

TechScape: Why Microsoft's mega-merger with Activision Blizzard is stalling

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"Oh my god. Wow." Phone calls with law professors about regulatory actions don't normally start with unprompted expressions of amazement, but regulatory actions don't normally come like this. Anne Witt, professor of law and member of the EDHEC Augmented Law Institute, had been expecting to have a very different conversation when we spoke last Wednesday. But then, just minutes before we were due to talk, the UK's competition regulator blocked Microsoft's attempted \$68.7bn acquisition of megadeveloper Activision Blizzard, the sprawling corporation behind games including Candy Crush Saga, World of Warcraft, Tony Hawk's Pro Skater and, most importantly, Call of Duty. Britain's Competition and Markets Authority (CMA) is just one of a number of international regulators which was investigating the proposed acquisition. In the US, the Federal Trade Commission (FTC) had already sued to block the takeover in December, with the case due in court later this year. The European Union is investigating, and has given itself a deadline of 22 May to make a decision, while Australia has paused its own investigation while it engages with overseas regulators. One of those regulators had already given the deal a pass. In March, the Japan Fair Trade Commission ruled that it was "unlikely to result in substantially restraining competition", and approved it to go ahead. Japan's justification for allowing the merger was also behind Witt's expectation it would be approved. "For 30 years or so, competition agencies, very much influenced by the US school, have taken the view that 'vertical mergers' are rarely dangerous," she explained, once the shock had worn off. "If you have a 'horizontal merger' – if Microsoft had bought up a competitor – it is very evident that that will have a direct effect on competition, because it eliminates one player in the market. But if you buy an input, competition is not immediately reduced. So there needs to be an additional action – they need to use the input in order to foreclose competition by denying competitors access to that input. And normally this is only problematic if there is no alternative. "The second issue is that by denying competitors access to the input, Microsoft forgoes a profit, so their key argument is 'this is not at all profitable for us'." Wheat and chaff This doctrine is clearer in a more physical, fungible market. If you turn wheat into bread and you buy a wheat supplier – well, all your baker competitors will just buy their wheat from someone else if you try and stop them getting wheat from your new subsidiary. And even if they can't, it's still probably not worth your while to block them, because the amount you have to pay for the acquisition means you're buying all those future revenue streams: stopping the sales would be a very expensive way to cut your nose off to spite your face. Even before the acquisition was referred to competition regulators, it was clear this doctrine would drive the discussion. Then, early this year, the CMA gave ground on what seemed like the key question: whether Microsoft's

purchase did risk damaging competition in console gaming. Critics of the deal had argued that it was different from the textbooks because of the singular power of Activision Blizzard's Call of Duty series. Those military shooters are the sort of game, along with EA's erstwhile Fifa series, that millions of people play almost to the exclusion of all others. That means it's not easy for a competitor to Microsoft to simply substitute another game: "Just make your own Call of Duty" is the video-game equivalent of Richard Branson deciding to compete with Coca Cola in the 90s, and likely to be about as successful. But Microsoft offered binding promises that it wouldn't withhold the game series from competitors, and the CMA accepted that those, plus the financial loss it would take from foregoing millions of sales on other platforms, were sufficient to conclude that the contest between Microsoft's Xbox and Sony's market-leading PlayStation wouldn't be unduly warped if the sale went ahead. And then, on Wednesday, the bombshell dropped: the acquisition would be blocked anyway. Although the CMA had publicly announced it wasn't concerned about the console market, it had concerns about another, much smaller industry: "cloud gaming". The nascent sector is best known for its biggest failure, Google's Stadia product, which launched to much fanfare and was ingloriously shuttered earlier this year after failing to win market share. But the CMA argued that there's no innate reason for scepticism around cloud gaming: yes, each major attempt so far has dropped the ball somewhere, be that in the underlying technology, the product on offer, or the marketing pitch, but all it takes is for one to get it all right, and the next big gaming revolution could occur. And Microsoft, as it will happily admit, is the closest to getting it all right. The company already has a successful subscription product with hundreds of games, the technological chops and infrastructure to get the back-end working and an efficient marketing machine cranking into operation. That changes the calculations around a vertical merger, though. With no meaningful competitors, it's hard for Microsoft to promise it won't withhold Call of Duty, because it's hard to even know what the competitive landscape will look like. And the argument that it wouldn't forgo profit is harder to make when the potential profit from destroying a nascent competitor far outweighs the minimal profit to be gained from licensing fees in a small industry. So the CMA blocked the merger. And Microsoft and Activision kicked off. What next? The two companies have spent the last week doing a tour of the airwaves, arguing that the decision to block the merger proves that the UK isn't ready for a vibrant tech sector. Microsoft's president, Brad Smith, hit the government where it hurts, saying that post-Brexit Britain had a worse regulatory state than the EU did, while Activision's fighty head of comms, Lulu Cheng Meservey, said that the company would "reassess our growth plans for the UK". In the narrow view, such arguments are unlikely to win decision-makers round. For all that Rishi Sunak and the Conservatives profess to love tech startups, their record in government record is more focused at the other end of the industry, with perennial promises to take on "big tech" on areas ranging from online moderation through to competition policy itself. A trillion-dollar company being prevented from buying a \$70bn one falls squarely in that battle, and there will be some inside government who view Microsoft's ultimately toothless complaints as a sign of victory. But the bigger question is how broadly the CMA's new doctrine is applied. Taken at face value, the regulator is effectively arguing that any acquisition in a nascent sector could be blocked on competition grounds. That could chill investment in a host of promising areas, critics argue: everyone would like to start the business that topples Facebook, but it's not worth the financial risk to backers unless there's also the possibility of a payout for the near-miss of "only" being bought by Facebook. In practice, however, the details of the CMA's finding suggest it thinks it's mostly applicable to this sort of mega-scale vertical merger, rather than the more common acquisition of a much smaller company aimed at bringing new expertise and talent in to a conglomerate. Activision Blizzard isn't valuable to Microsoft purely because it could be useful in cloud gaming, but because its product is already so valuable in established console markets that it is table stakes for any company wanting to compete in new ones. If you want to read the complete version of the newsletter please subscribe to receive TechScape in your inbox every Tuesday