger might substantially lessen competition. Therefore, as well as not believing that there is a significant prospect that the merger would substantially lessen competition, the OFT does not believe that there is a credible alternative view that the merger might substantially lessen competition.

DECISION

47. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

NOTES:

- 1 Actual figures replaced by a range at the request of the parties for reasons of commercial confidentiality.
- 2 Text or figure(s) deleted at the request of the parties for reasons of confidentiality.
- 3 That is, operators which operate non-gaming machines do not require a Section 27 Certificate.