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W27700

MICROSOFT ACQUIRES ACTIVISION BLIZZARD: BEATING SONY IN GAMING AND THE METAVERSE[1]

Gaming is one of the markets most likely to benefit, with "intensity of usage and business model diversity" boosting the attractions of the business.

–Satya Nadella, Chief Executive Officer, Microsoft Corporation[2]

On January 19, 2022, Microsoft Corporation (Microsoft) announced that it had offered to buy Activision Blizzard, Inc. (Activision) at an enterprise value of US$68.7 billion,[3] sending shockwaves through the video game market.[4] People were quick to comment that the offer was due to Microsoft's ambitions for the games console market, and more importantly, a step toward an expansion into the metaverse.[5] With a growing franchise of games, Activision was an attractive acquisition for Microsoft.

In 2020, US-based Activision was the second-largest publicly traded US video game publisher by market capitalization, with about 10,000 employees and $8 billion in revenue for 2020. Activision was known for its *Call of Duty*, *World of Warcraft*, and *Candy Crush* franchises. Its console, computer, and mobile games collectively boasted nearly 400 million monthly players across 190 countries.[6] Under the leadership of its chief executive officer (CEO), Bobby Kotick, the company's market value had risen from $14 billion in 2010 to about $54 billion a decade later. Activision owned some of the most popular games in the world and had a 40 per cent operating profit margin. Sony Interactive Entertainment (Sony), an affiliate of the Sony Group, was its largest customer in 2020, accounting for 17 per cent of revenue, and its third-largest customer in 2019 and 2018 behind Apple Inc. (Apple) and Alphabet Inc.'s Google.[7]

People were comparing Microsoft's acquisition of Activision to Walt Disney Co.'s $71 billion acquisition of 21st Century Fox's film and television assets, observing that the gaming sector had come into its own. More acquisitions were expected in this space. However, for Microsoft, gaming was a very small part of its business. In 2020, the revenues from games had risen by 33 per cent to $15 billion, due to increased sales of Xbox content and hardware, but this was still less than 9 per cent of the company's total revenue.[8]

This did raise the question, Why had Microsoft done this deal? Was the price too high? What advantages did Microsoft see in this acquisition? What would this move mean for Sony, the market leader in the video games industry?

MICROSOFT

Microsoft was a $2.3 trillion company with a cash surplus of $130 billion. It had tried to acquire companies such as TikTok, Discord, and Pinterest, but had not succeeded, and so might have seen the Activision acquisition as an opportunity to strengthen its position in the gaming sector. After this acquisition, Microsoft would become the third-largest game publisher in the world, owning over thirty game studios (see Exhibit 1).[9] Microsoft had already been actively acquiring companies, paying $16 billion for Nuance Communications, Inc. in 2021, $8.1 billion for ZeniMax Media in 2020, $26.2 billion for LinkedIn in 2016, and $8.5 billion for Skype in 2011.[10]

Microsoft, over ten years, had shifted its corporate clients over to subscription-based cloud services. This raised its market value to $2 trillion, making it one of the top tech companies globally. It was expected that Microsoft could use the same tactic after acquiring Activision, and convince gamers to play on the cloud rather than on expensive hardware consoles.[11] On an investor call, Microsoft CEO Satya Nadella said, "Together with Activision Blizzard, we have an incredible opportunity to invest and innovate, to create the best content, community and cloud for gamers to build substantial new value for our shareholders."[12]

THE RACE FOR THE METAVERSE

The term *metaverse* had attracted growing attention after Meta Platforms Inc. (formerly Facebook, Inc.) announced it as its main focus in October 2021. This was the name given to the virtual worlds that some tech companies believed would represent the next generation of the Internet. Metaverses were immersive virtual worlds of games where players (who could see each other as characters, referred to as "avatars")[13] could work, play, shop, and socialize, perhaps as effectively as in the real world. The technology and infrastructure needed for a metaverse was still being developed, but investors had placed their money on companies making early bets on metaverse-related technologies, such as Apple, which saw its valuation jump to $3 trillion in January 2022.[14]

Video games were seen as examples of these immersive online worlds—of the way these worlds might look and function, with multiple players engaged for hours, purchasing digital goods, and interacting with other avatars. This would explain the rush of the big tech companies to develop their gaming divisions, with gaming poised to be the next strategic battlefield for those tech companies wishing to retain their significance in billions of users' digital lives.[15]

Tech pundits predicted that, once the metaverse became a reality, besides games, there would be countless virtual realms in which people could gather. This would include virtual offices, sports arenas, and shopping malls. It was expected that many of the basic tools and technologies for the metaverse would first come out of games. For example, using the technology for tracking a person's movement in the real world to match it with their gaming avatar in the metaverse could improve virtual office-meeting experiences.[16] Video games had already been influencing various technologies, including graphics, cloud computing, artificial intelligence, and virtual marketplaces. Microsoft could apply the tools and knowledge of Activision to its other game studios and enterprise products. The metaverse technology at this time was attracting only gamers, an audience Microsoft was now trying to capture with the Activision acquisition.[17]

VIDEO GAMES MARKET: RISE OF CLOUD GAMING

The global gaming market had $203 billion in sales in 2020. This market was expected to grow to $545.98 billion by 2028.[18] Video games were of various types, such as shooter, action, sports, role-playing, and others. These games were played on three possible devices: expensive proprietary consoles, computers, and mobile devices (see Exhibit 2).

Cloud gaming was an emerging technology where users could stream interactive games—such as videos on a platform like Netflix—on any Internet-connected device with a screen.[19] Netflix Inc. (Netflix) was an early mover into this space, offering some games that subscribers could download on their Android or iOS devices. But streaming games from the cloud was more complex, as the interactive games needed a lot of data to play smoothly, requiring high-end data centres at the back end, something that Microsoft, Amazon.com, Inc. (Amazon), and Google were already building.[20]

Another trend globally was gamers abandoning their expensive computers and game consoles and shifting to playing on smartphones. This led companies to rush to develop streaming services for high-end games for all kinds of devices, similar to those for streaming movies and TV shows. Amazon, Google, Sony, and many smaller players were investing in this direction, but Microsoft emerged as an early leader in the cloud game space, having spent billions on infrastructure and acquisitions.[21] Microsoft was betting on its version of the future, where cloud gaming would use the company's data centres to power and stream its games to any device.[22]

In 2021, consumers spent $3.7 billion on cloud gaming, with Microsoft's Game Pass accounting for 60 per cent market share, and the company's total cloud game revenue expected to hit $12 billion by 2026. Microsoft also announced in January 2022 that subscribers to its Game Pass in the previous year had increased by 39 per cent to twenty-five million.[23]

In all its previous acquisitions, Microsoft had made all future game releases exclusive to Game Pass and Xbox consoles. Microsoft could diversify further into consumer-facing businesses by growing the cloud game business, thus helping to narrow the gap created by the dominance of Sony's PlayStation in the game console market and of Amazon in the cloud services industry. Nadella's strategy for Microsoft was, broadly, putting cloud computing in the centre of a bunch of varied businesses including corporate software, enterprise data storage, social media, and digital advertising. Based on this, Microsoft had been investing in offering cloud computing services to its enterprise customers to run their businesses. This was the primary reason behind Microsoft's rising valuations, making it the second most valuable company, at $2.3 trillion, behind only Apple.[24]

Acquisitions in the Video Game Industry

Video game developers were also consolidating. On January 11, 2022, Take-Two Interactive Software Inc. (Take-Two) agreed to buy Zynga Inc. (Zynga) in a cash and stock deal valued at $12.7 billion. This was the biggest acquisition in the video game arena to that point and comprised of a console game maker buying a mobile games maker. Zynga had been acquiring firms on its own, buying mobile developer Beijing StarLark Technology Co., Ltd. for $525 million and Chartboost, a mobile advertising specialist, for $250 million. These were just two of the three dozen or so acquisitions made by Zynga since its initial public offering in 2011. The Zynga stock had collapsed by around 40 per cent at the time of the acquisition announcement in 2022.[25] According to a *Forbes* article, earlier in 2021, "Take-Two rival Electronic Arts acquired Glu Mobile for $2.4 billion and Playdemic for $1.4 billion," and China-based Tencent Holdings Ltd. (Tencent) "acquired a majority stake in Supercell, . . . maker of the breakout mobile game 'Clash of

Clans' at $10.2 billion." And earlier, Microsoft had "paid $7.5 billion for ZeniMax Media, the owner of Bethesda Softworks, the studio behind the long-running 'Fallout' and 'Elder Scrolls' franchises."[26]

Microsoft saw the future of video games similar to a Hollywood studio, building up a library of well-known franchises. Microsoft was not only assembling a collection of popular games that could be played on all devices, but also lining up the developers who could make these games. Activision met both these requirements; it had over 5,000 game developers and famous titles.[27] Microsoft was preparing for a world where companies would use content along with their ability to offer cheap games for all devices in order to stand out from competitors. As a result, it was offering a Netflix-type video game subscription service, Game Pass, for a monthly rental fee, instead of appealing to the consumers based on the quality and brand of its gaming consoles. This was a different tactic to the traditional model being followed by the company's competitors Sony and Nintendo Co., Ltd. Nadella said that Microsoft intended to bring as many Activision games as possible to Game Pass.[28]

Microsoft was trying to extend its influence to players who participated in competitive video gaming leagues and to mobile gamers, particularly in Asia. Although this was a rapidly growing segment, Microsoft did not have a strong product in the mobile space. However, it helped that Activision's King studio's flagship product, *Candy Crush*, which was played mainly on mobile devices, made $1 billion in operating profit in 2021 and had generated $7.1 billion in player spending since 2014.[29]

There was also the question of exclusive content. Sony had been offering highly popular games such as *The Last of Us* and *Spider-Man* exclusively to PlayStation owners. Microsoft could do the same with the new titles (from Activision), requiring subscriptions to Game Pass or an Xbox console to play the latest *Call of Duty*. While there were regulatory concerns around the exclusivity of Activision games, Microsoft had earlier announced, in 2020, that its latest studio acquisition's eagerly awaited game, ZeniMax Media's *Starfield*, would be exclusive to Xbox.[30]

Another report stated that the Activision acquisition could be a pre-emptive move by Microsoft to strengthen its position relative to the other tech giants, such as Tencent, Amazon, and Google, who had deep pockets and who had stated their intentions to increase their investments in the attractive gaming business. Others were of the opinion that the acquisition was a defensive move to prevent anyone else from acquiring Activision first.[31]

MICROSOFT'S OPPORTUNITY AT ACTIVISION

Allegations of sexual harassment and discrimination surfacing in mid-2020 had a negative impact thereafter on Activision shares, which had fallen almost 30 per cent since July 2020, when California regulators filed a suit against Activision. By December 2020, shares were almost 10 per cent lower than the record high in 2020. This gave Microsoft the opportunity to jump in and grab Activision at a discount. Microsoft offered $95 a share, in cash. The shares went up 25 per cent after the news was announced. Market observers stated that Microsoft had a strong strategic reason for the purchase, and the news from Activision had lowered public opinion, thus adversely impacting the valuation.[32]

With the acquisition of Activision, Microsoft would add extremely profitable and top-selling Activision titles (see Exhibit 3) to its gaming division, where the Xbox console dominated. If regulators approved the deal, Microsoft would become the world's third-largest gaming company by revenue after Sony and Tencent. The deal would also give Microsoft ammunition to challenge the industry leader, Sony's PlayStation.

The acquisition of Activision would also help Microsoft expand its share in the mobile gaming space, which was an increasingly attractive market.[33] Activision had a significant presence in the mobile, PC, and console segments. Though Microsoft would be only the third-largest player in the world, the deal would be closely scrutinized by regulators, who would be wary of monopolies in the tech sector. Microsoft had already made large gaming acquisitions earlier, when it bought ZeniMax Media (2020) and Mojang Studios, the makers of *Minecraft*, in 2014.

By buying Activision, Microsoft would gain many online games with metaverse features. Activision's *World of Warcraft* had several million people as avatars in a fantasy virtual landscape playing, socializing, and buying virtual goods. The company's games overall had nearly 400 million monthly players, and Microsoft needed these players' support to make any impact in this space.[34]

Activision had 390 million monthly active users (down from 530 million in 2015),[35] which Microsoft's Game Pass subscription service—with twenty-five million users—could benefit from. There was also the possibility of making these Activision games exclusive to the Microsoft platform, which could hurt market leader Sony—though it could also cause players and regulators to rise up in protest, something Microsoft would likely prefer to avoid.

By acquiring Activision, Microsoft planned to make its online gaming subscription service, Game Pass, the Netflix equivalent of gaming.

KOTICK AT ACTIVISION

Activision was a start-up created by former Atari programmers and Jim Levy, a music executive, in 1979. It was the first company to develop game titles for platforms and consoles created by other companies. The company was not doing well in the 1980s and almost went bankrupt in the 1990s.[36] Around 1991, Kotick and his partner, Howard Marks, took Activision out of bankruptcy, "cheaply seizing a financial opportunity" for $400,000.[37] Kotick moved the company from Silicon Valley to Los Angeles, believing the gaming industry was more about entertainment than technology. He kept only eight of the 200 employees at the time of the move, firing the rest.[38]

Kotick changed the way the company worked. First, in the 1990s, he mined the back catalogue of titles. Then, in the 2000s, he figured out a way to launch blockbuster updates of expensively produced hit games such as *Call of Duty* annually, instead of every four years, the time it usually took to launch an update. He worked out ways to release sports titles like *Madden NFL* every season, simply by changing the names and numbers on the jerseys of the players.[39] On the other hand, for "first-person shooter" games like *Call of Duty*, which took four years to develop, Kotick developed an ingenious solution: he spaced out the game development so that three games were in development at a time, thus bringing in annual revenues from new releases every year.[40]

It was through Activision that Kotick displayed his sense of timing and ability to patiently identify high-quality assets; over time, the company aggressively acquired a series of companies. It paid $100 million for RedOctane, Inc., the publisher of *Guitar Hero*, a game that would later appear on the lists of the top ten best-selling games of all time. In 2008, "Activision merged with [Vivendi SE-owned studio Blizzard Entertainment] Blizzard, the studio behind PC hit *World of Warcraft*, . . . in a transaction that valued the combined entity at $18.9 bn."[41] The next target was *Candy Crush Saga*'s developer King, which Activision acquired in 2015 for $5.9 billion, "giving it a hit in the fast-growing mobile market."[42] Through these acquisitions, Activision received a major boost in gaming for the mobile, console, and PC markets. In the last quarter of 2020, Activision reported $800 million in sales; Blizzard reported $532 million; and the most profitable division, King, had revenues of $651 million.[43]

While the high profits indicated the success of Kotick's innovative thinking in launching more frequent updates, this need to aggressively release updates also resulted in more challenges. There was high staff turnover caused by overworked employees. Blizzard-owned developer Raven Software had been on strike since December 2021. Quality assurance workers, responsible for checking for bugs and glitches in *Call of Duty*: *Warzone*, had been on strike for five weeks as of January 2022. Other gamers complained that the company's attempts to find new ways to monetize its titles had led to declining quality. This perceived drop in the quality of the games, like the *Tony Hawk's* series of skateboarding titles, had caused players to become suspicious of Activision.[44]

Kotick had a profitable stay at Activision. He was paid $155 million in 2020 (becoming one of the highest-paid executives in the United States) and would be paid $293 million in 2021 if his employment were to be terminated due to a change of control. Though, as the company did hit performance targets in March 2021, $270 million had already been vested, leaving a balance of $15 million to be paid out to Kotick in the case of his termination resulting from a change of control.[45]

DEEP TROUBLE AT ACTIVISION

In July 2021, Activision was sued by the California Department of Fair Employment and Housing over allegations that the company's female employees were paid less than their male counterparts and had fewer opportunities for advancement. It was also alleged that Activision maintained a "frat-boy" culture and ignored complaints by female employees of blatant sexual harassment, discrimination, and retaliation, primarily at its Blizzard unit.[46] In one case, the New York Post had stated, "Activision Blizzard is a breeding ground for sexual harassment, with male workers fostering a "frat bro" culture full of rape jokes, crude comments and groping that even drove one female employee to suicide, according to an explosive lawsuit brought by the state of California.[47] Activision stated that the lawsuit included distorted and false descriptions of its past and that it strived to pay all employees fairly.

In August 2021, Activision was accused by the California regulator of withholding information from internal investigations into discrimination, harassment, and gender pay inequity. It also went on to say that the company had sought to curtail employees' rights through "repressive if not punitive" secret settlements.[48]

In September 2021, the National Labor Relations Board received a complaint against Activision from the Communications Workers of America alleging that company management used coercive tactics intended to prevent its employees from exercising their rights to organize under federal law. Earlier, on September 20, the US Securities and Exchange Commission had subpoenaed Activision following a wide-ranging investigation into current and former Activision employees' complaints about how the video game-publishing giant handled employees' allegations of sexual misconduct and workplace discrimination.[49] Later that month, Activision agreed to an $18 million settlement with the Equal Employment Opportunity Commission (EEOC). The EEOC had been looking into allegations of gender-based harassment and retaliation at Activision since 2018. The complaint stated that Activision employees were subject to "sexual harassment that was severe or pervasive to alter the conditions of employment." The complaint also stated that Activision had "failed to take corrective and preventative measures." As part of the agreement, Activision agreed to appoint an EEOC-approved external monitor to ensure that the company was in compliance with the settlement agreement. The monitor would report regularly to the EEOC and the board of directors at Activision.[50]

At this time, Activision CEO Kotick said in a statement, "We will continue to be vigilant in our commitment to the elimination of harassment and discrimination in the workplace," and noted that the company would take steps to "prevent and eliminate harassment," including providing better training.[51] Accordingly, Activision hired two senior executives to help in its efforts to build a more inclusive workplace and grow its revenue: Julie Hodges, a Walt Disney Co. executive, as chief people officer, and Sandeep Dube, a Delta Air Lines Inc. executive, as chief commercial officer.[52]

Finally, in October, 58-year-old Kotick told employees he would take a pay cut and stop mandatory arbitration for internal harassment and discrimination claims amid the regulatory probes into the company's culture. Kotick was the second-highest-paid CEO in the United States in 2020, earning $155 million. In a letter to the board, he asked that his salary be reduced to $62,500, the minimum allowed under California law for salaried workers, and said he would forgo all his bonuses and equity grants.[53] He also wrote to employees informing them that he was implementing a new anti-harassment policy companywide: "We need tougher rules and consistent monitoring across the entire company to make sure reports are being handled correctly and discipline is appropriate and swift."[54]

The *Wall Street Journal* reported that Kotick had also been "accused by several women of mistreatment both inside and outside the workplace, and in some instances has worked to settle the complaints quickly and quietly." The report said that, in 2006, Kotick's assistant complained of being harassed by him, including in a voice mail threatening to have her killed. This matter was later settled out of court.[55] The newspaper's report also stated that Kotick had not informed the company's board of directors about some reports of sexual misconduct by male employees toward female employees, including alleged rapes.[56]

Some reports in the press stated that Kotick had held back a summary of personnel issues, which he intended to release to the public, that showed the company had disciplined or caused the departure of more than eighty employees since July. This summary included around 700 reports of employee concern over misconduct and other issues, in some cases related to these incidents. An Activision spokeswoman disputed the figure "700", saying it included benign issues, and stated that "the assertion regarding Mr. Kotick is untrue."[57]

The reports had an impact on Activision's corporate performance. The company announced on November 2, 2021, that the launch of two games would be delayed and that its forecast for the holiday season earnings would fall short of Wall Street's expectations. The delays had been caused by the change in leadership at the Blizzard unit responsible for making the games; leadership changes which were a result of the company being sued by a California regulator over allegations of gender-based discrimination, harassment, and retaliation.[58]

Reactions from Sony and Microsoft

It was unusual for Sony to comment on a partner's business, but on November 17, 2021, PlayStation CEO Jim Ryan disclosed that Sony had reached out to Activision "to express our deep concern" about the *Wall Street Journal* article and said, "we do not believe their [Activision's] statements of response properly address the situation." There were also moves by more than 1,100 current and former Activision employees asking for Kotick's resignation.[59] Some other employees, from another division, were actively seeking to organize themselves into a union.

A day later, Microsoft was reported to be examining its relationship with Activision. In a letter to employees, Phil Spencer, executive vice-president of Gaming at Microsoft, said he personally had "strong values for a welcoming and inclusive environment for all of our employees at Xbox." He further said, "This is not a destination but a journey that we will always be on. The leadership at Xbox and Microsoft stand by our teams and support them in building a safer environment for all." The company's board released a statement shortly after, saying it "remains committed to the goal of making Activision Blizzard the most welcoming and inclusive company in the industry" and that it was "confident in Bobby Kotick's leadership, commitment and ability to achieve these goals."[60]

Kotick told the press in January 2022 that Activision had "moved with speed and unlimited resources" to change the workplace culture, adding that "it's continuous work."[61]

With Microsoft taking over, there was an opportunity for these practices to change if Kotick were to leave the company. Though Kotick was liked by investors, the internal employees and gamer communities did not like him, and the acquisition gave Kotick the possibility of an exit.[62] It was expected that Spencer would run Activision if Kotick left following the deal, as was expected.

SONY: PLAYSTATION AND GAMES

The day following the announcement of Microsoft's acquisition of Activision, Sony's shares plunged 13 per cent, while the shares of other video game publishers rose. There was pressure on Sony to make a higher counterbid for Activision or to announce a big acquisition of its own, which would now be more expensive due to the rise in all video game company stock prices.[63] But Sony was a relatively small company, with less cash to spend. Observers believed Sony would review its options for PlayStation, but it might not have the opportunity to respond.[64] Microsoft's Game Pass (with twenty-five million subscribers as of January 2022) was competing with Sony's PlayStation Plus service (with more than forty-seven million users as of September 2021), but Sony had traditionally focused on the superiority of its hardware, such as its proprietary game console PlayStation 5, which had the latest hyper-realistic graphics power.[65]

As for other parts of Sony Group, the company's video content business, which was run by Sony Pictures Entertainment, followed the "arms-dealer" approach, where it sold its content to all sides (for example, it had sold the streaming rights to its more-than-a-decade-old series *Seinfeld* to Netflix). Similarly, Sony Music content was available on Spotify, a non-Sony music streaming platform. In video games, Sony followed the Netflix model for its PlayStation Plus online gaming platform, which it sold directly to gamers. Gaming contributed to a large portion of profits, which lifted Sony stock prices. Video games as a share of revenue had increased from one-eighth less than ten years ago to one-third of revenue and operating profit in 2022, when games and network services were the largest segment for Sony Group.[66]

Sales of Sony's hardware had always rivalled those of Microsoft's Xbox. By September 2021, Sony had sold 13.4 million units of its PlayStation 5, which it began selling in November 2020—around the same time that Microsoft launched its Xbox Series X. It may have sold more had it not been affected by the semiconductor shortages caused by the pandemic. On the other hand, the pandemic, which forced people to stay at home, boosted video game revenues for all companies on most platforms (see Exhibit 2). The PlayStation system was a major force in the video game industry, with the PlayStation 4 console (released in 2013) having sold roughly 116 million units as of September 30, 2020, according to the company's data. Other, earlier versions of the PlayStation—that is, PlayStation 2 and PlayStation 3—had also sold in large numbers (see Exhibits 4, 5, and 6.)[67]

CONTENT IS KING

Activision's *Call of Duty* franchise, which included multiple titles, had sold 400 million games since 2003, ranking among the top ten best-selling games for PlayStation (see Exhibits 7 and 8). This caused concern that Activision, following its acquisition by Microsoft, would withhold newer Activision titles for the Sony platforms. Spencer, Microsoft's executive vice-president of Gaming, tweeted that he had expressed to Sony leaders "our desire to keep *Call of Duty* on PlayStation."[68] Observers believed the games could be offered across platforms, but that other distribution channels would be restricted to only Microsoft's cloud and subscription services.[69]

Sony had made smaller investments in and acquisitions of software companies earlier. For example, it had invested $200 million in *Fortnite* maker Epic Games, Inc. *Fortnite* was a global hit in 2017, having quickly gained over 350 million registered users by 2021.[70]

Another area of concern for Sony was Azure, Microsoft's cloud-computing service. Multiple players playing online needed powerful computers at the back end to support the data processing requirements. Through Azure, Microsoft could customize its cloud service to meet the needs of its video games. Sony had expressed an interest in using Azure and began talks accordingly in May 2019, but these had not progressed much. Sony employees had stated they were relying on Amazon Web Services for Sony's online games. And there were indications that Amazon was also looking at entering the gaming industry. However, with over 60 per cent of Sony's PlayStation Plus subscribers downloading the games on their consoles rather than streaming them on the cloud, cloud services were not yet a concern for Sony.[71]

The other competitor in the gaming space, China-based Tencent, the world's largest gaming company by revenue and a cloud operator, used its cloud to run its hit game *Honor of Kings*. This game was played more on smartphones than on dedicated game consoles.[72]

Sony could maintain its edge however, in the area of virtual-reality headsets—a piece of hardware that could be critical both for the next-generation video games and for the metaverse promoted by Meta Platforms Inc. Although it had not yet defined its strategy, it had a lead over all of its competitors, including Microsoft. By end of 2021, Sony had reportedly sold over six million units of its PlayStation VR [virtual reality] headset since the product had first gone on sale in 2016, and an updated version was expected later in 2022. PlayStation's CEO Ryan declared, "We are going to lead the way with exploring new technology that unlocks new entertainment experiences. Virtual reality is central to that philosophy."[73]

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) RISKS[74]

Microsoft was the number-one stock for sustainability-focused funds, which held over $53 billion of Microsoft shares (as of January 19, 2021). Activision was also in the list of stocks held by prominent ESG funds, which held about $859 million worth of Activision shares. Over many years, Microsoft had developed ESG policies, including several environmental and workplace-diversity disclosures, and it intended to compensate for all its past greenhouse-gas emissions.[75] It had also set a target of sourcing 100 per cent of its electricity from renewable sources by 2025. However, if gamers migrated to the cloud, carbon emissions were estimated to rise by between 30 per cent and 112 per cent over the next ten years.

Microsoft made information available by distinct reports addressing topics like corporate social responsibility, the environment, and diversity and inclusion. Its *2020 Environmental Sustainability Report* disclosed over 90 data items, including greenhouse-gas emissions, water use broken down by region, and energy from renewable and non-renewable sources by type and region.[76]

Activision, on the other hand, fell considerably behind, making significantly less ESG information disclosures and having significantly less rules in place. Experts predicted that it might take years for Microsoft to convince Activision to adopt its standards, if the deal did take place. The last report by Activision, published in 2021, did not disclose any environmental metrics, stating the company's inability to collect energy and water footprint data for its offices.[77]

Activision was using electricity-consuming servers, which were supporting the millions of players of its online games. Microsoft's sustainability teams would need to determine the environmental footprint. Issues to be checked on the social side were data breaches, player privacy, and any known potential illicit activities in Activision's online video games. On the governance side, there was the issue of Kotick not having informed the board of all the harassment complaints within Activision. The challenges around human capital and board oversight suggested there were "social" and governance investing concerns.

Activision was on the list of funds tracked by an index established and licensed by either MSCI Inc. or FTSE Russell. Both these firms had stated they would review Activision's presence on the list in the last two months of 2021. Activision stock was held by ESG and sustainability funds belonging to BlackRock Inc., The Vanguard Group Inc., and Fidelity Investments. There were reports that these firms would be reviewing Activision's inclusion in these funds.[78] Activision had mentioned its commitment to ESG in its 2020 ESG report,[79] saying it was "working to create the most diverse games in the world by creating innovative tools, training, and practices to ensure our players see themselves reflected in our games, including through characters of color, characters from the LGBTQ+ community, characters of differing abilities, and non-binary characters." It also said that it stood "with Black Americans and with all those fighting against systemic inequality and violence." As for the environment, the company said it would be "reducing packaging waste by 50% over the next five years and bringing our greenhouse gas emissions to net zero by 2050."[80]

Activision's ESG challenges had inadvertently attracted Microsoft to the acquisition because the share price had been beaten down in response to the accusations of sexual harassment and workplace misconduct. Addressing the workplace culture would be a priority for Microsoft, though doing so would not resolve the ESG challenges.

With its knowledge and resources, Microsoft was predicted to need around two years to gather the necessary environmental data from Activision in order to bring its reporting up to par with Microsoft's. According to one analyst, Microsoft would likely form a task force with assistance from teams working on sustainability, investor relations, strategy, and regulations to integrate its policies into the newly acquired company. Executives in charge of sustainability would like to collect more data and create goals for Activision to catch up to Microsoft. In the long run, Microsoft may bring more value to Activision by addressing these issues.[81]

REGULATORY RISKS

The deal was subject to regulatory approvals, but no one expected the deal to be in jeopardy. It was expected that regulators would scrutinize the deal very closely but would find it difficult to suggest that Microsoft would get disproportionate control of the video game market. Microsoft had gaming revenues of around $16 billion for the calendar year 2021; coupled with Activision's estimated revenues of $8.7 billion for the same period, this would total less than 14 per cent of global spending on video games in 2021. Microsoft had stated that the combined entity would be third globally, behind China's Tencent and Japan's Sony Group Corporation.[82]. The focus of US lawmakers to encourage domestic tech companies in the face of foreign players would work in its favour.[83]

The Federal Trade Commission, led by chairperson Lina Khan, and the US Department of Justice, led by anti-trust head Jonathan Kanter, had over 4,100 mergers before them in 2021 for approvals. These had not abated during the pandemic but in fact doubled, with December 2021 having almost 300 mergers, the highest in a decade. The Federal Trade Commission and US Department of Justice needed to evaluate how these mergers "may underemphasize or neglect" other impacts such as labour, innovation or "quality degradation" via privacy incursions, and more. In other words, "would consumers, and smaller competitors, suffer from a bad deal that appears to be a good deal?"[84]

The Federal Trade Commission's Khan commented, "I think it takes courage. These are enormously well-resourced companies. They are not shy about deploying those resources. And I think in these moments, it's important to ensure where we're really showing these companies, but also showing the country, that enforcers are not going to back down because of these companies flexing some muscle or kind of trying to intimidate us."[85]

On its part, Microsoft had also signalled that it would not use the acquisition to give an inherent advantage to its Xbox platform, and it would honour all existing Activision game contracts, including the PlayStation versions of the next three instalments of blockbuster game *Call of Duty*.[86] Although, Microsoft could opt for exclusivity upon the expiry of these agreements in the future.

Microsoft could afford to be flexible at the moment, since its ultimate vision was for a cloud-enabled gaming service that could be offered across a range of different devices.[87] The fact that Microsoft had stayed away from many political controversies, unlike its tech peers, would stand in its favour with regulators. Besides, it had learned valuable lessons on handling the government after having successfully defended itself against being broken up over twenty years earlier.[88] Though it seemed that the deal would be successfully closed in eighteen months, there also loomed the possibility of paying Activision a breakup of $3 billion if regulators blocked the transaction.[89] Additionally the questions still remained, was the deal price justified? Would Microsoft gain from this acquisition? Would Microsoft be able to resolve the ESG issues? And more importantly, how would Sony respond?

EXHIBIT 1: TOP 8 COMPANIES BY GAME REVENUES, THIRD QUARTER 2021

	US$ Millions
Tencent Holdings Ltd.	8,299
Sony Interactive Entertainment	4,342
Apple, Inc.	3,610
Microsoft Corporation	2,887
Google	2,823
NetEase, Inc.	2,435
Activision Blizzard, Inc.	1,921
Nintendo Co., Ltd.	1,589

Source: Compiled by case author based on NewZoo, “Top 25 Public Companies by Game Revenues,” NewZoo, accessed April 12, 2022, https://newzoo.com/insights/rankings/top-25-companies-game-revenues/; Aaron Tilley and Sarah E. Needleman, “Microsoft’s Activision Blizzard Deal to Power Its Netflix-of-Gaming Aspirations,” *Wall Street Journal*, January 19, 2022, https://www.wsj.com/articles/activision-deal-is-set-to-power-microsofts-push-to-be-the-netflix-of-gaming-11642597205?mod=series_activision.

EXHIBIT 2: GAMING PLATFORM GROWTH RATES AND SEGMENT SALES (US$ BILLIONS)

	2018	2019	2020 (Estimated)
Mobile	8.70%	15.40%	24%
PC	3%	6.20%	11%
Console	13.60%	−2.60%	19.60%
Total	**$139.8**	**$150.2**	**$179.7**

Source: Adapted from Wallace Witkowski, “Videogames Are a Bigger Industry than Movies and North American Sports Combined, Thanks to the Pandemic,” MarketWatch, December 22, 2020, https://www.marketwatch.com/story/videogames-are-a-bigger-industry-than-sports-and-movies-combined-thanks-to-the-pandemic-11608654990.

EXHIBIT 3: TOP TEN VIDEO GAMES BY US SALES, 2020

Rank	Game	Publisher
1	*Call of Duty: Black Ops: Cold War*	Activision Blizzard
2	*Call of Duty: Modern Warfare*	Activision Blizzard
3	*Animal Crossing: New Horizons*	Nintendo
4	*Madden NFL 21*	Electronic Arts
5	*Assassin's Creed: Valhalla*	Ubisoft
6	*The Last of Us: Part II*	Sony
7	*Ghost of Tsushima*	Sony
8	*Mario Kart 8: Deluxe*	Nintendo
9	*Super Mario 3D All-Stars*	Nintendo
10	*Final Fantasy VII: Remake*	Square Enix

Source: Excerpted from Jeff Grubb, “NPD Reveals the Best-Selling Games of 2020 in the US,” VentureBeat, January 15, 2021, https://venturebeat.com/2021/01/15/npd-reveals-the-best-selling-games-of-2020-in-the-u-s/.

EXHIBIT 4: LIFETIME SALES OF VIDEO GAME CONSOLES WORLDWIDE AS OF APRIL 2022

Console	Units Sold (millions)
PlayStation 2 (PS2)	157.68
Nintendo DS (DS)	154.90
Game Boy (GB)	118.69
PlayStation 4 (PS4)	116.91
Nintendo Switch (NS)	106.23
PlayStation (PS)	102.50
Wii (Wii)	101.64
PlayStation 3 (PS3)	87.41
Xbox 360 (X360)	85.80
Game Boy Advance (GBA)	81.51
PlayStation Portable (PSP)	81.09
Nintendo 3DS (3DS)	75.95
Nintendo Entertainment System (NES)	61.91
Xbox One (XOne)	50.56
Super Nintendo Entertainment System (SNES)	49.10
Nintendo 64 (N64)	32.93
Sega Genesis (GEN)	29.54
Atari 2600 (2600)	27.64
Xbox (XB)	24.65
GameCube (GC)	21.74
PlayStation 5 (PS5)	19.09
PlayStation Vita (PSV)	16.21
Wii U (WiiU)	13.97
Xbox Series X/S (XS)	13.66
GameGear (GG)	10.62

Source: Thomas Alsop, "Lifetime Sales of Video Game Consoles Worldwide 2022," Statista, April 27, 2022, https://www.statista.com/statistics/1101872/unit-sales-video-game-consoles/.

EXHIBIT 5: GLOBAL CONSOLE GAMING HARDWARE ACTIVE INSTALLED BASE BY BRAND, 2012–2025 (IN MILLION UNITS)

Year	Microsoft Corporation	Nintendo Co., Ltd.	Sony Interactive Entertainment
2012	41.80	54.70	45.70
2013	41.40	44.10	48.20
2014	41.10	34.60	54.80
2015	42.20	28.20	62.90
2016	41.50	20.70	63.60
2017	38.90	26.40	63.40
2018	33.40	31.90	63.80
2019	25.60	44.40	59.70
2020	22.30	60.80	59.10
2021*	25.60	67.40	64.20
2022*	29.60	67.30	71.30
2023*	31.60	57.40	65.10
2024*	31.10	42.20	63.40
2025*	30.50	24.60	59.30

Note: * Estimate
Source: Thomas Alsop, "Global Console Gaming Hardware Active Installed Base from 2012 to 2025, by Brand," Statista, Statista, accessed May 4, 2022, https://www.statista.com/statistics/1260264/global-gaming-console-installed-base/.

EXHIBIT 6: COMPARISON OF XBOX AND PLAYSTATION CONSOLE SALES (IN MILLION UNITS)

Year	Sony PlayStation 5	Microsoft Xbox Series S and X
2020	5.00	3.90
2021	17.90	13.50
2022	33.50	23.70
2023	50.20	34.50
2024	67.30	44.30

Source: Thomas Alsop, "Installed Base of Next Generation PlayStation and Xbox Game Consoles Worldwide 2020–2024," Statista, February 8, 2022, https://www.statista.com/statistics/1195453/next-gen-playstation-xbox-installed-base-worldwide/.

EXHIBIT 7: ALL-TIME BEST-SELLING VIDEO GAMES ON PLAYSTATION 4 (IN MILLIONS) BY UNIT SALES, AS OF AUGUST 2021

Marvel's Spider-Man	20.00
God of War (2018)	19.50
Grand Theft Auto V	19.39
Uncharted 4: A Thief's End	16.25
Call of Duty: Black Ops 3	15.09
Red Dead Redemption 2	13.94
Call of Duty: WWII	13.40
FIFA 18	11.80
The Last of Us Remastered	11.78
FIFA 17	10.94

Source: J. Clement, "All Time Best-Selling PlayStation 4 Video Game Titles Worldwide as of August 2021, by Unit Sales," January 13, 2022, Statista, https://www.statista.com/statistics/953073/all-time-best-selling-video-game-ps4-global/.

EXHIBIT 8: ALL-TIME BEST-SELLING VIDEO GAME TITLES ON PLAYSTATION 3 (IN MILLIONS) BY UNIT SALES, AS OF AUGUST 2021

Grand Theft Auto V	20.32
Call of Duty: Black Ops II	13.80
Call of Duty: Modern Warfare 3	13.35
Call of Duty: Black Ops	12.67
Gran Turismo 5	10.75
Call of Duty 6	10.61
Grand Theft Auto IV	10.57
Call of Duty: Modern Warfare 4	10.13
FIFA 13	8.01
Battlefield 3	7.21

Source: J. Clement, "All Time Best-Selling PlayStation 3 Video Game Titles Worldwide as of January 2020, by Unit Sales," Statista, January 29, 2021, https://www.statista.com/statistics/953081/all-time-best-selling-video-game-ps3-global/.

ENDNOTES

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