



# Playing for Keeps

Challenges to sustaining a world-class UK games sector

UK  
TRADE &  
INVESTMENT



COMMERCIAL MODELS



# Playing for Keeps – challenges to sustaining a world-class UK games sector

## Monograph: Commercial models

Prepared for:



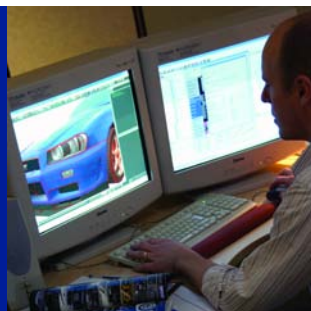
DEPARTMENT FOR BUSINESS  
ENTERPRISE & REGULATORY REFORM

T i g a

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Release date:  
October 2007



# Introduction to Playing for Keeps

The UK computer games and video games industry makes a valuable contribution to the UK economy: in 2006, games generated £2 billion in retail sales in the UK, £370 million was invested in games creation and approximately 21,000 people worked in the sector, 8,000 of these in games development. Games are increasingly becoming part of the lives of millions of UK citizens: 59 per cent of the UK population are gamers and this is growing fast as the demographic widens and games evolve beyond the original genres into casual, lifestyle and learning applications. Games technology and content are at the cutting edge in terms of innovation and creativity. Games sector jobs are typically high quality and high value. These points are not lost on the three Government departments that support the games industry in the UK – UK Trade & Investment (UKTI), the Department for Business, Enterprise & Regulatory Reform (BERR) and Department for Culture, Media and Sport (DCMS).

Both Government and industry have been concerned about the lack of authoritative and up-to-date data on the UK games sector. In late 2006 UK Trade & Investment, in partnership with BERR and trade association TIGA, commissioned independent research on the UK computer games industry in a bid to help fill this gap and to provide much-needed evidence to contribute towards the development of relevant Government policy. The resulting work by Games Investor Consulting Ltd (GIC) – *Playing for Keeps – Challenges to Sustaining a world-class UK games sector* – is a detailed examination of the UK games sector and how it compares globally, with a particular focus on the creation of new games intellectual property, the ability of new companies to start up and grow in the UK and the barriers to inward investment by global companies into the UK.

*Playing for Keeps* is published in three separate monographs:

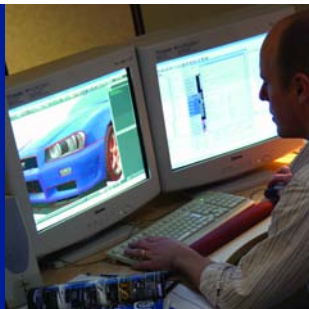
**Country Profiles** – Games Investor Consulting profiles the UK along with a number of leading games development territories around the globe using a series of key performance indicators;

**Intellectual Property** – Games Investor Consulting examines ten of the most successful, influential and representative pieces of intellectual property generated in the UK since the birth of the UK games industry back in the early 1980s;

**Commercial and Distribution Models** – Games Investor Consulting analyses the prevalent commercial models and distribution channels in the games industry today to better understand the key drivers and the future development of the sector.

Each of the monographs includes the results of an Industry Survey which GIC undertook with senior representatives from UK-based development and publisher companies to inform their research.

GIC's research informs us that there are many positives for the UK: we have a world-class hub for games development with an excellent track record in producing hit games which have global appeal. The UK is known for its ability to combine strong characterisation with humour and creative flair; the UK has good levels of development staff and graduates compared to most of our competitor territories; we remain the preferred location for the European headquarters of global games companies.



# Introduction to Playing for Keeps

However, Games Investor Consulting's findings also warn us that we have no room to be complacent: for example, in 2006 for the first time the UK moved from being the world's third to its fourth largest producer of games based on revenue and some territories are showing growth rates that out-pace our own.

*Playing for Keeps* is an evidence-rich piece of research which will help inform the policies of Government departments and agencies but will also be of great value to the industry itself. UKTI, BERR and DCMS are now evaluating this research and discussing it with the industry: we need to determine together what it tells us about the UK's future competitiveness in the global games sector, about our ability to remain competitive and to fully exploit the massive growth of the global market and what actions Government and industry might take to help ensure that we have the best possible business environment for games companies in the UK.

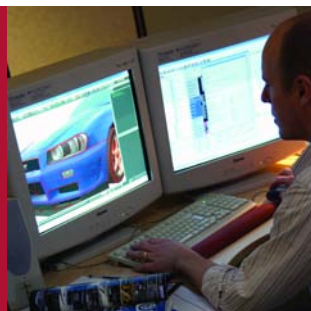
UK Trade & Investment

*Department for Business, Enterprise & Regulatory Reform*

November 2007

All three of the monographs can be downloaded from UKTI's website  
–[www.uktradeinvest.gov.uk](http://www.uktradeinvest.gov.uk)





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# Executive summary

## Commercial climate

The report investigates the leading games business models and distribution channels in action in the global and UK marketplace and finds that:

- Whilst network technology has introduced new business models that give games companies the potential to disintermediate traditional publishers, distributors and retailers and sell direct to consumers, the decades-old advance recoupment commercial model and retail-based publishing model remain standard for most of the games industry and will do so for many years to come.
- Games publishers remain the pivotal link in the games value chain, providing almost all finance for games development. Most independent developers have neither the financial strength nor access to sufficient third party finance to fund more than the very earliest stages of a new game's development.
- Global conditions of dramatic rises in development costs and publishers' increasing risk aversion combine with the UK-specific conditions of poor access to finance and developers' weakening financial and negotiating positions to create an IP poverty trap which has triggered a decline in new UK games IP creation, a critical and worrying development for an industry driven by IP creation.
- These conditions represent a clear failure in the mechanism of the market which reduces new IP availability for publishers, threatens the independent sector's viability, throws the balance of independent and publisher studios, is stifling new IP and threatens to reduce the rate of start-ups. Other territories combat these challenges through better access to finance, either capital markets, investment incentives or IP funds.

- With original IP development by UK companies under threat, the UK sector finds itself in an increasingly commoditised and cost-driven international development services market where the advantages of its creativity and experience may yield diminishing returns.

## Industry survey

A detailed survey of 15 of the UK's most successful independent studios, publisher studios and publisher head offices was conducted for this report and concludes that:

- Most respondents acknowledge that games IP is a critical revenue stream and nearly 90 per cent of independents surveyed will self-fund part of a new game's development. For independents, owning technology IP is also an important factor in increasing production efficiency and winning work-for-hire.
- There was strong agreement that independents struggle to get new original IP distributed. Many think new platforms open opportunities for new original IP, but a sizeable number of respondents think that the UK's ability to generate new IP is diminishing. Most think this situation will persist for the foreseeable future.
- Most companies face recruitment difficulties trying to find suitably skilled and experienced new staff, and 40 per cent of respondents' companies are expanding in competitor territories.
- Most respondents described heavy competitive pressure from playing fields made uneven by government subsidies and investment incentives overseas, and almost all wanted such incentives matched by tax breaks and prototype funds in the UK.



# Introduction to the monograph

## About Games Investor Consulting Limited

Games Investor Consulting is a specialist games industry consultancy founded in 2003 to provide independent games research and corporate finance consulting to the games industry and financial community. Games Investor Consulting is one of the industry's most trusted sources for market intelligence, has generated a number of industry-standard reports, has surveyed over 200 games companies internationally and has consulted on games strategy and research for numerous games and media companies as well as trade and governmental bodies.

## Methodology

Games Investor Consulting gathered primary data through interviews with senior industry figures, but the majority of the research derived from secondary research comprising desk-based research and Games Investor Consulting's existing knowledge of the European and global games industry and capital markets. Qualitative and, where possible, quantitative data processing was conducted. The project was broken down into five discrete work packages which were phased consecutively or in parallel between October 2006 and April 2007.

Data gathered for this report was accurate at the time of each monograph's completion, but, for reasons of budget and timing, new data could not be updated once a monograph was completed. The report focuses on a fast and ever-changing industry and therefore it represents a snapshot of the industry at the time of writing.

## Definitions

The following definitions are used throughout the report:

**AAA:** For the purpose of this report, an AAA IP means a game that has achieved over one million unit sales worldwide.

**Angel funding:** Funding for unlisted companies from high net worth individuals.

**BERR:** Department for Business, Enterprise & Regulatory Reform. BERR was one of the new Departments created following the major Machinery of Government changes announced in June 2007 which also saw the discontinuation of the DTI.

**Currency:** For the purposes of facilitating benchmarking between territories, all sums are in US\$ dollars, with exchange rates from late November 2006 (£1:US\$1.9)." to "For the purposes of facilitating benchmarking between territories, unless otherwise noted all sums are in US\$ dollars, with exchange rates from late November 2006 (£1:US\$1.9)."

**Current generation:** Still anachronistically referred to as "next generation", this refers to the PlayStation 3 and Xbox 360 games console generation.

**DCMS:** The Department for Culture, Media and Sport.



# Introduction to the monograph

**DTI:** Department of Trade and Industry. This Department no longer exists following the Machinery of Government changes made in June 2007. Some of DTI's business support activities described in this report are now part of the newly-created BERR whilst others are part of the similarly newly-created Department for Innovation, Universities and Skills (DIUS).

**ELSPA:** The Entertainment and Leisure Software Publishers Association.

**IP:** Intellectual Property. Unless otherwise stated, the use of the word IP refers to games IP, as opposed to technology IP. IPR refers to Intellectual Property Rights.

**MMOG:** Massively multiplayer online games.

**Overages:** Royalties earned after advance payments from a publisher have been recouped by an independent developer against a pre-negotiated percentage of net receipts.

**Private capital:** Funding for unlisted companies from specialist private equity firms (a sector in which venture capital forms the most relevant part for games businesses).

**Public funding:** Funding for companies from national, federal, regional, provincial or state governmental funds.

**R&D:** Research and Development.

**RDA:** Regional Development Agency.

**RSA:** Regional Screen Agency.

**SKU:** a version of a game tailored for a specific platform.

**TIGA:** The trade association representing the interests of publisher's and independently owned development studios in the UK.

**Trade capital:** Commercial funding arrangements with games companies such as publishers.

**UKTI:** UK Trade & Investment.

**Work-for-hire:** Games development undertaken by independent games developers working on IP owned by third parties, usually publishers, from which most see limited or no post-advance revenues.



# Commercial models and distribution channels in use in the industry today

## Introduction

This monograph looks at the commercial climate for games companies, analysing the prevalent commercial models and distribution channels in the industry today to better understand the commercial drivers for the industry. The monograph is designed to profile the commercial pressure under which companies operate, which feeds into their decisions about location, growth, creating IP, starting up and ultimately their viability and sustainability.

The section on commercial models analyses four major commercial models. For independent developers' own Intellectual Property (IP), we look at the advance models, both part-funded and 100 per cent self-funded, and for work-for-hire on behalf of publishers, the buy-out and revenue share models. Each model profiled will provide an overview of the commercial model and its major drivers and inhibitors, an analysis of its benefits and downsides, its sustainability and other metrics. Detailed platform-by-platform analysis of the different models is provided in the Appendix .

The following section discusses a range of distribution channels that are used by developers and publishers to get product to market today. The section will discuss in detail the viability of five major channels – the retail, mobile, online direct download, gaming on demand, micro-payment based incremental content distribution – and subscription channels. Each profile will provide metrics on how the channel functions, their merits and demerits, key metrics and sustainability. Detailed platform-by-platform analysis of the different models is provided in the Appendix .

Finally, an analysis of the impact of this commercial climate on games companies is provided, looking at the context of these deal structures and distribution mechanisms, looking at barriers and drivers of new models, and giving an outlook for developers and publishers

## Major commercial models

### Independent IP models – Advance model (part-funded)

#### Overview

**Platforms:** Xbox 360 / PlayStation 3, Nintendo Wii, offline PC, Massively Multiplayer Online Games (MMOG) PC, handheld console, mobile, console casual, casual online

**Main stakeholders:** Independent developers, publishers, console manufacturers, distributors and retailers

**Structure:** The advance model (part-funded) is the most frequently found business model in operation between publishers and third party developers when the game is based on the developer's own IP. It works as follows:

- The developer builds a prototype and one or more playable levels of the game to demonstrate its sales potential and technical feasibility to a publisher, self-funding on average 15-25 per cent of the completed game.
- If the publisher signs the game, it does so by agreeing to fund the remainder of the game's development via a series of royalty advances paid to the developer over the life of the title's development. Typically these advances also allow for a small profit margin (five to ten per cent) for the developer.



# Commercial models and distribution channels in use in the industry today

- The higher the developer's initial investment (and the reduced risk that it delivers for the publisher), the better the negotiating position the developer can find itself in and the higher the potential share of net receipts it can secure (typically 20-30 per cent for a part-funded title).
- The publisher then markets the game to consumers, manufactures the boxed product, distributes it to retail stores, and takes the lion's share (on average 65 per cent) of the net receipts.
- Once the title goes on sale, the publisher first recoups the advances paid to the developer before overages start to be generated for the developer<sup>1</sup>.

**Critical analysis:** The advance model (part-funded) has become more common in the industry as publishers' risk-aversion has risen. Publishers have tended to retreat away from new IP during the industry down-cycle between console generations towards safer IP (often in sequels) that has known audiences and more predictable revenue streams.

This model has been widely regarded in the industry as broken for nearly two generations of console. It has a few benefits but many downsides. The benefits are as follows:

- Potential upside:** the sharing of the net receipts can, albeit infrequently, generate additional and high margin revenue flow for independent developers, should the game generate enough revenue to allow the recoupment of the advance.
- IP retention:** the advance model (part-funded) is routinely cited as the best way to retain the rights to the IP for future use, which, should the game prove a success, puts the developer in a uniquely powerful position to secure the most favourable terms for any sequel and for any spin-offs.

- Lower risk for developer:** Although some of the development is self-funded, the developer still relies on the publisher for funding most of production costs, and of course marketing, manufacturing and distributing the product to the end consumer.

The downsides are manifold. The reality for some time has been that, unless the developer produces an AAA hit (over one million units sold), they are caught in the Catch-22 situation. This is due to several factors:

- Rising development costs and the infrequency of overages:** As production values and development costs rise, the break-even barrier rises and is rarely achieved, because average sales volumes on most platforms are now well below the break-even point for developers. Overages are thus rare, representing a small proportion of an average developer's total revenues. As a result, developers wanting to exploit new IP are forced down the value chain to less expensive platforms.
- Publishers may commit less to independent IP:** Although publishers will mostly allocate a proportion of their development expenditure to independently-owned IP, the risk of that IP receiving a lower level of commitment in terms of marketing, resources and emphasis is high. Much independently-owned IP fills in gaps in the publisher's portfolio between wholly-owned or licensed IP, the latter (due to its lower risk and no revenue sharing) taking priority.
- Rising development complexity:** Risk is rising due to rising development complexity for new platforms in a more even market spread across the three major console manufacturers.

<sup>1</sup> The definition of 'net receipts' varies by publisher but usually includes cost of goods, console manufacturer royalty, and a returns provision. The publisher only pays additional sums to the developer once it has recouped its costs



# Commercial models and distribution channels in use in the industry today

- iv. **Weak negotiating position:** Independent developers have fragile balance sheets and increasingly weakened negotiating positions, especially with unproven original IP, traditionally the riskiest for publishers.
- v. **Vicious circle:** Under pressure from the above factors, most independent developers struggle to create new IP, operating at the break-even point, finding it hard to grow or maintain stable revenue flow.
- vi. **Project cancellation:** Milestone payments can and have frequently been stopped by publishers arbitrarily, leading to sudden loss of anticipated revenue for a developer, sudden contraction in staff numbers and in several cases, the demise of the company.
- vii. **Lack of secondary markets:** The games industry is unlike most other media in having almost no secondary market<sup>2</sup>. If a game is not profitable at launch, it will (almost certainly) never be. Digital distribution offers hope but has yet to deliver meaningful revenues.
- viii **Lack of funding for independents:** Many console developers do not have the capital to invest in more than the very earliest stages of a game's development. Most alternative sources of funding rely on publisher buy-in, which usually occurs after development has begun.

The model is primarily disabled by most independents' lack of access to funding.

**Balance of power:** The balance favours publishers over developers. Publishers incur greater risk and disproportionately greater upside potential, often making a meaningful profit on games which result in little or no overages to the developer.

<sup>2</sup> Here we ignore additional sales channels associated with the primary retail release, such as OEM, compilation and budget sales, which can contribute useful sums but are rarely generated by products that have not already been retail hits

**Most advantaged party:** Console manufacturer – reaps a guaranteed share of the wholesale price for no primary effort which equates to a zero risk source of profitability.

**Least advantaged party:** Developer – creates the product but less likely to see overages.

**Overall sustainability:** This model is relatively sustainable for those better funded developers that can afford to invest in new IP, as most publishers will only accept titles with working prototypes before they commit to full development. Despite the downsides for developers, this model is favoured by publishers, and it is expected that the model (gradually changing towards variations that are slightly more favourable towards developers) will remain the dominant commercial model for original, independent IP.

**Variations and viability:** The variations largely revolve around how much production is funded by developers and thus how much revenue share is ceded by publishers. However, a few more arise:

- Retrospective funding for initial development costs. Upon reaching the agreement with the publisher, the publisher can agree to cover part or all of the development costs incurred by the developer to date. Predictably, this often results in a lower royalty rate for the developer, Frequency – common.
- Publisher break-even royalties. These are royalties that are calculated to start when the publisher reaches break-even rather than the developer (often half the number of units sold) – infrequent but becoming more commonplace
- Lump sums based on unit sales milestones that replace royalty overages – rare.
- Day one royalties paid on a sliding scale of percentages as unit sales grow from the very first sale – they occur but rarely result in significantly higher revenues for developers as the percentages used are tiny.



# Commercial models and distribution channels in use in the industry today

**Territorial variations:** Japanese and Korean publishers have a reputation for being less aggressive than their western counterparts, with some offering to more evenly split net or even gross revenues, rather than take 80 per cent or more of them, as found in the west.

**Platform variations:** see the Appendix

## Independent IP models – Advance model (100 per cent self-funded)

### Overview

**Platforms:** Offline PC, MMOG PC, handheld console, online console casual

**Main stakeholders:** Independent developers, publishers, console manufacturers, distributors and retailers

**Structure:** The 100 per cent self-funded mode – where the developer foots the entire development bill – is the least risky of all commercial models for the publisher and the riskiest for the developer. This model eliminates the advance altogether and confines the publisher to a role of marketing and distribution of the game, reducing their up-front costs significantly, and releasing the highest proportion of net/gross publisher receipts to the developer. Due to the high costs involved with console development, almost no self-funding or self-publishing occurs for full console titles (and as such is not modelled here) but it is common on cheaper platforms such as handheld, casual PC, casual console, and mobile games.

**Critical analysis:** The self-funded model is largely confined to cheaper platforms. Publishers would like their risk reduced across the board but can only impose this in the case of very cheap platforms such as mobile and casual online games.

The self-funded model offers significant upsides:

- i. **Higher portion of net receipts:** Revenue flow from self-funded games is higher and sooner, due to lower break-evens at higher percentage of net receipts – typically 60 per cent to the developer.
- ii. **IP retention:** The self-funded model is the best way to retain the rights to the IP for future use, which, should the game prove a success, puts the developer in a uniquely powerful position to secure the most favourable terms for any sequel and for any spin-offs.

The central problems surrounding the self-funded model are as follows:

- i. **Lack of funding for independents:** Again, even on mobile or casual online games, most developers do not have the capital to invest in self-funding a game frequently, if at all, due to the constraints of uneven and/or limited cash flow.
- ii. **Rising development costs:** As the cheaper platforms diversify and increase in processing power, production values will continue to rise. The game's engine and related technology must be ready and functional. Again, this comes back to the developer's access to funds.
- iii. **Publishers may commit less to independent IP:** Although publishers have a much lower risk with a distribution-only deal, the priority given to independently-owned IP is still low, as discussed in the advance model (part-funded) above.



# Commercial models and distribution channels in use in the industry today

- iv. **Sales risk:** Publishers' aversion to independently-owned new IP makes it difficult to sell to them. A number of projects have reached well over 80 per cent complete without a publisher agreeing to distribute it. AAA sales success in this category is rare.
- v. **Publishers' lack of input into the design and development of the title:** Publishers are deterred by lack of input during development in order to best fit the title into their existing portfolio and to maximise marketing efficacy. Games signed after completion can suffer from the absence of such market seeding. These can combine to reduce the attractiveness and increase the commercial risk of signing a completed, self-funded product for a publisher.
- vi. **Lack of secondary markets:** See model (own IP).

The model is primarily disabled by independents' lack of access to funding, but it works well on cheaper platforms.

**Balance of power:** almost equal but the balance still favours publishers over developers, given that the publisher is still responsible for marketing and selling the product to the end consumer. The developer is at risk of the publisher giving the product much less emphasis than its own products.

**Most advantaged party:** Publisher – shares much more revenue but takes much less risk.

**Least advantaged party:** None.

**Overall sustainability:** The model is relatively sustainable in theory – good shares of net receipts come to both parties, risk is shared but its use relies on the developer's access to funding. Given that this is generally low, the proportion of games made with this model is likely to remain relatively low.

**Variations and viability:** The variations largely revolve around how much production is funded by developers and thus how much revenue share is ceded by publishers. Some games are funded 80 per cent by developers and the remaining 20 per cent by publishers, or distributors, or even private financing.

**Territorial variations (if any):** See advance model (part-funded).

**Platform variations:** see the Appendix .

## Third party IP – Work-for-hire (buy-out) model

### Overview

**Platforms:** Xbox 360, PlayStation 3, Nintendo Wii, offline PC, handheld console, console casual, mobile, casual online

**Main stakeholders:** Independent developers, publishers, hardware manufacturers, distributors and retailers

**Structure:** The work-for-hire (buy-out) model is used when third party developers work on IP that is owned or licensed from third parties by publishers. The publisher shares no royalties with the developer, but covers the developer's costs allowing the developer a better profit margin (15 to 20 per cent). Developers with strong processes and good reputations can charge a premium for delivering quality games on time.

**Critical analysis:** The work-for-hire (buy-out) is found frequently in the industry on lower cost platforms, and is largely driven by well-financed publishers who can afford to pay good rates to developers without needing to share revenues.



# Commercial models and distribution channels in use in the industry today

It has the following benefits:

- i. **Lowest risk for developer:** The developer is sharing less commercial risk and has one commercial objective, to negotiate a deal allowing it a fair margin over its costs. Timing is often the most significant development risk and technology risks are low since contracts are won by developers with proven technology.
- ii. **Higher quality IP can establish a developer's reputation:** Third party IP development projects require strong development discipline and processes and solid, versatile development technology. Successful third party IP development projects will often generate sales levels in excess of typical original IP sales levels all of which considerably augments the reputation of the developer, and drives new business.
- iii. **Training ground:** It allows new hires to gain invaluable experience on big brand names with cutting edge technology in firms that are more likely to be process-driven and efficient.
- iv. **Lower risk of cancellation:** Work-for-hire contracts on third party IP tend to have a far lower cancellation rate than original IP as quality is far less of an issue. Delays on titles in this category have a serious impact on the publisher's release schedule, and if they occur are usually solved by publishers dedicating emergency resource to guarantee on-time delivery.

On the downside, this model has some short-term and longer-term effects:

- i. **Developers must invest in technology:** Publishers choose developers for these projects based on who has ready-made technology that minimises the technology risk (which in turn minimises the timing risk). The model therefore attracts developers with tried and tested technology on which investment has already been made.

- ii. **Stricter production targets:** The developer must deliver the game on time, on budget, on specification and to an acceptable quality. It must also avoid any penalties for missing milestones or quality thresholds.
- iii. **IP-poverty:** Although strong games design and development skills are fostered with this model, studios share in no overages. Many studios effectively become service companies providing premium contract work but develop little or no original IP.
- iv. **Threat of lower-cost markets:** Today studios win this kind of work by being very good at what they do – which makes their publishers look good while sharing none of the upside. However, as development costs rise, cost may begin to outweigh the quality, reliability and sustainability of known western developers. As Eastern Europe rises in quality and reliability, British developers will face increasing competition.
- v. **Continual sales effort:** Developers of every type need to be continually looking for the next deal. This leads to heightened levels of uncertainty for the company, unless it can establish itself as a safe pair of hands with a group of publishers and possibly strike multi-title deals.

This model has long-term effects on the UK industry, primarily in commoditising developer's output

**Balance of power:** The publishers, as buyers, squarely hold the power.

**Most advantaged party:** Console manufacturer – see other models.

**Least advantaged party:** Developer – continual search for the next job and possibility of project cancellation.

**Overall sustainability:** Work-for-hire (buy-out) often represents a treadmill for studios with limited growth potential, and the UK faces increased competition from lower cost territories with rising levels of experience.



# Commercial models and distribution channels in use in the industry today

**Variations:** Some variations on the model have been suggested and trialled in a few cases. These include:

Lump sums based on unit sales milestones that replace royalty overages – rare.

**Territorial variations (if any):** None, but better studios in lower cost markets, as they become more experienced, will increasingly exploit a significant cost advantage to win more business from UK companies who work solely on licence projects.

**Platform variations:** see the Appendix

## Third party IP – Work-for-hire (revenue share)

### Overview

**Platforms:** Xbox 360, PlayStation 3, Nintendo Wii, offline PC, MMOG PC, handheld console, console casual, 2D Java

**Main stakeholders:** Independent developers, publishers, hardware manufacturers, distributors and retailers

**Structure:** The work-for-hire (revenue share) model features a medium-sized advance and a low share of net receipts for the developer. The publisher shares some post-advance receipts (ten to fifteen per cent of net receipts) which often include third party IP licensing costs) with the developer after recouping its advance, covering the developer's costs plus a small profit margin of around ten per cent.

Developers with strong processes and good reputations tend to win this kind of work, and may command slightly higher shares of post-advance receipts but overages still represent on average only a small portion of total studio revenues.

**Critical analysis:** This model is the prevalent model in the industry, and is largely driven by publishers who want competitive rates from developers while conceding a low level of sharing of post-advance receipts.

It has the following benefits:

- i. **Lower risk for developer:** The developer has funded little or no development itself, thus bears little risk. The developer has two commercial objectives: to negotiate a deal allowing it a fair margin over its costs, while securing a royalty rate that has a chance of generating overages. Developers still have to prove that they have the technological capability to develop cutting edge games on the latest platforms.
- ii. **Higher quality IP establishes developer's reputation:** See work-for-hire (buy-out) model.
- iii. **Company stability:** Some of the most stable and consistently profitable development studios are found working purely in this category.
- iv. **Training ground:** See for work-for-hire (buy-out) model.
- v. **Upside potential:** There is a chance that the model will generate additional revenues by sharing in post-advance receipts, but the metrics of the model mean that the chance of meaningful profits is small.



# Commercial models and distribution channels in use in the industry today

On the downside, this model has some short-term and longer-term effects:

- i. **Margins are unpredictable:** Developers often aim, within their internal budgets, for a higher margin than is achievable and few projects go exactly to budget. Invariably the margin is lower than either the developer or publisher anticipated – only the highest quality developer can hit their internal budgets consistently.
- ii. **IP-poverty:** See work-for-hire (buy-out) model.
- iii. **Cost drivers may rise in importance:** See work-for-hire (buy-out) model.
- iv. **Slow steady growth vs meteoric rise:** See work-for-hire (buy-out) model.
- v. **Continual sales effort:** Although this is a more stable commercial model than developing own IP, the lower levels of margin leaves most developers still hunting for the next job.

This model has the same long-term effects on the industry as the work-for-hire (revenue share) but is the prevalent revenue stream for most developers of any scale.

**Balance of power:** The publishers, as buyers, funders and marketers of the product, squarely hold the power.

**Most advantaged party:** Console manufacturer – see advance model (own IP).

**Least advantaged party:** Developer – tough negotiations are expected to produce a mechanism that generates overages, and the continual search for the next job and potential for project cancellation still exist.

**Overall sustainability:** The work-for-hire (revenue share) model represents a significant proportion of most independent developers' deals in recent years. It represents a continual source of pressure in negotiations as publishers

squeeze down developers' margins, while raising the break-even points by increasing budgets. It also has the side effect – given the lack of overages – of reducing growth potential. Its use will continue to grow, reducing the potential for most independent studios to move up the value chain, and, like the work-for-hire (buy-out) model, encourages competition from lower cost territories such as Eastern Europe.

**Variations:** Some variations on the model have been suggested and trialled in a few cases. These include:

- Part-funded model (see later section) is utilised to reach prototype stage, all of which cost is self-funded by the developer. Upon reaching the agreement with the publisher, the publisher strikes a side-deal to cover the initial development costs of the prototype, at which point the deal reverts to the advance model (part-funded) described above.
- Royalties that kick in when the publisher reaches break-even (often half the number of units sold) – increasingly common, but not prevalent.
- Lump sums based on unit sales milestones that replace royalty overages – rare.
- Day one royalties paid on a sliding scale of percentages as unit sales grow – they occur but rarely result in higher revenues for developers as the percentage shared decreases accordingly.

**Territorial variations (if any):** Japanese and Korean publishers have a reputation for being less aggressive than their western counterparts, with some offering to split net revenues, rather than take 80 per cent or more of them, as found in the west.

**Platform variations:** see the Appendix



# Commercial models and distribution channels in use in the industry today

## Distribution channels

### Distribution channel – Retail

**Platforms:** Xbox 360, PlayStation 3, Nintendo Wii, offline PC, MMOG PC, handheld console, console casual

**Main stakeholders:** Publishers, retailers, hardware manufacturers, distributors, and independent developers

**Overview:** Retail is today the dominant sales and distribution channel for games with no challenger of major scale – and none is expected to come close to retail as the primary sales channel for games products in the next five years. The mechanisms behind the retail distribution channel – physical manufacturing of boxed product, the infrastructure of distribution, retail sales, inventory costs, point of sale marketing, sale or return agreements – are the foundations of the most common commercial models in the industry. Their rigidity is behind the intransigence in commercial models, and, in contrast, behind the innovation in commercial models found when digital delivery cuts out physical products.

### Channel characteristics:

There are three main steps in this channel: manufacturing, distribution and retail.

- **Manufacturing** is largely in the hands of the publishers, who are responsible for arranging the manufacturing and distribution of a retail-bound title. Console games are manufactured in close collaboration with, and sometimes by, the console manufacturers.

- **Distribution** is managed by publishers who either work with third party distributors or handle the wholesale of their products directly to larger retail customers. Third party distribution facilities provide the selection, packaging and carriage of boxed products from the manufacturer/warehouse to individual retail stores or retail chain depots (known as “pick, pack and ship” distribution). Larger distributors offer wholesale services, managing the responsibility for selling publishers’ products into retailers, and sometimes providing in-store merchandising and marketing support.
- **Retailers** comprise high street outlets, mail order companies or websites that sell boxed products on to the consumers, co-ordinating point-of-sale marketing and handling returns. At present few, if any, high street retailers operate in the electronic distribution market. Retailers are influential in terms of purchasing decisions. Retail wields considerable power although this influence is confined to the largest specialist (eg Game or GameStop) and non-specialist (eg Wal-Mart or Tesco) retailers whose volume ordering commands preferential treatment from publishers.

**Revenue splits:** the following is an example of the revenue splits for a console product utilising developer IP.



# Commercial models and distribution channels in use in the industry today

**Table 1: Retail revenue splits**

Consumer spend (net of tax)	\$49.99
Retailer	\$10.99
Platform provider	\$10.00
Physical distributor	\$2.00
Manufacturing	\$2.00
Marketing	\$4.00
Publisher	\$15.60
Developer	\$5.40

**Critical analysis:**

The benefits are as follows:

- i. Access to the broadest base of consumers:** Distribution of boxed product to retail enjoys high levels of access to and, to a degree, control of the consumer.
- ii. Established mechanisms, relationships and commercial models:**  
No experimentation.
- iii. Device stability:** Games on consoles benefit from being built to a single technical specification, screen resolution which does not change for the life of the console (up to ten years), and delivers a growing installed base to market to.

The downsides are:

- i. Static business models:** Digital distribution is definitely a threat to retail, and western retailers have shown little in the way of strategy to fight this growing threat. Some have even sought to undermine it by taking aggressive stances with publishers that have sought to use discount-priced digital distribution.
- ii. Commoditised distribution model:** What could provide a source of finance to the industry has been largely commoditised out of existence by aggressive publishers.
- iii. Inventory management:** Retail suffers from being driven by shelf-space, the pressure of the number of units actually manufactured, and the moveable feast of pricing.
- iv. Piracy and hacking:** Boxed products are less resistant to piracy than digital products (which require registration and continual log-ins to play). The average game is cracked and made available for free online within ten to twenty days after retail release.
- v. Customer "ownership":** Consumers are "owned" by the retailers. Developers and publishers have limited access to information about who is buying their games and how they are using them, especially relative to digital distribution.

**Balance of power:** The major retail outlets buying in volume, such as Wal-Mart or Tesco, hold the balance of power in this distribution channel. Retailers control volume, sales focus, and consumer experience. They are also powerful in deciding pricing levels, which have a direct knock-on effect on developers.



# Commercial models and distribution channels in use in the industry today

**Most advantaged party:** Volume retailers can decide the fate of titles before they launch, often choosing only titles in games charts, excluding non-mainstream products, or products that have courted too much controversy.

**Least advantaged party:** Developers who create products but have no say whatsoever in pricing decisions.

**Publisher risk level:** medium: sale or return agreements between publishers and retailers primarily disadvantage the former, who pay a largely fixed fee to console manufacturers in advance of sales. This means that they are forced to reduce prices for titles that sell less well without benefiting from a lower toll as prices are discounted.

**Developer risk level:** high: Developers have no say in (and zero direct feedback from) this channel, and those with deals that rely on variable revenue share percentages dictated by retail pricing can face sudden drops in their chances of reaching overages when the ramp-down occurs.

**Distributor risk level:** low-medium: Most distribution deals to the larger retailers are handled directly by the publishers using internal distribution resources or highly commoditised pick, pack, and ship third party distributors. They thus feature little direct risk for the distributors.

**Overall sustainability:** The model is pretty rigid in terms of how it works for the various stakeholders. It will retain its position at the head of list of distribution channels for at least the next five years, and probably much longer. It does, however, face a gradual war of attrition with digital distribution, which will take, albeit incrementally, small proportions of the market away from boxed products.

Interestingly, this war is largely being waged by the larger independent developers, the category of company most removed from, and disadvantaged by, the retail model.

**Platform variations:** Some variations are available. These include:

- **OEM:** Games bundled with other products such as computer hardware and sold below wholesale prices
- **Game rental:** Boxed games rented for set periods or via monthly subscriptions.

**Territorial variations (if any):** Retailers in the USA take a smaller proportion of the revenue than in Europe although this is partly made up for with additional point-of-sale marketing charges. In Japan, web purchases are often made for delivery to a local shop where cash changes hands, which changes the revenue share percentage by adding a second retailer.

**Overall market share<sup>3</sup>:** 72 per cent of 2006 global games software revenues, falling very gradually.

## Distribution channel – Mobile

**Platforms:** 2D / 3D mobile games

**Main stakeholders:** Independent developers, publishers, content aggregators and network operators

<sup>3</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally



# Commercial models and distribution channels in use in the industry today

**Overview:** The mobile games channel, heavily hyped in recent years as the next big thing, has continued to grow although penetration of gaming has not grown as fast as hoped. Despite low break-evens, rapid development cycles combined with low production costs, the channel is hamstrung by structural problems which have slowed (and will continue to slow) its growth. These problems are such that the content industry as a whole is putting its faith in bypassing operators entirely and going direct-to-consumer, a channel that is still very much in its infancy.

## Channel characteristics:

Mobile game aggregators conduct the following steps before a game reaches a consumer.

- **Porting:** With well over 500 handsets in European and North American markets alone, the task of porting games to ensure coverage of around 70-80 per cent is lengthy and expensive, even using specialist porting companies in low cost markets such as Russia or India. At US\$150-200 per port, the cost racks up quickly.
- **Testing:** Conducted by the network operators to ensure that the game is broadly compatible with their delivery protocols, chosen platform (such as Java or Brew) and handsets. Operators often dictate that publishers go through a blanket testing regime such as the Java certification, which is managed by a handful of pre-defined third parties, or Qualcomm certification.
- **Sale:** The game once delivered in a small file to the operator joins the queue for placement in the game deck, a walled garden area within most network operators' online services, with the capability to highlight only a handful of games.

Games are usually paid for in Europe and North America on a per-download basis. European operators take 30 per cent of the revenue from a direct to bill payment mechanism, and 50 per cent from a premium SMS, and the choice of which to use is largely defined by handset and operator, on a country by country basis.

**Revenue splits:** the following is an example of the revenue splits for a developer-owned mobile IP.

**Table 2: Mobile revenue splits**

Consumer spend (net of tax)	\$4.50
Operator	\$1.80
Publisher	\$1.35
Developer	\$1.35

## Critical analysis:

The benefits are as follows:

- Limited delivery costs:** A game is delivered to the operator and consumer digitally, which means no inventory costs or management, no manufacturing costs, and only nominal data transfer costs.
- No 5-6 year upgrade cycle:** Faster upgrading but slower pace of technology change means that no sudden leaps in technology are experienced in mobile. This has not stopped a number of mobile developers investing heavily in 3D mobile games engines when only a handful of handsets support them.



# Commercial models and distribution channels in use in the industry today

- iii. **Connected user:** The user is always connected to the network, meaning that a continual stream of new content is available to the user, and connected gaming offers new opportunities for games companies.
- iv. **High penetration of handsets:** Massive penetration of mobile handsets – and massive growth in emerging markets – means that the potential for growth is huge. The installed base globally far outstrips any dedicated games platform (but see ii below).

The downsides are:

- i. **High retail costs:** Mobile operators take 30 to 50 per cent of the retail price of the game, dependant on which billing mechanism is in place. Billing functionality does not always work, and customers can become frustrated with fiddly payment mechanisms and the poor quality service provided by network operators, most of whom fail to support individual games.
- ii. **Low penetration:** On average five per cent of mobile phone owners have actually paid for a mobile game, despite around 50 per cent having tried one. This has led to strenuous marketing efforts by publishers who are forced by network operators to help drive mobile gaming deeper into the population of mobile phone owners.
- iii. **Poor quality games:** This reluctance to buy is driven in part by poor quality games often towed behind larger film, television and console game launches, such lack of quality impacting the entire market. This of course is also an opportunity for higher quality games to shine – if they can be found by consumers.
- iv. **Device proliferation:** Most mobile publishers have to support well over 400 handsets' in Europe and North America, that make use of a growing range of technology platforms – Java, Brew, Symbian, Imode et al. Porting is a difficult, expensive and time-consuming process. Device incompatibility, whether in screen sizes or resolutions, memory or graphical processing power, network technology or keypad layout, plagues the developers and publishers of mobile games.
- v. **Deck placement:** Over-crowded game decks have the significant downside of placement being dictated by co-marketing expenditure and scale of brand as opposed to game quality. Operators have begun dictating terms to publishers and aggregators, effectively denying high deck placement to those who will not help them drive mobile gaming penetration through consumer market campaigns and expenditure. Thus it is harder to get a game high into the game deck, and few games thrive outside the top ten recommended games.
- vi. **Operators consolidating their games partners:** Mobile aggregators and publishers in the mobile space must strike territory by territory deals with the local operators' organisations, reducing their opportunities for simple, mass distribution. Mobile operators have focused on a reduced number of partners, resulting in a fair degree of consolidation among mobile aggregators.
- vii. **Poor demographic data:** Mobile operators provide little or no information about the mobile user, which impedes the development of new commercial models based on advertising, the targeting of games towards specific demographics and product development in general. Effectively this leaves mobile games developers working on hunches rather than solid data on consumer behaviour.



# Commercial models and distribution channels in use in the industry today

The channel has potential, but at present is hampered by these structural problems which make it a difficult channel to exploit to high levels of profitability.

**Balance of power:** Operators have a distinct advantage in defining which games reach the top of the deck, and, as their attempts to sell games into a wider public have met with limited success, they are less than enthusiastic about promoting games based on merit alone.

**Most advantaged party:** Operators (see above).

**Least advantaged party:** Developers, who have no say over deck placement, little power to negotiate marketing expenditure from publishers, and, in the case of new IP, have a real struggle getting such games high in the decks.

**Publisher risk level:** low-medium. Cost of development and generally low distribution costs compared to other games platforms are such that its efforts are largely expended in relationship management and business development with operators in multiple territories.

**Developer risk level:** medium. Although many games are covered with the standard model's advance system, the chances of break-even are reduced by the ability or otherwise of the publisher in securing top tier distribution of the game with operators.

**Distributor risk level:** low. Operators simply choose games whose marketing expenditure reassures them that sales levels will be high. But its support and distribution costs are almost asymptotic.

**Overall sustainability:** low. The structural problems in this sector are such that only a few companies can survive at scale.

**Platform variations:** Some variations are available. These include:

- **Off-portal:** This is where content providers run their own web and WAP sites where users can pay for and download games directly, sometimes without paying a fee to the operator.
- **Subscription:** Common in Japan, but found also for some major content aggregators' services, users pay a monthly fee to access individual titles or baskets of content, which makes revenue sharing for individual games more complicated for the publisher, raising barriers to entry for third party IP.

**Territorial variations (if any):** The major variation in this channel is cost of the game. AAA titles can be much more expensive, but average prices per download vary from £4 in the UK, to US\$5 in the US, to €3-5 in the EC, to £0.15 in China.

**Overall market share<sup>4</sup>:** Ten per cent of 2006 global games software revenues

<sup>4</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally



# Commercial models and distribution channels in use in the industry today

## Distribution channel – Casual PC games

**Platforms:** PC

**Main stakeholders:** Casual games portals, independent developers, publishers, hardware manufacturers

**Overview:** The casual PC games market has enjoyed rapid growth in the last five years driven by demand from a broad, mass-market demographic for simple, fun and fast gameplay experiences. The demographic playing these games is overwhelmingly (65 per cent+) female and older (average age between 24-36). Since the collapse of the dotcom bubble in the early 2000s, casual games companies have been increasingly monetising these games through a range of different commercial models including advertising, subscription and wagered gaming based on skill rather than chance (which avoids regulatory oversight in most western territories). Distribution of casual games is achieved via a rapidly growing number of channels including community sites, games portals, instant messaging platforms and direct from developers' sites. Companies such as PopCap Games and Miniclip aggregate casual downloadable or browser-based games, casual games publishers like Oberon Media provide unbranded, "white label" services to consumer-facing sites and some traditional games publishers operate large casual games portals such as EA's Club Pogo. Whilst the larger aggregators and publishers can boast substantial operating profit margins, many casual games developers struggle to grow and are hampered by increasingly harsh publisher deal terms which are weighted towards (sub US\$10,000) up-front fees for development and no royalty upside.

### Channel characteristics:

Developers and publishers need to go through the following steps to access these casual PC games channels:

- **Create and license small games:** Such games are usually created very quickly for low fees by bedroom programmers or small developers and licensed, often with no royalty sharing, by games aggregators and publishers.
- **Creation and maintenance of an online destination site:** Often the biggest investment for publishers or aggregators is in the infrastructure behind their sites, in services like community management, billing systems, customer support and compatibility with existing browser and other technology standards.
- **Promotion:** Growing such games sites is an art achieved by online marketing skills, viral content promotions, web advertising, quality of content, careful market seeding via test sites, partnerships with games review sites, more recently widgets that play through sites such as Facebook or YouTube and other creative marketing methodologies.
- **Sale and delivery:** In the case of premium downloadable casual games, these games are purchased by users using credit cards, site specific wallets or PayPal-like alternative payment mechanisms for between US\$5.00-US\$20 per game.
- **Advertising serving:** Advertising sales companies are often drafted in to sell banner ads, interstitials and site sponsorships to brands on behalf of sites, which is usually a plug and play solution. Some use even simpler mechanisms such as Google AdWords.
- **Support:** A budget line item which can get increasingly onerous as a site reaches scale, support for casual games is usually less difficult due to the less demanding customer and less complex games, but nevertheless important.



# Commercial models and distribution channels in use in the industry today

**Revenue splits:** The revenue models in operation in this channel vary by the type of distribution channel (see Platform Variations below), and dependent upon whether developers go direct to consumer (developers take all the revenues after fulfilment costs) or via an aggregator (20-75 per cent net revenues ceded by developer). In addition, the advertising network sales companies commonly employed by aggregators will take 30-50 per cent of gross advertising revenues with predominantly low advertising rates, meaning that revenues are likely to be very low for content creators unless a game is a runaway hit.

## Critical analysis:

The benefits are as follows:

- i. **Cheap, fast development:** Casual games in these channels are often created in under a month by small teams for low fees and aggregators can acquire high volumes of games fast with relatively low outlays.
- ii. **Simple value chain for premium games:** With most models, fewer companies take a cut of the gross revenues of casual games.
- iii. **Multiple distribution channels:** As a developer, there may be multiple routes to market for the same content unless a game has been acquired exclusively. Originators often embed URLs in games seeded on other sites that return users to their originating sites to capture new users.
- iv. **Huge addressable market with mass-market demographics:** The growth of casual gaming has been evolving rapidly and with the greatest levels of innovation online. The addressable market is massive – potentially all internet users – and demographically the casual gamer is easier to acquire, maintain and support than a hard-core gamer.
- v. **Growing potential:** The casual PC games market has had a profound influence on the strategies of the console manufacturers because it is servicing the next growth target – the mass market.

The market is far from peaking on connected PCs. The phenomena of social networking and user generated content should drive casual gaming further forward in coming years.

- vi. **Innovation is rewarded:** Gameplay quality and innovation are rewarded to a greater extent than the traditional video games market due to the lower reliance on licensed third party brands and marketing spend, and the avoidance of retail shelf space limitations which effectively filter and reduce the range of new boxed product. Successful casual games and information about them are more easily disseminated and accessed online.

The downsides are:

- i. **Low development fees and returns:** Although some operate a traditional advance and net revenue share model, most simply pay low fees to developers. These highly short-term commercial models ensure a commoditised channel that favours the aggregator rather than the originating studio, but can impact quality. Revenues are further suppressed with advertising-supported channels, where the longer value chains including advertising sales companies that further suppress revenue potential for the creators of content.
- ii. **Highly crowded marketplace:** Games developers competing in this space are significant in number and global in location, leading to an over-supply of developers and titles, competition from lower cost markets and generally low quality thresholds for many games portals.
- iii. **Plagiarism rife:** A good new casual game concept will quickly be plagiarised and re-published within weeks of launch, and the location of the copier, commonly in Asia or Eastern Europe, makes such piracy almost impossible to stop.



# Commercial models and distribution channels in use in the industry today

- iv. **Low barriers to entry:** The plethora of casual games “bedroom programmers” that has resulted from the low commercial and technical barriers to entry into this space, commoditises the market, restricting the numbers of professional casual games developers (as distinct from aggregators) that the market can support in developed countries.
- v. **Customer management:** While lower maintenance than traditional gamers, the high volume of customers who can vote with their feet if quality is not high enough means that customer support is an important and potentially costly activity.

**Balance of power:** Games aggregators and publishers, more often than not, own the user and have the upper hand over an increasingly commoditised development market.

**Most advantaged party:** Games aggregators and publishers, whose models are based on volume and who benefit from the snowball effect once reaching critical mass.

**Least advantaged party:** Developers that fail to aggregate content themselves command little or no power in the relationship, and their IP faces swift piracy.

**Publisher risk level:** medium. Initial risks are high regarding investment in reaching critical mass which, once achieved, ensures natural growth but portals still face a sudden loss of customers if service quality drops, mounting operating costs, and the challenge of maintaining quality.

**Developer risk level:** low. A short term source of revenue but not one with strong growth potential.

**Overall sustainability:** Good. The channel, although fairly crowded, has strong potential for growth as geographic and demographic penetration is far from complete. It will also benefit from the console games platforms efforts to drive the medium forward. For developers however, control will probably come through opening direct channels to users.

**Platform variations:** Numerous variations are available. These include:

- **Advertising-supported model:** Still the most common and largest segment of the casual PC games market, this model is a volume play which largely favours the aggregator not the content creator. Gamers provide registration information to enable better targeting of advertising. This model is also used for user generated content, either home-baked flash games or using specific tools offering game templates which can be customised.
- **Full game download:** Often extended versions of existing browser games, here gamers pay between US\$10-20 to download and play a game offline.
- **Skill-gaming:** Players wager other players on their ability to play specific games, entering tournaments, head-to-head multiplayer games or timed sessions, with the ‘house’ taking a small percentage of gross wagers.
- **Subscription model:** Gamers pay a monthly fee of rarely more than US\$5 on sites such as Club Pogo to access premium games, community services and customisation features.

**Territorial variations (if any):** A great degree of cross-over between casual games and massively multiplayer games is found in Asia.

**Overall market share:** 3.2 per cent of 2006 global games software revenues.



# Commercial models and distribution channels in use in the industry today

## Distribution channel – Online full-game direct download

**Platforms:** Offline PC, MMOG PC (Xbox 360, PlayStation 3, handheld consoles in future)

**Main stakeholders:** Independent developers, publishers, download providers

**Overview:** This channel enables the digital download of games direct-to-consumer via the internet using an outright (or, rarely, subscription-based) purchase model. Consumers pay for games or premium games content (such as add-ons to existing games) through an e-commerce site or other online service, which allows them to download the games onto their PCs or consoles in their entirety. Digital download services can be managed by a number of different parties, including developers, digital rights management (DRM) technology companies and games publishers as well as e-tailers and other online delivery specialists. The size of most modern games (measured in the high hundreds of megabytes to multiple gigabytes) largely limits this channel to broadband subscribers.

### Channel characteristics:

The delivery of a game utilising this channel consists of several steps, all of which are normally (but not always) included in the service of the digital download provider, for which they take 40-50 per cent of a games retail price.

- **Security procedure:** The completed game is encoded with security technology (digital rights management) that prevents it from being played until payment has been verified and received, and the player authenticated. Games downloaded in this way are often checked at the start of each game session by a game client resident on the user's PC. Direct download providers often rely on third party DRM solutions.

- **Authentication and payment:** The user normally purchases a game in advance from the provider, which registers and authenticates the user, verifies payment has been received and then begins the process of a download to the customer's hard drive. Direct download providers rely on third party billing and fulfilment solutions.
- **Delivery:** The game is usually delivered via a client programme, such as Steam or EA Link, which manages payment, downloading, authentication and sometimes updating of the game's code via patches or even additional game episodes. Today's games weigh 1GB to 4GB, which would take 0.4-1.6 hours to deliver via a standard 2MB broadband connection. Direct download providers rely on third party server solutions.
- **Support:** Most providers will support the games post-delivery, although the quality of service varies widely.

**Revenue splits:** The following is an example of the revenue splits for a direct download game owned by a publisher. Clearly, if self-publishing the developer would take both the publisher and developer portions.



# Commercial models and distribution channels in use in the industry today

**Table 3: Online full download revenue splits**

Consumer spend (net of tax)	\$49.99
E-tailer	\$15.50
Billing	\$2.50
Electronic distribution	\$2.00
DRM	\$2.50
Publisher	\$21.99
Developer	\$5.50

**Critical analysis:**

The benefits are as follows:

- i. **Lower costs:** A game is delivered to the consumer digitally, which means no boxed product inventory, manufacturing or distribution costs. However, it is a common misconception that there are no costs involved, as electronic retailers are often utilised, and publishers have to make substantial investments in network capacity, redundancy, storage, digital rights and download management.
- ii. **Connected user:** Most internet users today are always connected to the network, meaning that these massive downloads can be managed via a continual stream of new content to the user, often during “down-times” and connected gaming offers new opportunities for games companies.

- iii. **High penetration of broadband:** High and growing penetration of broadband in the west means that most gamers are online via a fast enough connection to enable downloading within acceptable time frames. It is still nowhere near 100 per cent of households and as such is a restriction of the overall PC gaming marketplace.
- iv. **More favourable revenue shares:** A service like Steam offers the potential for independent developers to disintermediate publishers completely, and take a better share of gross revenues. However, other intermediaries (in DRM, billing and serving) quickly appear, so the impact of disintermediation on the value chain is less pronounced than often is stated.

The downsides are:

- i. **Limited opportunity today:** The opportunity is fairly limited today, with low penetration of even the most successful providers. For instance, Valve’s Steam service currently has five and a half million registered users, but may have peaked. There are indications that Steam works well for Valve’s own titles, but not for third parties<sup>5</sup>; EA, for reasons of politics or performance, has not released usage figures<sup>6</sup>.
- ii. **Publisher apathy:** Publishers have in the past been resistant or at best apathetic about breaking into the new ground of digital downloads. Although the availability of AAA games at or close to launch has increased to much healthier levels, the number of games on the most popular download sites do not come close to the full coverage of titles available at retail.

<sup>5</sup> One of its Steam’s first independent signings, SiN from Ritual Games, was dropped when it failed to perform after a Steam-exclusive launch

<sup>6</sup> EA’s Link service is the first major investment made by a publisher in this area, and it is consistently downplayed by its managers as being an adjunct rather than a threat to traditional retail



# Commercial models and distribution channels in use in the industry today

- iii. **Technology:** Even those providers in the market for several years have experienced difficulties in researching, developing, financing and maintaining the technology back-ends. The costs of managing server infrastructure are high.
- iv. **Security:** DRM is a critical component, and even the most robust solutions will get cracked by determined hackers, many of whom, of course, are gamers. Valve has had to remove tens of thousands of fraudulent accounts of people accessing content for free.
- v. **Loss of publisher marketing clout:** Although this route is seen as attractive by independent developers, a decision to go down this path is one that can deprive a game of the value of an experienced and well-funded marketing machine that can deliver sales. Word of mouth works fine for niche web gamer communities, but break-out beyond that requires marketing expenditure. Many games have failed to sell well via digital download as consumers simply fail to hear about them.

This channel has been heavily hyped as the saviour of independents but it is far from that today, and is probably only viable for a couple of genres with online features.

**Balance of power:** This channel has a much more equitable split of revenues, between publisher/developer and distributor. It's simpler, faster and has fewer players in the value chain.

**Most advantaged party:** None – split between provider and studio.

**Least advantaged party:** None – split between provider and studio.

**Publisher risk level:** medium. Although manufacturing and distribution costs are reduced, the risks on this platform come from piracy.

Since retail is still the major component of any release, digital delivery is generally seen as almost a secondary market.

**Developer risk level:** medium. A game which has been self-funded still carries the risk that it will not sell, despite the reach of a digital delivery partner.

**Distributor risk level:** medium. Although some providers create their own content, the major risks for all providers are technological and service based – how to maintain the technology and quality of service for online customers.

**Overall sustainability:** Currently only a small fraction of the overall games market is allocated to direct downloads, and, despite their existence for several years, the market has been slow to grow. Only a handful of providers (Valve's Steam and EA's Link) currently offer this service, but the number is expected to increase over time<sup>7</sup>. Sony and Microsoft will start full game downloads to Xbox 360 and PS3 in 2007-08, and their captive audience is expected to start to drive the market forward. Direct downloads are expected to deliver only ancillary revenues streams for the medium term as publishers favour the traditional route to retail.

**Platform variations:** Some variations are available. These include:

- **Subscriptions:** Some providers allow subscription to a basket of services rather than simply a single game.

<sup>7</sup> The tide is changing slowly, with Activision, 2K Games and Majesco providing relatively new (but rarely launch) content to Steam



# Commercial models and distribution channels in use in the industry today

**Territorial variations (if any):** Asian markets (excluding Japan) utilise digital delivery exclusively for all their content, including MMOGs. This is one reason for the popularity of games cafés, which preload the game engines onto their machines, and strike up direct relationships with the developer/publishers.

**Overall market share<sup>8</sup>:** 0.3 per cent of 2006 global games software revenues

## Distribution channel – Gaming on Demand

**Platforms:** Offline PC

**Main stakeholders:** Independent developers, publishers, Gaming on Demand providers

**Overview:** Gaming on Demand (GoD) delivers games by streaming them in pieces to the user's PC. Although the kernel of the game's engine and proximate levels reside on the player's hard drive, they are wrapped in DRM (much as direct digital downloads above) to stop or slow the process of the game being cracked and distributed for free. GoD providers typically offer subscription services to multiple games to disguise the paucity of recent AAA titles. This platform is a niche within a niche, and generates low levels of revenue globally.

### Channel characteristics:

The delivery of a game utilising this channel consists of several steps, all of which are normally (but not always) included in the service of the digital download provider, for which they take 45 per cent of a games subscription.

<sup>8</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally

- **Security procedure:** The completed game is encoded with security technology (digital rights management) that prevents it from being played until payment has been verified and received, and the player authenticated. Security is less of a concern because the service never allows all of the game code to reside on the user's PC. Any DRM is designed to prevent the fragmented game from being reassembled and distributed. GoD providers often rely on third party DRM solutions.
- **Authentication and payment:** The user normally purchases a subscription to a basket of games in advance from the provider, which registers and authenticates the user, verifies payment has been received and then begins the process of a streaming download to the customer's hard drive. GoD providers rely on third party billing and fulfilment solutions.
- **Delivery:** The fragmented game is delivered via a client programme which manages payment, authentication, downloading, and live streaming of the pieces of the game needed by the player at a specific point in the game. Significant portions of the game (and often the game interface) are pre-loaded, giving the semblance of a full game installation. The server therefore simply acts as a remote hard drive from which game data is drawn at the appropriate time. Direct download providers rely on third party server solutions.
- **Support:** Most providers will support the games post-delivery, although the quality of service varies widely.

**Revenue splits:** The following is an example of the revenue splits for GoD services, which are pro-rated by number of hours played on games owned by each publisher.



# Commercial models and distribution channels in use in the industry today

**Table 4: Online Gaming on Demand revenue splits**

Subscription fee	\$9.99
GoD technology / management	\$1.50
E-tailer	\$2.00
Billing	\$0.50
Electronic distribution	\$0.70
Royalty pool	\$5.29

**Critical analysis:**

The benefits are as follows:

- i. **No delivery costs:** See direct downloads above.
- ii. **Connected user:** See direct downloads above.
- iii. **High penetration of broadband:** See direct downloads above.
- iv. **More favourable revenue shares:** GoD providers offer roughly 55 per cent revenue share to IP holders. However, the subscription-based nature of the charging model means that sharing revenues with individual IP owners is unlikely to generate much revenues.
- v. **Subscription model:** The typical model allows all-you-can-eat gaming from a wide array of older titles.

The downsides are:

- i. **Limited opportunity today:** The most established providers, with access to millions of users via their distribution deals have only been able to attract low hundreds of thousands of subscribers<sup>9</sup>. The market leader Exent has begun to move into in-game advertising to drive new revenues after disappointing results with GoD.
- ii. **Publisher apathy:** GoD has always suffered from being an afterthought for publishers, who treat it as a way to monetise their back catalogues but do not allow major games to be distributed via these services until long after their retail release. Penetration is expected to remain low.
- iii. **Technology:** See direct downloads above.
- iv. **Security:** While most GoD providers boast that their services have not been compromised, that is largely because they do not have top tier content. As soon as (or if) it becomes available on this kind of service, hackers will start to target it.
- v. **Loss of publisher marketing clout:** The lack of synchronisation with the launch marketing efforts of publishers means that providers have largely been forced to find their own route to market – with a great deal of success (in terms of scale of partners), if not much revenue.

In summary, GoD is a minor opportunity, particularly for independents.

**Balance of power:** Publishers own and often delay the release of the IP on this platform, which makes this channel less viable for new product.

<sup>9</sup> A handful of providers like Exent and Stream Theory have been in the marketplace for many years, and have struck distribution deals that underpin popular services such as Yahoo, Verizon and Deutsche Telecom. Despite strong distribution, the key to this market has always been the content (or lack of it), and revenues have been low



# Commercial models and distribution channels in use in the industry today

**Most advantaged party:** Publishers control which IP makes it onto the channel, thus dictating the success of the channel.

**Least advantaged party:** Developers largely have no say over the process.

**Publisher risk level:** low. The publisher operates at arm's length from this process, low user penetration makes the threat of hacking negligible and low revenues keeps it a low priority.

**Developer risk level:** See direct downloads above.

**Distributor risk level:** See direct downloads above.

**Overall sustainability:** Despite strong distribution, GoD has made slow progress due to publisher reluctance in releasing premium games. While direct downloads move forward in attracting premium content, GoD is expected to be slower to win content. GoD is a clever piece of intermediate technology that was designed to overcome bandwidth constraints while broadband was in its infancy (256-512MBps), as well as providing a fairly strong solution to piracy. As average bandwidth increases beyond 4-8MBps, the need for this kind of service declines because full games can be downloaded fast enough. Therefore we believe that while GoD will grow, its share of the digital distribution market will start to fall.

**Platform variations:** Some variations are available. These include:

- **Rental:** although subscriptions are predominant, some services charge a time-limited rental fee instead for more prominent titles. This is relatively rare.

**Territorial variations (if any):** Asia has very little of this kind of service due to higher bandwidth and use of games cafés.

**Overall market share<sup>10</sup>:** 0.1 per cent of 2006 global games software revenues.

## **Distribution channel – Downloadable console game**

**Platforms:** Xbox 360, PlayStation 3, Nintendo Wii (PSP)

**Main stakeholders:** Independent developers, publishers, hardware manufacturers

**Overview:** All three current generation consoles have launched online stores selling casual, retro and back catalogue games direct to their users. These games typically weigh 50-500 MB and are downloaded directly to the console's hard drive or flash memory cards, depending on the console<sup>11</sup>. It is a young market, but hundreds of such games are in development<sup>12</sup>. Some publishers are reported to be considering using these services as a way of testing new independently owned IP before scaling up to a full console production. However since no games have yet made this transition, the viability of this use of the channel is still very much untested. The PSP is expected to be included in Sony's EDI soon, with games available for download over a wireless connection.

<sup>10</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally

<sup>11</sup> The Wii has no hard drive, so storage on comparatively expensive flash memory cards is required

<sup>12</sup> It is thought that there are over 200 games in development for Microsoft's Xbox Live Arcade (400 developers have registered with Microsoft), Sony's e-Distribution Initiative (EDI) and Nintendo's Virtual Console. Many of Nintendo's Virtual Console games are first party developed and they have not yet released information about how publishers can create such games, although many Japanese publishers have signed up to release versions of older games



# Commercial models and distribution channels in use in the industry today

## Channel characteristics:

Developers and publishers need to go through the following steps to access this channel:

- **Approved developer:** Developers need to achieve approved developer status before starting work on such games.
- **Approved concept:** Developers need to provide a concept doc or a working prototype for approval from Sony or Microsoft (which has two approval committees, one for publishers and one for developers). At this stage, the game gets a release window from Sony or Microsoft.
- **Funding:** Developers can, via this process, access funds from Microsoft or Sony directly, self-fund or utilise publisher funds to create the game.
- **Promotion:** The game is delivered to the console provider's online team, and the game is then promoted in the walled garden of the service, probably by genre as well as "recently released".
- **Sale and delivery:** The game is purchased by users from points or funds in their wallets, for US\$5-20 per game. The game is downloaded to the hard drive (or other storage) for instant access.

**Revenue splits:** the following is an example of the revenue splits for a new IP downloadable console game funded by a publisher.

**Table 5: Downloadable console game revenue splits**

Consumer spend (net of tax)	\$15.00
Console manufacturer	\$4.50
Publisher	\$7.87
Developer	\$2.62

## Critical analysis:

The benefits are as follows:

- **Cheaper, faster development:** The developer has a substantially lower production budget from a small team over a period of a few months. This equates to lower advance recoupment barriers and lower break-even targets, particularly if part of the build has been self-funded, which is more likely given the low levels of overall budget.
- i. **Better commercial terms:** The developer has faster revenue flow with lower break-even targets and given that such games are more likely to be new IP, the revenue share is likely to be higher.
- ii. **Low/no marketing costs:** Built into the console manufacturer's 30 per cent revenue share is the cost of promoting the game to its online user base, so a game must survive on its own merits without the need for significant consumer marketing (although this may change in time as the channel develops into a significant revenue driver in its own right).
- iii. **Simpler porting:** Once a game has been created for one of these platforms, it is easier to port it to other downloadable formats, either for other consoles, or for handheld, mobile or downloadable PC games.



# Commercial models and distribution channels in use in the industry today

- iv. **High conversion to sale ratios:** Microsoft has reported that its Arcade users have a higher tendency to purchase online content once they have tried it (an average of 24 per cent) so the “try before you buy” appears to work well.
- v. **Direct to Developer relationships:** Sony and Microsoft’s inclination to go direct to developers, thus bypassing publishers, is a good indication that they view independents as the source of fresh ideas into which they wish to tap. Blast Factor, Sony’s first EDI game, was created by an independent developer.

The downsides are:

- i. **Small market:** Today downloadable console games represent a tiny market for all concerned, and, despite the enthusiasm of Nintendo (who think that the Virtual Console could become one of the most significant revenue streams for the company), the overall proportion of the console market taken by this channel is expected to remain small.
- ii. **Competition:** Currently, console decks suffer from being overwhelmed by the big-brand back catalogues of major publishers, and there is already a fight for placement. Nintendo in particular has been aggressive in targeting back catalogue content from Japanese partners such as Konami, Capcom and Namco/Bandai, even targeting content from now defunct companies. For Sony and Microsoft’s services, placement is becoming booked up 12 months in advance.
- iii. **Low/no marketing:** The lack of consumer marketing will have repercussions on the total unit sales, which are not expected to match those found for console games for some time. The passive browsing nature of finding a game on these services means that some users will not use the service or purchase such games.

- iv. **Viability untested:** The kinds of games that succeed on this channel have largely been untested, as has the strategy of testing a game as a downloadable product before ramping up to full console production.
- v. **Rapidly rising budgets:** Budgets for these games, as they get larger, will inevitably rise, raising the bar for smaller games developers with lower budgets.
- vi. **Publishers’ arrival:** As publishers come on board this channel in force and begin marketing their back catalogue games heavily (as they have done in the mobile space), they may eclipse the smaller games from independents, both in terms of budgets but also in marketing power.
- vii. **Limited game size:** Microsoft (to date) has largely kept to a limit for almost all games on the arcade of being 50MB or below, and even Sony’s theoretical limit of 500MB is still a fairly low level for most modern games. This is expected to rise over time.

**Balance of power:** Console manufacturers are, more than with full console games, the absolute gatekeepers for the content.

**Most advantaged party:** Console manufacturers choose the content, fund it in some cases, distribute and market it to their users.

**Least advantaged party:** No major party in this value chain is disadvantaged.

**Publisher risk level:** medium. Their risk comes from being bypassed, from focusing too heavily on expensive, lengthy full console titles, while ignoring the nimble, innovative titles from independents. If they do fund these games, the risk is low, given the modest outlay.



# Commercial models and distribution channels in use in the industry today

**Developer risk level:** medium. Quick, cheap production and low cost delivery should mean that such games are low risk for developers, but the profusion of similar titles may see games lost in the crowd, particularly if publishers wake up to the opportunities of this channel and begin marketing more heavily.

**Distributor risk level:** low. The console manufacturers have already invested in the majority of their technology, server and billing infrastructure. This is largely a low maintenance value-add.

**Overall sustainability:** This is a relatively new channel, is largely unproven, but it has good potential, particularly on Nintendo's service. Its early results have been promising<sup>13</sup>. Competition between the consoles' services will drive the market forward. Sony and Microsoft will be targeting roughly the same audience of early adopters, but if Nintendo continues to sell Wiis in volume to a mass market audience, its Virtual Console could attract significant revenues from quick, cheap and fun casual games<sup>14</sup>.

**Platform variations:** None. The platforms are flexible and already incorporate a wide array of game types, including multi-player and eventually mobile / PC connections (in Microsoft's case). Incremental content downloads and subscriptions will be examined in a later channel profile.

**Territorial variations (if any):** Japanese publishers appear to have greater access to Nintendo's Virtual Console at this stage.

**Overall market share**<sup>15</sup>: 0.1 per cent of 2006 global games software revenues.

## Distribution channel – Micro-payment-based incremental content distribution

**Platforms:** PC, Xbox 360 / PS3, Nintendo Wii, MMOG PC, handheld console, console casual, casual online, mobile

**Main stakeholders:** Independent developers, publishers, hardware manufacturers

**Overview:** This new channel has emerged from both the online console market (where incremental content is bought for boxed product games) and from Asia (where item selling / trading has begun to overtake subscription as the prevalent commercial model). Most providers rely on a wallet being filled with cash (via credit cards, or game cards purchased in retail outlets) allowing micro-payments to be extracted in return for small goods and services, including added functionality, personalisation, game levels and other content. Incremental content downloads on online consoles have been trialled by a number of leading games, with a handful of the more prominent games (such as Oblivion) generating over US\$1 million in post-launch revenues on Xbox 360.

<sup>13</sup> Microsoft's recently released statistics showing that 12 million Arcade downloads had occurred in the first year of its Arcade operating. In an analysts' briefing recently, Peter Moore admitted that much of the US\$30-40 million generated to date by Xbox Live derives from this channel

<sup>14</sup> Satoru Iwata, Nintendo's president, said in October 2006 that he expected the Virtual Console to be one of the Wii's most significant revenue streams

<sup>15</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally



# Commercial models and distribution channels in use in the industry today

## Channel characteristics:

Developers and publishers need to go through the following steps to access this channel:

- **Investment in new game infrastructure:** Developers making micro-payment based games need a wide array of server, account management and support, billing and fulfilment, security and DRM technology in place beneath an existing game to service this model. This is a highly specialised set of software and skills, and is no small investment (roughly tens of millions of dollars), often necessitating partnership with specialists.
- **Radically different production pipeline:** Adding micro-payment transactions to a game's production pipeline necessitates a very (and sometimes radically) different production pipeline. The game must be built with the ability to continually add new content, or allow players to pass items between them in exchange for game tokens or real cash. Developers need post-production teams to continue to create content, extending the pipeline well after launch to enable the addition of new nuggets of the game without the need for patching or additional support.
- **Digital rights management and security:** DRM is an important component of the service. In addition to the normal security found in online games (see online subscription channel), micro-payments and especially item trading between players require a more strict set of checks and balances to avoid fraud, copying and/or theft of the virtual items being traded.
- **Promotion:** The new pieces of the game code are delivered to the console provider's online team for posting in the Xbox Live Arcade, the Sony PS3 store or Nintendo's Virtual Console store.

Pricing is established (often a process of trial and error to reach a balance between perceived value and price, especially challenging in early months of any game). The game is then promoted in the walled garden of the service.

- **Sale and delivery:** The game asset is purchased by users from points or funds in their wallets, for US\$0.50-US\$10 per game asset. The assets are then unlocked or downloaded to the hard drive (or other storage) for instant access within the game.
- **Support:** Although this is normally a fire-and-forget type of content, they will need some form of support from either the console provider's own teams (first line), the publisher's support team (second line) and (if appropriate) the developer's support team (third line).

**Revenue splits:** With item trading between players, the provider takes on average ten per cent of any trade value. The following is an example of the revenue splits for an incremental download (funded by a publisher)<sup>16</sup>.

**Table 6: Micro-payment-based incremental content revenue splits**

Consumer spend (net of tax)	\$1.87
Console manufacturer	\$0.56
Publisher	\$0.98
Developer	\$0.33

<sup>16</sup> Average charges for such items vary widely.



# Commercial models and distribution channels in use in the industry today

## Critical analysis:

The benefits are as follows:

- i. **Low cost and high return:** This kind of content is cheap to produce, coming as it does once the main production has been completed, but delivering high margins for a small piece of work.
- ii. **User price insensitivity:** Purchasers of this kind of content have been shown to be more price insensitive than offline buyers. This effect may be found more on platforms with proxy currencies (MS points or Wii Nintendo) than for Sony (measured in US\$/€/£). The average price point settled upon by Bethesda for Oblivion downloads is 150 points (or US\$1.87), which means that a tiny fragment of the (vast) game is bought for one thirty-second of the total game's price.
- iii. **Potentially higher revenues per user:** The success of micro-payment-based games in the Far East has shown that some titles can generate per-user revenues higher than would be achieved by a fixed subscription or a one-off retail purchase.
- iv. **Useful ancillary revenue stream:** A useful way to extend the life of a game after the peak of launch revenues without major marketing.
- v. **Captive audience:** Once a player has purchased the game, they are more likely to consider buying games assets and features that enhance their ability to play it.
- vi. **Customer focus:** As most item-selling games are free to play, company focus must be entirely on devising what assets will sell to whom at what frequency and price. Once found, these can provide high levels of low cost revenue.

The downsides are:

- i. **High technology development and maintenance costs:** Even the specialist providers have high initial and ongoing costs to keep a service like this up and running. Users are often vocal, blunt and will vote with their feet if service levels are not up to scratch. Maintaining concurrencies of over a few tens of thousands of users is very expensive, labour intensive and time consuming (on a 24-hour basis).
- ii. **Regulatory back-lash:** This kind of game is extremely addictive, and authorities in Asia and elsewhere have begun to try to limit the hours people can play. Chinese MMOG providers have been hit by a number of policy changes to try to regulate the market. Virtual theft, hacking and fraud have become fairly widespread, and authorities are beginning to fear the social cost, following some high-profile deaths.
- iii. **New taxes in discussion:** Territories across the world have begun investigating the markets for item trading and selling in or around online game worlds. It is a matter of time before these handful of people making a living selling virtual items become liable to income tax.
- iv. **Low studio take up to date:** Incorporating changes into one's production pipeline is difficult at best of times, but allocating a mini-production team to work on post-launch content for an untested market is quite a risk and is currently largely confined to the Far Eastern games market.
- v. **Skill-set and mind-set barriers:** This kind of service relies on feedback from users to establish what items will sell, for how much and at what refresh frequency (too rapid a roll-out of items can reduce overall profitability). It also relies on mechanisms to monitor and respond rapidly to customer activity.



# Commercial models and distribution channels in use in the industry today

This is a service mentality (and technology) that currently is lacking in most independent developers and publisher studios, all of whom normally have moved on to the next (and thus more exciting) game. Change in this area is expected to be slow.

**Balance of power:** Evenly balanced between studio and publisher, although publishers may antagonise unready developers by asking for lots of post-launch content.

**Most advantaged party:** Console manufacturer, who sits back and takes a cut of every sale with costs that are almost asymptotic. For other platforms, there is no most advantaged party.

**Least advantaged party:** Developers under instructions to produce more post-launch content on an unproven model to sell to inadequately profiled customers without the processes in place to manage that cost effectively. For other platforms, there is no least advantaged party.

**Publisher risk level:** high. This is a technically difficult, expensive, labour intensive, highly competitive and increasingly regulated field, and the number of successes is dwarfed by that of the failures. In the west, this model is largely untested (which will change through 2007).

**Developer risk level:** medium-high. High levels of risk only occur when processes are not in place to manage post-launch content creation cost effectively and efficiently.

**Distributor risk level:** None.

**Overall sustainability:** The channel has great potential but in the west the surface has barely been scratched<sup>17</sup>. Process change is expected to slow the uptake of this kind of opportunity and produce high costs as studios learn to act more as service companies than as fire-and-forget developers. Some publishers are bullish about the opportunity that this represents to their bottom lines. (EA at E3 2006 said that up to one-third of their future revenues could come from digital distribution of this of content, which would have to be measured in average revenue per user.)

**Platform variations:** Some variations are available. These include:

- **Costs by platform vary:** Microsoft takes an average of 30 per cent of any transaction, Sony takes an average of 20 per cent, and Nintendo's split has not been publicised.
- **Single item sale:** A single item is the only thing traded, but the item (usually some kind of token) can be used to access an array of game abilities or assets.
- **Multiple items sale:** Selling a wide range of goods at in-game stores
- **Avatar sales:** Some gamers will sell their avatars to players to achieve a rapid entry into the game. Most of these sales are frowned upon and occur outside the game's auspices, but some are encouraged by providers.
- **Trading between players:** Assets earned in the game are sold on to other gamers.

<sup>17</sup> Oblivion is reported to have made over US\$3 million in post-launch content alone, so the right kind of content sold to console players of the right kind of game can bear fruit



# Commercial models and distribution channels in use in the industry today

- **Insurance:** Some Chinese games have begun offering a kind of game character life insurance, based on payments if certain levels of game expertise have been reached within certain time frames (which act as rebate on all the purchases that have to be made to achieve that level). These encourage addictive levels of game play.

**Territorial variations (if any):** Most of these games are popular in Asia (in the past this did not include Japan because of low PC gaming penetration, but this is changing), but few have succeeded in the west. NCsoft's Guildwars has pioneered the channel in the west, and despite many western MMOG providers reporting they are investigating this commercial model, the changes in infrastructure and account management from a subscription to an item trading model are significant.

**Overall market share**<sup>18</sup>: 7.3 per cent of 2006 global games software revenues.

## Distribution channel – Online subscription

**Platforms:** MMOG PC, (Xbox 360, PlayStation 3), casual PC

**Main stakeholders:** Independent developers, publishers (and eventually hardware manufacturers)

**Overview:** The online games subscription market is currently dominated by MMOGs, most of which have been role-playing games such as World of Warcraft, Lineage and Ragnarok. Most MMOGs are available as a free download, although some of the more major releases are sold as a boxed product at retail. A monthly subscription enables continuing access to the game world, in which the user plays, socialises and, increasingly, transacts. Subscription revenue is offset by the high costs of creating, marketing, maintaining and updating that game world and subsequently achieving critical mass or break-even is far from guaranteed. A high proportion of subscription-based MMOGs fail to survive past their first few months, and the overall failure rate for MMOGs is high. Although today these games are found exclusively on PC, the two console providers with hard drives (needed to support this genre of gaming) are working to bring these sporadically profitable games to their Xbox 360 and PlayStation 3 consoles.

**Channel characteristics:** Studios choosing this genre of game have to take the following steps:

- **Investment in game infrastructure:** Developers making MMOGs need a wide array of server, account management and support, billing and fulfilment, security and DRM technology in place beneath an existing game to service this model – a highly specialised set of software and skills, and no small investment (roughly tens of millions of dollars).
- **Continuous production pipeline:** The studio can expect to be in production mode preparing for release for three to five years, and then produce a continual stream of content to keep the game world fresh during the lifetime of the game.

<sup>18</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally



# Commercial models and distribution channels in use in the industry today

- **Promotion:** Most MMOG providers try to market their game to users via online advertising, but some of the larger games use traditional games marketing channels (including television).
- **Sale and delivery:** Subscribers register, are authenticated, pay their subscription and then gain access to the game usually for around US\$10-US\$15 in the west, and much less in Asia.
- **Digital rights management and security:** Stopping fraudulent accounts, robot farming of characters while the actual players are away, cheating via software hacks, mirror servers ripping off the game servers and offering it elsewhere online – these are full-time occupations for staff at an MMOG provider.
- **Support:** The provider should expect to offer high levels of support to players, and will have to handle all kinds of enquiry from bandwidth problems, account issues, server difficulties through to traditional game support calls.

## Critical analysis:

The benefits are as follows:

- Steady, predictable revenue stream:** Subscription provides a steady and relatively predictable stream of revenue for providers that have jumped through the numerous and difficult hoops to deliver a successful game. Subscription revenues deliver higher sums over longer periods, and can result in immensely profitable titles.
- Captive audience of subscribers:** Subscribers to these kinds of games quickly become enmeshed in a web of social or collaborative gaming, acting out roles as part of a community or marketplace of players. It takes a significant investment in time and energy to build up these links and to establish a character in a game world.

As such, the barriers to exit (which could be termed – loosely – social and professional) are raised to very high levels.

- Self-sustaining growth:** MMOGs can reach a critical mass whereafter the games subscribers themselves pull in players from their own extra-game social networks. This can mean that games can grow, after a successful initial marketing push, without much marketing from their providers.

The downsides are:

- High risk:** Building, marketing and maintaining an MMOG is, as stated before, the single most expensive, difficult, complex and lengthy form of games development. Just getting a game to market is an achievement, but many find that, after all the effort, the game is not going to work (either through the extensive user testing that is required in MMOG pre-launch testing or once customers have tried the game).
- Post-launch costs:** Many MMOGs are built without full consideration let alone costing of the post-launch period. A single support call can eliminate that month's profitability for that subscriber. Technical problems can have huge knock-on effects on cash flow and profitability.
- Critical mass:** Such games require a critical mass of players otherwise there just are not enough other people to socialise and play with. Many games fail to reach that point.
- Churn:** Even the most successful MMOGs lose players, and these can also generate their own critical mass, as groups of players move games. It's estimated that the average playing time per MMOG gamer is between six and nine months. This can be extended by deepening the game, but that can make the learning curve to the game more steep which raises barriers to entry for new subscribers.



# Commercial models and distribution channels in use in the industry today

- v. **Project change:** User testing is undertaken increasingly early in the development process, not least because providers are learning from their and other companies' mistakes about creating game worlds or mechanics that users simply do not like or refuse to pay for. These changes mid-cycle are relatively common and can kill MMOG projects, as the extent of reworking is costed.
- vi. **Hacking and security:** Hacking, cheating and farming are facts of life for any online service. For MMOG providers they can at any one time represent up to 30 per cent of the subscriber base, equating to lost revenue, unbalanced game play, annoyed or disappearing customers and heavy support costs.
- vii. **World of Warcraft's domination:** With some three and a half million subscribers in the USA and Europe (eight million subscribers worldwide), World of Warcraft currently dominates the western MMOG market and, although it has substantially expanded the market, it has also taken considerable business away from other games and has raised substantial barriers to effective competition in these markets. In Asia this game is dwarfed by far more popular games.

**Revenue splits:** The MMOG provider can expect the following revenue split (for a self-published game) for subscription:

**Table 7: Online subscription revenue splits**

Consumer spend (net of tax)	\$14.99
Server host	\$3.00
Billing	\$0.75
Publisher / developer	\$11.24

**Balance of power:** NA – usually only one party involved, a developer/publisher.

**Most advantaged party:** NA – usually only one party involved, a developer/publisher.

**Least advantaged party:** NA – usually only one party involved, a developer/publisher.

**Publisher / developer risk level:** high. This is a technically difficult, expensive, labour intensive, highly competitive and increasingly regulated field, and the number of successes is dwarfed by that of the failures.

**Overall sustainability:** The market for subscription MMOGs is being challenged by new MMOG models such as item selling/trading, but successful games like World of Warcraft are driving subscription gaming into new demographics, ultimately benefiting the entire market.

**Platform variations:** See micro-payment-based incremental content distribution section.



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**Territorial variations (if any):** The west has been slower to adopt the new commercial models powering out of Asia, and Korea in particular, and there is some doubt about whether these models will have the same kind of impact in Europe and North America as they have in Asia. In particular, casual MMO games involving item selling and avatar customisation are less likely to mirror their success in Asia in the west.

**Overall market share:** 6.7 per cent of 2006 global games software revenues<sup>19</sup>

## Analysis

The following section will reach some conclusions about the commercial models and distribution channels found today in the games industry, and suggest some likely scenarios for how they will change in future. We will look at key trends in the industry around commercial and distribution models, a SWOT and value chain analysis, and finally suggest some potential market characteristics for 2010.

## Key trends in commercial models and distribution channels

Although the games industry is in a constant state of flux, there have been a number of major drivers of change in the last few years which are starting to restructure the industry:

- **Consolidation:** The games industry has been consolidating at a rapid pace in 2005 and 2006, with an unprecedented number of acquisitions and liquidations of independent developers and games companies. Over half of the acquisitions in the industry have been publishers buying developers, while a great extinction of independent games developers has occurred largely between 2000 and 2005.
- **Rising development costs:** Development costs have been rising rapidly with the advent of Xbox 360 and PlayStation 3, driving up the break-even point for developers and lowering the chance of independents achieving overages until these platforms hit the mass market (2008 onwards).
- **Platform proliferation:** As new platforms launch but old platforms extend their shelf-lives, the number of technologies that a publisher or developer needs to support grows. This drives up costs for developing AAA titles which have in many cases been launched across multiple formats.
- **“One size fits all” becomes harder:** As platforms, formats, channels and technologies fragment and proliferate, in parallel audiences have begun to shift towards customising their content to ever more personal requirements, disrupting attempts to pigeon-hole them into easily identifiable groups. These changes impact “the one size fits all approach” of publishing a title across all major formats without major changes more difficult and expensive to market. Niche products focusing on fewer or even single platforms may prove more profitable, which opens up opportunities for independents.
- **Broken commercial models:** the advance models predominating in the industry have been shown in this report to disadvantage an important player in the value chain – the independent developer – who commonly struggles to see royalty overages for the majority of their games. This is expected to continue to restrict the amount of new independent IP that has historically derived from independents.

<sup>19</sup> GIC estimate 01 07: includes retail games, mobile games, subscription and micro-payment MMO games, direct download games, casual games and games on demand globally



# Commercial models and distribution channels in use in the industry today

- **Developers driven down value chain:** As overages remain elusive for most independents, many are being driven down the value chain towards less prestigious projects on cheaper platforms or service provision that deliver more profitability. Not in itself a bad thing, the result is that the number of independents experienced and capable of working on premium console IP is reduced.
- **Barriers to entry for new IP:** Publisher risk aversion for new IP from independents means that there are structural barriers to entry for new IP, which lacks routes to market. Even when a publisher has been found, many new IPs have underperformed as publishers focus on licences and internally developed IP. This tendency risks impoverishing the overall market by ignoring the historically rich source of new IP from the independent sector.
- **New distribution channels slowly maturing:** After years of hype, new routes to market are starting to open up opportunities to independents, with direct-to-consumer distribution and downloadable console games disintermediating publishers. However, these channels are crowded and are not expected to win a significant market share for several years.
- **Online has deeper impact:** The online components of games have grown from an optional extra through a standard bolt-on feature towards becoming integral features of many games. This requires a change in production pipelines and skills sets within publishers and developers (towards service provision and account management) and the adoption of new operating processes that correspond more closely with, and react more rapidly to, what the customer wants. Such provision is being pioneered in Asia, particularly Korea.
- **Game supply chain lengthens:** As development becomes a more intricate, expensive and lengthy process on current generation platforms, as online delivery extends the typical games pipeline beyond launch and as service provision becomes part of most publishers' and many developers' business models, the supply chain for the industry will naturally lengthen, providing opportunities for service provision specialists to enter the supply chain to provide services either before, during or after production.

## SWOT analysis

The following is a SWOT analysis of the current standard commercial models and distribution channels.

### Strengths

- Publishers are in a strong position in terms of controlling the commercial model, having relatively high levels of access to funds, holding almost all of the profitable IP
- New IP typically emerges from stable, well-run and well-funded studios
- Consolidation has threshed out the weaker developers, leaving higher quality, better managed companies still standing
- New platforms offer well-funded studios the opportunity to exploit powerful new technology

### Weaknesses

- Independents are an important source of new IP, but the climate leaves many struggling to stay afloat
- The predominant commercial model is heavily weighed in publishers' favour and largely excludes independents from overages



# Commercial models and distribution channels in use in the industry today

- Publishers invest less time, effort and resources to promote new independent IP
- This imbalance inherently reduces the opportunities for independents to deliver innovative new IP to market
- Developers are being forced down the value chain to work on cheaper, more profitable platforms
- Developers are being tempted into investing in unproven new distribution channels

## Opportunities

- Consolidation within the independent developer market is benefiting the stronger, surviving developers making them more attractive to publishers and investors
- Digital distribution will eventually deliver new opportunities for independents (but not as fast as some would like)
- Platform proliferation will level the playing field, allowing more variety in games companies, and new IP the chance to flourish in a platform's early years
- New funding models arise that allow new IP to reach the market under stronger commercial terms with publishers

## Threats

- A two-tier industry emerges – small-scale independents working on lower value IP on cheaper platforms and large publishers who fail to invest in new third party IP but deliver less innovative, more repetitive titles
- Third party IP work takes over as the only way independents can gain experience on more expensive platforms, and cost differentiation sees more established markets lose ground to cheaper emerging games markets

## Impacts of key trends

As the number of platforms proliferates and different types of digital distribution slowly become more viable, we believe that the value chain that delivers a game from inception to end consumer will change as follows:

### Digital distribution (publisher-driven)

It is commonly thought that digital distribution – even that driven by publishers – cuts out the retail / distribution component of the value chain, thereby releasing more revenue to share to the publisher and thus the developer. This is not true, because the retail and distribution component simply shifts to their counterparts in the online world. A number of new players in the value chain arise – server hosting, billing and fulfilment, and online retail companies – to take a very similar share of revenues as traditional retail. Taking the small market share for digital distribution today into account, any company using solely digital distribution will on average reduce their potential revenues, not increase them. The primary impact on the publisher is a slight rise in actual revenues, but the reduction in risk (largely that associated with manufacturing) is more significant.

### Digital distribution (direct-to-consumer)

Using a direct-to-consumer channel such as Steam cuts out three major components found in the publisher-funded retail model: the major source of funding for production, the major source of marketing expenditure, and the largest revenue share component. While the developer can take closer to 50 per cent of the gross revenues, the game, probably with substantially lower production values, is released on a direct-to-consumer digital platform but reaches far fewer people due to the lack of marketing.



# Commercial models and distribution channels in use in the industry today

A flagship Steam-exclusive release, the episodic game SiN created by Ritual Games, was recently dropped after poor sales and loss of staff. Despite the much lower break-even point, the net result is often a loss of gross revenue, and increased risk that the investment will be lost.

## Platform proliferation

Platform proliferation and fragmentation primarily impact publishers, because they are forced to handle multiple platforms whereas an individual developer is more likely to specialise in one or two rather than ten. Publishers intent on getting their brands across more platforms will find their portfolios spread thin, and thus will require assistance from third parties to cover all the bases. By simple virtue of the numbers of platforms involved, the net impact of platform proliferation is that specialty in individual platforms, genres or technology is rarer and thus more valuable. Independents with platform-specific experience (for example a specialist in DS or Wii) are likely to become valuable partners for publishers looking to excel on one particular platform, rather than adopt the "one size fits all" approach.

## Downloadable games on console

The lack of boxed product simplifies the value chain for downloadable games, but given that Sony or Microsoft share in 20-30 per cent of the retail price, these games have fairly similar metrics to retail once publishers become involved. Since console manufacturers' publishing divisions are working hard to sign up small, innovative developers to produce games for their EDI and Xbox Live Arcade, in essence these are no different to any other second party deal. However, stiff competition for the space does not mean that the Arcade or EDI are the Sundance festivals they are claimed to be, nor that they will deliver dramatic new revenue streams to independents.

As marketing becomes a key component of these channels, independents' roles in the value chain will not shift substantially.

## Incremental content download

As these games rely on full console titles which require, by dint of budget, publisher funding, opportunities for exploiting new revenue streams from incremental content are expected to be useful but not significant. Successful games will generate revenues from retail and incremental downloads are an added bonus. However, we do expect a number of lower priced games that use incremental payments as primary as opposed to secondary revenue streams to arrive, particularly on PlayStation 3, which has a payment system that enables in-game transactions, which Microsoft's marketplace currently does not support.

## New game revenue streams

In-game advertising has taken a very long time to grow, and in 2005 represented a tiny fraction of the total market globally<sup>20</sup>. It has received much hype in recent months, especially following Microsoft's acquisition of Massive in 2006, and Valve's addition of IGA advertising into its ever-popular Counter-Strike game servers. However, the effectiveness of in-game advertising is still in question, and while it represents a good ancillary revenue stream for publishers, most analysts forecast that it will take no more than a few per cent of the overall market by 2010. For most developers, it is not yet a source of revenue, and may not be for some time.

<sup>20</sup> GIC estimates that total market value in 2006 was US\$300 million including Asia



# Commercial models and distribution channels in use in the industry today

## Impacts of changes on publishers and developers

We believe that the 2010 UK games development market – in terms of its predominant commercial models and distribution channels – may have the following characteristics:

- The market will still be dominated by work-for-hire with diminishing revenue share opportunities for boxed products, possibly with the gradual introduction of more equitable variations on the traditional revenue sharing of post-advance net receipts. Most independents will survive on work-for-hire, and be able to invest in new full console game IP rarely if at all.
- A small fraction of the market will work under agreements with advances for new IP and some revenue sharing of post-advance net receipts but few developers will make overages. These titles will be more frequently found on PC, last generation consoles and downloadable consoles.
- Digital distribution for lower end games such as downloadable console, handheld and mobile, will remain relatively small and grow slowly, but provide opportunities for testing new IP before they are brought within mainstream models and larger console budgets, again reducing the chance of overages.
- A handful of larger developers and production houses such as Rebellion, Blitz, Jagex and Climax, will be able to initiate and fund original IP creation, but the vast majority of developers will be confined to work-for-hire, creating new IP for cheaper platforms or performing specialised services.

In particular, we believe that publishers and independent developers will exhibit the following characteristics:

## Publishers

We believe that publishers will use highly experienced third party developers for 25-30 per cent of their important IP, and will use internal studios, which will continue to grow in size both organically and via acquisition through this cycle, for the remainder. The amount of new IP from independents will remain roughly stable at around 15-20 per cent. Despite current fears about independent IP reducing in value or number, publisher risk aversion, peaking at the beginning of a new cycle, will decrease as the cycle progresses and new consoles start to break into the mass market. A new console launch does offer opportunities to create new IP and gain greater mind-share or brand-share, but for reasons of control and budget (production costs are always highest at the beginning of a cycle before learning effects and new technology start to mitigate some previously un-scalable costs) many of these titles are developed internally.

When ownership of new IP is broken down by platform, most new PS3, Xbox 360 and Wii games IP will be owned by publishers, with IP from cheaper platforms being more evenly spread between independents and publishers. Platform proliferation means that publishers will find it increasingly difficult to spread their own IP effectively across all these platforms, because one size will be harder to fit all. For this reason, independents, although finding it hard to retain the rights to new IP for more expensive platforms, will find new opportunities for new IP, particularly ideas specific to the different platforms (DS, Wii, console casual games). We also believe that publishers will slowly become open to new metrics for sharing IP ownership which would incentivise the developer to continue producing new IP.



# Commercial models and distribution channels in use in the industry today

## Independent developers

It is expected that independent developers will be able to access a wider range of funding for new projects, but the large majority of funding will still derive from publishers. On expensive platforms, independent developers will mostly work-for-hire, receiving overages rarely. Despite independent developers finding it difficult to produce new IP for the more expensive platforms, platform proliferation should open up new opportunities for developers to specialise in individual platforms. In particular, strong new IP for DS or Wii is a good opportunity, as publishers react to the unexpected success of these new platforms by signing new IP more widely from third parties. Experience, track record, strong process-focus and technology remain as important assets in the armoury of independent developers as their creativity. Game engines (following the purchase of Criterion by EA, and, we believe, the inevitable purchase of market-leader Epic) in the hands of independent developers are also important assets in winning business. In the face of price and quality competition from globalisation, western developers must continue to improve on their professionalism to balance the creative abilities which, in tandem, should ensure that they continue to win business. However, competition from maturing territories, particularly Eastern Europe, will become more severe.

One result of the Darwinian extinction of developers in the west is that those still standing represent more stable, more efficiently run companies, to which greater publisher and investor interest is being attracted, and for which currently demand outstrips supply.

These companies will increasingly dominate the independent IP creation market, having the financial strength (or ability to use more sophisticated finance vehicles) to self-fund, retain and derive greater profits from new IP, thus creating a virtuous circle of profit and re-investment. The attraction of attaining this status will continue to inspire new developers to start up especially as the current cycle starts to reach mass market sales levels. However, smaller developers will struggle to start up due to poor access to finance. Those that survive will focus either on newer, smaller, cheaper platforms, or could become satellites around larger studios and publishers, providing specialised outsourced services such as platform-specific services, online game development or management, outsourced art and programming, and other niche services.



# The industry survey

## Introduction to the industry survey

### The interview programme

GIC conducted an interview programme between November 2006 and March 2007 investigating games development in the UK with a particular focus on the development of games intellectual property (IP), the UK as a market for games development and the commercial climate for making and distributing games.

The interview programme targeted leading developers and publishers of games, covering independent studios, publisher-owned studios and publisher head offices. The programme succeeded in interviewing managing directors, commercial directors, chief executive officers and senior technologists at 15 UK-based development and publishing companies.

These companies are:

Blitz, Codemasters, Eidos, Electronic Arts, Eurocom, Eutechnyx, Climax, Iomo (Infospace), Kuju, Rebellion, Revolution, Team 17, Sony Computer Entertainment Worldwide Studios, Sports Interactive (Sega), Swordfish (Vivendi).

Of the sample, seven are independent developers, three are development subsidiaries of publishers, one the development subsidiary of a media services company and four are the publisher head offices (or in Sony Worldwide Studios' case, the publishing arm of a console manufacturer). Each interview was conducted by telephone for one to one and a half hours.

The interview data has been anonymised, although permission has been sought for any quoted material. Companies were reassured that the interviews were confidential and that individual company opinions would not be published.

We have aggregated the opinions of both publisher-owned studios and publisher head offices. Where appropriate, some results have been defined in terms of these two sub-groups (some results have been highlighted as data provided by acquired studios from before their acquisitions), but by default the term publisher refers to both sub-groups.

We have aggregated the opinions of independent games development studios and the one non-independent studio, Kuju (which is an independent developer recently acquired by a media services group that still retains its independent status in terms of how it works with publishers), under the heading of independents.

### Questionnaire content

We proposed a first draft of the questionnaire, which was subsequently checked and amended by the programme sponsors. The interviews were conducted as conversations which GIC guided towards specific questions. Some questions were open discussion questions, and some were built as scored answers. After the interview, GIC gave marks to grade the strength of some companies' responses to these scored questions; but to increase the fluidity of the conversations, few interviewees were asked to grade statements directly.



# The industry survey

## Response rate

The questionnaire had a total of 38 (publishers) to 41 (developers) questions. GIC obtained an average of 85 per cent of the questionnaire answered, exceeding its own expectations. However, inevitably, some questions remained largely unanswered. This is partly due to the deliberate repetition of some questions through the report, which were designed to elicit a range of responses from the more reticent interviewees. However, it is also due to the structure of the survey, conducted as wide-ranging conversations in which it was inevitable that gaps would result.

## How results are analysed

It should be heavily stressed that such a small sample group of such heterogeneous companies, in different commercial situations and multiple sectors of such a diverse industry, cannot deliver statistically significant data, and GIC has always strived to manage expectations about this interview programme. Although we have presented results in terms of percentages and average scores, the results of this survey are presented as indicative of broad trends, rather than representative of the industry as a whole or any one games company type.

The results of this survey have been aggregated into a spreadsheet for ease of analysis. Answers to more discussion-based questions were grouped together into broad themes. GIC's methodology has been to use these results to direct its analysis of answers to each question in turn. The following results are from the entire sample, which includes publishers and developers. GIC has also conducted differential analysis to isolate opinions by different groups, namely independent developers and publishers, which comprise publisher studios and developers acquired by publishers. The aggregate results from the spreadsheet are in *The industry survey*.

## Formats and appendices

The format of this report will be to state the results to each question, giving percentages where appropriate, then analyse trends and identify specific statements that illustrate such trends. Because of the wide-ranging nature of some of the more open questions, we cannot discuss all answers and ideas generated by our interviewees. At least three questions (26-28) that reworded earlier questions were deliberately included to encourage less forthcoming interviewees and the results have been included in the earlier questions rather than being repeated later.



# The industry survey

## Headline results

- Fifteen independent developers, publisher studios and publisher head offices were interviewed by phone about the UK as a market for games development
- Only 12 per cent of independent studios' revenues derive from overages, and most revenues came from advances for work-for-hire deals
- Most acknowledge that new games IP is a critical revenue stream and nearly 90 per cent of independents will self-fund part of a new game's development. For independents, owning technology IP is a critical factor in increasing production efficiency and winning work-for-hire
- All respondents agreed that publishers will not distribute new original IP without controlling or owning its rights, and most agreed that publishers invest less time, effort and money in new independent IP
- Most publishers acknowledge the creativity and importance of the independent sector as a source for new original IP, but several thought it unlikely they would licence independent IP
- Sixty per cent of respondents are using, or are planning to use, project financing and 75 per cent of independents plan to go direct-to-consumer via Xbox Live Arcade (or similar)
- Variable rate royalties, royalties at publisher break-even or partial self-funding are seen as the best commercial models, because they deliver the fastest recoupment
- R&D tax credits were the most frequently accessed source of finance (after publisher funding for games development)
- A wide array of methodologies for capturing ideas for new original IP is in practice, but formal assessment of these ideas is used by only half of the sample. Technology development is more formal and continuous
- Design and project management skills are considered the most important skills for creating new original IP. Opinions were split about how difficult it was to recruit in the UK, but nearly half of respondents have links to universities
- Staff are trained mostly through mentoring, and nearly half expect new hires to learn on the job
- There was strong agreement that independents struggle to get new original IP distributed. Many think new platforms open opportunities for new original IP, but a sizeable number of respondents think new UK IP is shrinking. Most think this situation will persist for the next five years
- Eighty-seven per cent of respondents think that the UK government should introduce tax breaks for games production similar to those available for film production to counter the threat of subsidies in competitor markets. Prototype funding also gets good support.
- All respondents were aware of the Canadian incentives. Forty per cent have set up or acquired studios in markets where such incentives are offered, half of those in Canada. Forty-seven per cent of respondents thought that Canada had drained talent from the UK



# The industry survey

- Nearly three-quarters of respondents thought that incentives offered overseas destroyed the level playing field, and made the UK less competitive. Forty per cent thought UK companies would slow or stop their growth in the UK, with a knock-on impact on creating new original IP
- Nearly three-quarters of respondents see outsourcing as an opportunity to design a game in the UK but to build it overseas, resulting in leaner, more cost-effective and efficient studios
- When asked for one single measure to help UK companies create IP, 60 per cent said tax breaks
- Forty per cent of respondents thought that digital distribution of games would transform the industry

## Strategies for intellectual property

### Own IP vs third party licences (Question 4)

Interviewees were asked what proportion of their revenues over the past three years derived from original IP and what proportion from third party licences.

**Table 34: Ownership of IP versus third party licences**

	Total	Independents	Publishers
Own IPR	52%	42.5%	67%
Third party licence	48%	57.5%	33%

This fairly anodyne result illustrates the make-up of our sample. Half of the respondents are independents, among whom work-for-hire predominates, and the other half of respondents are publishers or acquired studios, among whom work on original IP predominates. Here is Kuju on the subject of work-for-hire:

*Work-for-hire is consistent, scaleable and since demand outstrips supply, we have no problems generating revenues. **Jonathan Newth, CEO, Kuju***

When split into these sub-groups, independents are deriving more revenue from working on IP that is not their own, and publisher studios are clearly focused on internally generated IP.



## The industry survey

However, while independents are almost inevitably working on IP that derives from publishers (including licences from other media), it does not follow that publishers are working on games IP originated by independents. Most of the work discussed by publishers involved licences from other media such as film and television.

### Frequency of overages (Question 5)

Interviewees were asked what proportion of their revenues over the past three years derived from overages generated after their advances. Included in these payments are additional revenues from original IP and a proportion from third party licences. Acquired and independent studios answered this question, although acquired studios were asked to give historical figures from before their acquisition.

**Table 35: Frequency of overages**

	Total	Independents	Publishers
Overages	13%	12%	25%

These statistics confirm the conclusion in *Monograph 3, Commercial Models* (which detailed the drivers, inhibitors and metrics of the predominant commercial model in the industry) that overages are rare and do not represent significant portions of most studios' revenue streams. The independents in this sample are all at the more successful end of the market, which means that they have a higher chance than most to develop new original IP. If they cannot derive meaningful revenue streams from new original IP, then smaller, less successful developers cannot either.

The higher level of overages at acquired studios indicates that they were probably more successful in driving revenues from their IP (a fact that undoubtedly contributed to their acquisition), but none reported revenues from overages of over 40 per cent as independents. Here is Revolution on the Catch-22 situation:

*The problem with production values rising, and therefore costs, is that developers of original IP very rarely earn any royalties under the traditional recoupment model; and yet publishers expect developers to create the products at cost. The effect of today's business models is that it either drives developers down a work-for-hire route which, ultimately, doesn't build value in their companies, or encourages them to go down the value chain towards cheaper formats that disintermediate publishers altogether by going direct-to-consumers digitally. **Charles Cecil, MD, Revolution***

### Partial game development (Question 6)

Interviewees were asked what proportion of their last three years' revenues came from doing parts of games rather than complete development (excluding porting from one platform to another). An example might be that one development company might create the main game, and another might create the multiplayer version or technology.

Only two studios (7 per cent of respondents) reported that they worked on partial game development, representing 20 per cent of their revenues. This practice is clearly rare among large studios, but is probably likely to occur more frequently among smaller ones, who may need to pool resources to work on more expensive platforms.



# The industry survey

## IP ownership (Question 7)

Interviewees were asked to describe the IP that they owned in terms of game and technology IPR.

**Table 36: Ownership of IP**

	Total	Independents	Publishers
Games engine IPR	87%	75%	100%
Tools	80%	75%	86%
Productivity tools	40%	38%	43%
Licences from third parties	40%	13%	71%
Games IPR (no./ studio)	3	3	4

Games engines (and to a lesser extent tools and project management tools) are highly important features of successful games studios, irrespective of who owns them. As we shall see with later questions, having good technology is a critical success factor for independents working for hire for publishers. A few independent studios have no engines of their own, but they are either those that operate using the Hollywood model of having no permanent development resource, or those that rely on publishers to provide game engines such as Epic's Unreal Engine. The importance of licences for publisher studios is highlighted by 71 per cent of publisher studios owning licences for movie or television IP.

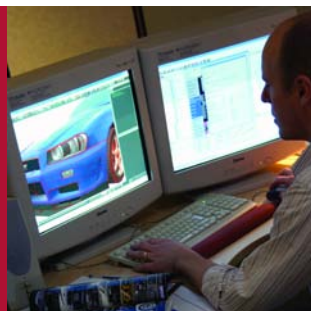
The importance of IP has resulted in some changes in direction, as Climax describes:

*We've gone from being Europe's largest full service work-for-hire games company to being a development hub that creates IP with multiple partners. When we looked at how to grow to company, we decided that the real value is in creating IP. We aim to self finance a game to the point of a prototype, and then licence the IP to publishers, getting a better royalty position, and getting that all-important rapid recoupment of any advance. **Karl Jeffrey, CEO, Climax***

All studios in our survey possess games IP, but they were asked how many IPs (whether completed games, games in development or game prototypes) were owned. The results show that in general low numbers of unique IPs are possessed by studios in the industry working on traditional console platforms. However, publishers were not asked to list all the extensive IP in their portfolios, and as such these results are indicative only of independent and acquired studios.

## The role of games IP (Question 8a)

Interviewees were asked to describe the role that games IP played in their company. The following is a selection of the most common responses.



## The industry survey

**Table 37: Role of games IP**

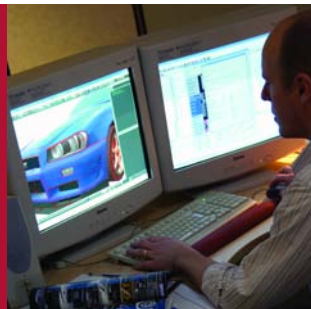
	Total	Independents	Publishers
Critical revenue stream	67%	38%	100%
If you can't own the IP, it's not worth anything	53%	25%	86%
Exploit IP across or from other media	47%	38%	57%
Balances work-for-hire revenue	33%	63%	0%
Studios are self-funding prototypes	33%	63%	0%

The strongest message concerning IP from this section is that IP is a critical revenue stream. Publishers are very clear that they want to own any IP that they publish. This is because they make such a significant investment in a brand that the risk of a developer going to another publisher for a sequel negates the viability of picking up rights to only one iteration of a game. Eighty-six per cent of publisher studios voiced this sentiment. The market reality of the strength of publishers' opinions on this naturally results in a lower percentage of independents wanting to retain their rights in new original IP.

This market structure is also behind the lower importance given towards new original IP as a revenue stream (versus work-for-hire) by independent studios. Some publishers and a few independent studios were also keen on exploiting IP across different media, such as film, TV and print. Many independents see IP as an important business line that balances the majority of their work performed for publishers.

Over half the independent studios interviewed were investigating new funding vehicles for IP, mostly single project financing. Some of these were alternative financing schemes, including some specifically targeting games production (eg debt-based and off-balance sheet finance such as completion bonds), and others were being set up in Germany where fund management companies have created funds to benefit from tax breaks for individuals' financing media projects. Here is Kuju on the subject:

*What we really need is better access to financing that is less risk averse, which means there should be a better tax regime in the UK to promote investment in riskier projects. Sadly, political reality means that this is unlikely to happen. We don't approve of hand-outs or grants, because an industry builds up around them which is not based on the market and which will collapse when the grants are stopped. Instead we need a more favourable environment for risk financing. We are now part of a group which is listed on the German stock exchange and will be looking outside the UK for alternative financing going forwards. **Jonathan Newth, CEO, Kuju***



# The industry survey

## Value of Games IP (Question 8b)

Interviewees were asked to describe the value that the ownership of games IP provides to their company. The following is a selection of the most common responses.

**Table 38: Value of games IP**

	Total	Independents	Publishers
Highly valuable revenue stream / essential to own IP	93%	88%	100%
Licences from other media are too important to ignore	20%	0%	43%
Must keep a fresh supply of IP coming in from independents	20%	0%	43%

Every publisher and almost all independent studios stressed the importance of owning games IP. Here is Sony Worldwide Studios on the subject:

*When it comes to new original IP, it's all about the long game – you have to own the IP you're developing to exploit franchises and get long-term customer buy-in to a brand. The only people who really benefit from an IP are those that own it 100 per cent. **Shawn Layden, Vice President, Sony Computer Entertainment Worldwide Studios Europe***

Some publishers acknowledged that world-class independent studios have a right to retain ownership in part of a strong new original IP going forward. Interestingly, the publishers surveyed see equal value in harvesting new original IP from licences as they do from a vibrant independent sector.

## Strategy for Games IP (Question 8c)

Interviewees were asked to describe their company strategies for games IP. The following is a selection of the most common responses.



# The industry survey

**Table 39: strategy for games IP**

	Total	Independents	Publishers
Self-fund part of game, keep rights	53%	88%	14%
Must not relinquish sequel rights	53%	50%	57%
Scale of prototype makes self-funding difficult	47%	75%	14%
Strong IP allows better negotiating position	40%	63%	14%
Invest in new platforms with minimal or no publisher involvement	33%	63%	0%
Looking to create specific funding vehicles for new original IP	33%	63%	0%
Long-term investment in brands	33%	0%	71%
Go direct-to-consumer	27%	50%	0%
License media brands	27%	0%	57%
Must keep an open mind about independent IP, unpredictable but essential	27%	0%	57%

From this study, it is clear that most games studios (as opposed to head offices, for which this is not relevant) have in the past self-funded or, for those still independent, currently do self-fund part of a new game IP (often the prototype) in order to win a larger share of the rights or royalties from their publishers. Again, this reflects the more successful studios in this list, rather than the entire industry. This has become core company strategy for some – such as Kuju:

*Publishers won't fully back IP that they don't own or have a significant interest in, so we decided not to produce new original IP and try to keep all of it. Instead our strategy is to provide an IP generation service for publishers. We can make better revenues from a game that is fully backed by the publisher than we could if we tried to keep a hold on to 100 per cent of the IP, won a better revenue share percentage on a game that was then not fully backed by the publisher. **Jonathan Newth, CEO, Kuju***

Just over half of respondents agreed that the rights to a sequel are too important to give away. Most independents who voiced this opinion said that they would expect to develop the sequel, or at the least get paid a royalty if their technology were used by another developer. All publishers voicing this opinion said that their investment was in a franchise not a single iteration of a game. Almost all independents want to self-fund lower cost games on new platforms in order to get more revenue, retaining more or all of the rights. Some anticipated using the distribution services of publishers to get their titles onto the decks of Xbox Live Arcade or its PC and console competitors. A number expressed the desire to bypass the publisher altogether and self-publish online or on online consoles. Here is Blitz on the new platforms:



# The industry survey

*We want to develop new original IP for new platforms like Xbox Live Arcade, for one tenth of the price of a full console product. It's attractive because there is the opportunity to go direct to the consumer, take 60-70 per cent of the revenues, equating to roughly £3.50 per unit sold – not far off what we would earn from a full console product selling for £40. Philip Oliver, MD, Blitz*

Publishers are reasonably enthused by well-known media brands, in which they make long-term investments. The same number endeavour to keep an open mind about the opportunities coming from the independent sector, which were often described as unpredictable in throughput but an important ingredient for a successful portfolio.

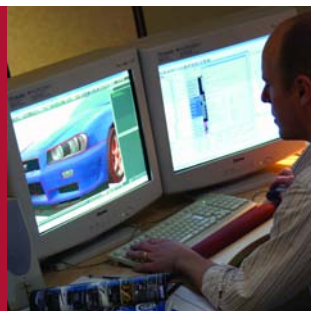
### Challenges of games IP (Question 8d)

Interviewees were asked to describe the challenges of developing original games IP. The following is a selection of the most common responses.

**Table 40: Challenges of games IP**

	Total	Independents	Publishers
Publisher will not publish new original IP without owning all (or most of) the rights	100.0%	100%	100%
Must be cross-platform	60%	63%	57%
Publishers under-perform on IP that's not 100% theirs	47%	63%	29%
New original IP brands are very (even too) expensive to market	47%	25%	71%

In the clearest indication of the conflict between developers and publishers, every respondent agreed that publishers will refuse to publish new original IP if they have funded its development without taking a controlling stake in the IP in question. Independents see this as a challenge because they want to retain control over their creation and keep revenue streams flowing from it in sequels.



# The industry survey

Publishers see this as a challenge because independents try to negotiate retention of rights, and face losing a sequel to a rival. In another indication that the studios profiled here are at the highest end of the industry, most publishers and half independents said that their work must cross platforms to perform well, and that this brings high production costs, particularly in games engines and other development technology which must deliver across games platforms. A strong sentiment among independent studios is that games that were not owned by a publisher were given lower priority and thus underperformed in sales and revenues. A few acquired studios agreed that this was often the case. Several independents reported changing their strategies for IP in the face of publishers' newfound demand for control or outright ownership of IP, commenting that this is driving them towards digital downloads, project financing or even towards creating IP for the sole purpose of selling outright to a publisher.

Here is Eutechnyx on the financial barriers affecting new original IP and the need for alternative financing:

*For the future growth of the UK industry, we must find new ways to finance game production in order to retain ownership of new original IP. If a publisher is spending US\$8 million on production, the same again on marketing, it's natural that they would want to own the IP themselves. The problem is that developers generally need the advance funding to finance their overheads, and are therefore forced to hand over their IP. Alternative financing would separate the money from the deal, making it faster to recoup, generating better deal terms and sharing more risk with the publisher. **Darren Jobling, Director of Business Development, Eutechnyx***

## The role of technology IP (Question 9)

Interviewees were asked to describe the role of creating and owning technology IP and its position in their portfolio of assets. The following is a selection of the most common responses.

**Table 41: Role of technology IP**

	Total	Independents	Publishers
Makes production more efficient, esp. across platforms	60%	75%	43%
Sharing technology across the group	47%	0%	100%
Critical in terms of winning work for hire (proves capabilities, lowers risk)	40%	75%	0%
Proportion of development headcount working on technology full time	12%	7%	22%



# The industry survey

Following the earlier indication of the importance of game engine technology to studios, the results about the role of technology IP are clear. Two-thirds of independents see creating and utilising proprietary game engines and technology as important for their efficiency, although a lower number of publishers mentioned this factor, which reflects the lower premiums put on efficiency in publishers' internal studios. However, closely related to this was the need to reduce duplication and share knowledge across global organisations, which of course would increase efficiency if effective.

Many independents see technology as a demonstration of their ability to win work-for-hire, or as a separate business line. Developers with complete and proven game engines are considered lower risk by publishers and are more likely to win time-critical licence development contracts such as those based around upcoming movie releases. One example is a production management system created by Climax:

*Our proprietary web-based production management technology is making our production much faster and more efficient, and despite not marketing it heavily we have now licensed it to partners such as Disney and Microsoft, after they saw it in action on games in development. **Karl Jeffrey, CEO, Climax***

Several respondents provided statistics about the number of staff working in their UK studios on technology development in full-time creation and maintenance roles, and the average proportion of their total headcount was 11 per cent. Significantly, publishers dedicate over three times the resources (22 per cent of publishers' UK studio headcount vs seven per cent of independents' studio headcount) to this role than independents, which reflects the need for control over proprietary technology (particularly after EA's purchase of Criterion) but also their focus on expensive and often cross-platform current generation games, and possibly looser budgetary controls.

## Publishers' work with independents

### Working with independent studios (Question 10a)

Publisher head offices were asked about their attitudes towards working with independent developers. The following is a selection of the most common responses:

**Table 42: Working with independent studios**

	Total
Independents are an important creative source	67%
Must maintain their growth through external and internal development	67%
Internal teams work on new original IP, external teams on licences	50%
External teams used when internal resource is unavailable	33%

Despite the low proportion of most major publishers' revenue that derives from licensed third party IP, senior executives at publisher head offices were extremely positive about the creativity of work provided by third party studios. Many see their growth as inextricably tied to genre-changing or genre-redefining games that spring unanticipated out of the independent sector. Here is Electronic Arts on the subject:



## The industry survey

*The industry will continue to grow with games created by companies like EA and by independents. That growth is very dependent on what's available, and it's very important to keep a flow of fresh ideas coming in from independents.*

**Colin Robinson, EA Partners**

A number use external teams as overflow when internal teams are too busy or as developers of licensed content.

### Working with independent studios' original IP (Question 10b)

Publisher head offices were asked about their attitudes towards working with independent developers who approach with new original IP ideas or prototypes. The following is a selection of the most common responses:

**Table 43: Working with independent IP**

	Total
Independents are an important source of new original IP	83%
We must own the IP	83%
Extremely unlikely we'll hire them / buy the idea / fund it	33%
Must see a prototype	33%

In some contradictory statements, the majority agreed that independents were an important source of new original IP (only one publisher, working on lower value platforms, refused to consider publishing third party game IP). All publishers considering third party games as viable said that they must own the IP to fund its development and publish it. Here is Codemasters on working with independents:

*We want to be a magnet for talent, and we won't turn away emerging talent. Talent is unpredictable. It doesn't matter what marketing research you get, if someone walks in with a good idea, and we love it, they are entitled to own a part of the new IP, share royalties and risk. Having said that, we must see a prototype before we'll sign a game.* **Rod Cousens, CEO, Codemasters**

Some publishers said that independents' game ideas were rarely if ever funded. A number said that they would not fund anything until they had seen a prototype, because the ability to produce a high-quality game was as important as a great game idea.



# The industry survey

## Business models

### The impact of the advance model (Question 10)

Interviewees were asked to describe the impact of the predominant commercial model in the industry, the advance model, on their company. Publisher head offices were not asked this question, but acquired studios were. The responses were graded (1 = strong disagreement to ten = strong agreement) and the following is a selection of the most common responses.

**Table 44: Impact of the advance model**

	Total	Independents	Publishers
Publishers invest less time, effort and money in new original IP	9.5	9.8	8.7
Publishers want to own the most successful IP	8.7	9.5	6.7
Post-advance royalties are rare	5.5	7.5	0.0
Reduces our ability to invest in new original IP	4.6	6.4	0.0
Post-advance royalties are non-existent	2.5	3.4	0.0
Impossible to do a current generation game without a publisher	1.8	2.5	0.0



# The industry survey

As we have seen, independents strongly believe that publishers downplay games which they do not own, but from these results it is clear that acquired, formerly independent studios strongly agree with them. Here is Revolution on the problem:

*IP owned by developers is inevitably exploited more aggressively and it therefore assumes a greater value. If ownership of the IP is taken by the publisher, the likelihood of it being effectively exploited is greatly reduced.*  
**Charles Cecil, MD, Revolution**

Most reiterated that publishers want to own the most successful IP, and several said that this was a sign of the times, suggesting that the climate had changed over the last few years. Although there is a spread of results about the frequency of overages, the two strongest opinions voiced were that overages are rare or non-existent. Almost no-one said that overages were routine or even patchy, which reinforces the key finding of *Monograph 3, Commercial Models* that production costs have driven up break-even points over the average game's unit sales.

### Deal examples (Questions 11-13)

Interviewees were asked for examples of average deals, and the following results were recorded. They come with a strong proviso because they are hypothetical rather than actual deals, because they span different platforms and because production values and commercial terms vary so much between companies and games (particularly in the definition of what constitutes a net receipt). Publishers were asked what sums they would pay out as advances, whereas independents were asked what sums they would receive.

Only a low proportion responded (31 per cent) with estimates of their break-evens.

More (61 per cent) responded when asked about the level of advance and royalty share of net receipts, although no publisher head offices answered that question (eg acquired studios gave historical numbers).

**Table 45: Average deal terms**

	Total	Independents	Publishers
Unit sales break-evens	700,000	800,000	300,000
Advance	NA	£3,916,667	NA
Revenue share of net receipts	21%	20%	26%

Break-evens are higher for independents because they get a much lower share of gross revenues with which they have to recoup their advance before breaking even. Publishers have lower break-evens because they receive a higher share of gross revenues. The level of advance for independents reflects their work on more expensive current generation games. Revenue share levels are also fairly accurate as approximate industry averages for console games – the levels indicated for publishers represent the respondents' status as formerly independent studios with strong IPs that allowed better revenue share. For more accurate indications of standard advances, break-evens and revenue shares for different platforms, see *Monograph 3, Commercial Models*.



# The industry survey

## New commercial models (Question 14)

Interviewees were asked whether they see any new models emerging from the marketplace that might vary or replace the traditional advance recoupment model. The following is a selection of the most common responses:

**Table 46: New commercial models**

	Total	Independents	Publishers
Project financing vehicle being planned / in use	60%	63%	57%
Sell direct-to-consumer	53%	75%	29%
Royalties start from publisher break-even point	47%	63%	29%
Advertising-funded development	13%	13%	14%

Top in overall popularity was the suggestion of using some form of non-publisher project financing of single purpose vehicles in which the developer's IP resides to avoid the advance recoupment model and simply rent a publisher's services. This model was suggested by several publishers and indeed a couple were utilising alternative financing like completion bonds to free up cash flow. Here is Rebellion on completion bonds:

*We have self-financed parts of our development before, and we like the game bonding model. Roles are simplified – the developer develops, the bank finances, the insurer insures and the publisher publishes. We may get slightly lower margins but it means less risk for all parties and it's good for everyone.*

**Jason Kingsley, CEO, Rebellion**

Many independents and formerly independent studios agree that selling games directly to the consumer represented a viable alternative to the standard commercial model in the industry. Most relied on Xbox Live Arcade (or its PC and console competitors) as the distribution channel of choice.

A number, just under half of respondents (including, significantly, two publisher head offices), agreed that royalties paid to independents when the publisher had broken even were a viable and fairer alternative for independents. A couple of companies had optimism about advertiser-funded gaming but they were not echoed more widely by the sample.

## Best commercial models (Question 15)

Interviewees were asked which were the optimal commercial models for third party development deals. The following is a selection of the most common responses, and respondents were not limited to one response:



# The industry survey

**Table 47: Best commercial models**

	Total	Independents	Publishers
Royalties at publisher break-even	54%	63%	40%
Variable rate royalties to speed recoupment	46%	50%	40%
Self-funded (in part)	46%	50%	40%
All development funded in advance, higher share of net revenues	23%	13%	40%
Some development funded in advance, higher share of net revenues	23%	25%	20%

Half of respondents agreed that royalties at publisher break-even point were the best kind of deal and these results were the same for independents and for non-independents. Independent studios were keener on variable rate royalties (royalties based on revenue share percentages that vary depending on pre-recoup, post-recoup or some other sales milestone and are designed to speed recoupment) and self-funding than publishers. However, both variable rate and self-financing deals are certainly seen as viable by a reasonable number of our sample, including a few publisher head offices. In joint fourth place comes the model based on strong, branded IP which led several studios to claim bullishly that this is the best model. However given the paucity of strong independent IP, it is unlikely that these respondents would agree that this model is viable for every studio. The other fourth placed model was that where a self-funded prototype delivers a higher share of net receipts.

**Reasoning behind the best commercial models (Question 16)**

Interviewees were asked for the reasoning behind their choice of optimal commercial models for third party development deals. The following is a selection of the most common responses:

**Table 48: Reasons for best commercial models**

	Total	Independents	Publishers
Fastest route to royalties	46%	75%	0%
Strong IP allows better negotiating position	23%	13%	40%



# The industry survey

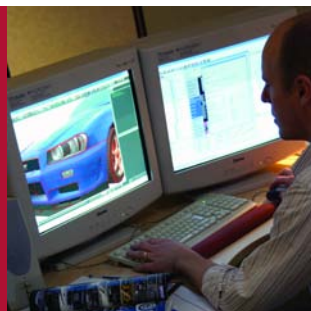
The need for faster recoupment was stated by two-thirds of independents, and those independent or acquired studios with experience of using strong IP in their negotiations cited it as strong leverage in getting better deals in the past.

## Types of deals struck (Question 17)

Interviewees were asked for the proportions of types of deals struck in terms of their total revenue over the last three years. Too few publisher studios or head offices responded to make the data meaningful or indicative, and their responses are not listed here. The following lists responses from independents in their entirety:

**Table 49: Types of deals struck**

	<b>Independents</b>
Licence work, advance, low share of net receipts	33%
Own IP, advance, net share of net receipts	22%
Licence work, advance, variable rate share of net receipts to speed recoupment	21%
Licence work, all advance, no revenue share	9%
Own IP, partly self-funded, reduced advance, higher share of net receipts	6%
Licence work, advance, share of net receipts at publisher break-even	4%
Own IP, advance, variable rate share of net receipts to speed recoupment	3%
Own IP work, advance, share of net receipts at publisher break-even	2%



## The industry survey

For independents, the most frequent deals are clearly for licence work (which is dominated by the traditional advance recoupment model and to a lesser extent variable rate revenue share) which totals 67 per cent of revenues. Traditional publisher-funded, advance recoupment deals for own IP represent 23 per cent of an average independent's revenues from our sample. Deals involving own IP (funded mainly in the form of advances) represent over a third of independents' revenues, the majority of own IP deals are struck with the traditional advance recoupment models, with under 15 per cent of total revenues coming from more equitable – deals like variable rate revenue sharing – that speed recoupment.

### Access to finance (Question 18a)

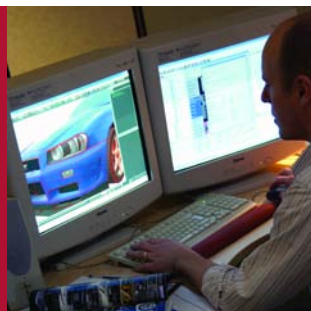
Interviewees were asked which sources of financial assistance they had accessed during the lifetime of their companies, and those who answered the question (85 per cent of the total sample) responded thus:

**Table 50: Access to finance**

	Total	Independents	Publishers
R&D tax credits	92%	100%	75%
Publisher advances	75%	100%	25%
Grants	42%	50%	25%
VC / angel and other unlisted company investors	42%	25%	75%
Debt	42%	50%	25%
Listing & public funds	33%	25%	50%
Completion bonds	33%	25%	50%

R&D tax credits are clearly popular with games companies – although as we see in Question 32 (page 72) the extent to which they provide relief is questioned by a quarter of the total sample. Here is Rebellion on the value of R&D tax credits:

*R&D tax credits are very, very important. We can do real R&D and it won't cost a fortune. We have our battles with HMC&R over what constitutes R&D but it's very useful.* **Jason Kingsley, CEO, Rebellion**



## The industry survey

Independents also appear to have no trouble accessing work from publishers, which is undoubtedly the largest source of finance for such companies. Interestingly, over half of respondents have accessed local grants, with two-thirds of independents having done so. Venture capital funds have not been accessed (and indeed are viewed with suspicion) by independents, but equity investment is a critical source of capital for publishers. Debt is apparently not popular with publishers (although almost all are understood to have either short-term credit or factoring facilities) but half of independents had used some form of loan. Completion bonding, which has risen in profile and popularity in recent years, has been used by over one-third of respondents.

### Ease of access to finance (Question 18b)

Interviewees were asked about the ease with which they accessed the following sources of finance over the lifetimes of their companies. The responses were graded (1 = easy to ten = very difficult) and a selection of the most common responses follows:

**Table 51: Ease of access to finance**

	Total	Independents	Publishers
R&D tax credits	6.5	7.9	4.3
Publisher	6.2	7.4	4.0
VC / angel and other unlisted company investors	4.3	3.1	6.3
Grants	3.6	5.3	0.8
Debt	3.5	3.3	4.0
Completion bonds	2.1	1.9	2.5

The results indicate that independents find it easiest to access R&D tax credits (which given their role as creators rather than distributors of games, is no surprise), publisher funds and grants (which are normally of insufficient size to provide anything other than minor ancillary financial assistance for most independent developers). Independents find it difficult to access other sources of finance such as venture capital, debt and completion bonds. Publishers find it easiest to access R&D tax credits, publisher funding (in this case when studios were once independent) and venture capital. Completion bonding is difficult for everyone. One publisher called for publishers to work together to finance new games IP. Codemasters made the following call to the industry:

*We'd like to see publishers working together to create a fund for developing new IP in the UK. The fund could act like a private equity company and fund UK development. **Rod Cousens, CEO, Codemasters***



# The industry survey

## Innovation

### Innovation practice – idea capture (Question 20a)

Interviewees were asked about the process of harvesting new game IP in their studios. The following is a selection of the most common responses:

**Table 52: Idea capture methodology**

	Total	Independents	Publishers
Top people meet to generate & propose ideas	36%	50%	17%
Formal request for ideas	36%	38%	33%
Creative individuals informally pitch their ideas	36%	25%	50%
R&D team create new ideas	21%	0%	50%

Most new game IP generation occurs from the top down in independent studios, a practice dismissed by one senior executive at a major global publisher as delivering lower quality games. Senior managers and executives discuss ideas and then propose them to their peers. Equally popular was the formal request for ideas from the ranks, which occurs more often in publisher studios where innovation from within has become more important in recent years. In joint first place is the ad hoc practice where individuals fight from the ranks to present their ideas without a formal process. Some companies confine innovation to an R&D team that formally harvests ideas from within the company and then builds them into viable concepts.

### Innovation practice – idea filtering (Question 20b)

Interviewees were asked about the process of filtering ideas once they have been generated. The following is a selection of the most common responses:

**Table 53: Idea filtering methodology**

	Total	Independents	Publishers
Team assigned to investigate and cost idea	64%	63%	67%
Stage & gate process assesses cost & viability	57%	50%	67%
Market research	36%	50%	17%



## The industry survey

A more uniform response towards how ideas are filtered. Most companies have a team that works up concepts and then presents them to a board of executives for discussion and green lighting. Some of these companies have an evaluation process where the game concept must meet certain criteria such as cost limits, viability, fit and in some cases enthusiasm of those presenting the ideas. Market research at the concept stage is also a part of some companies' filtering processes. Some, such as Team 17, see market research as critical to the success of future pitches:

*We have seen lots of companies innovating without testing the market or their potential partners first, something that Team 17 always does with new original IP. Rushing ahead like that leads to poor business decisions. You need to understand how publishers work and the fact that it's a global market, and look at how and where the game will be distributed on what platform before starting full production.* **Martyn Brown, Studio Director, Team17 Software**

### **Innovation practice – implementation (Question 20c)**

Interviewees were asked about the process of moving from filtering to implementation. The following is a selection of the most common responses:

**Table 54: Idea implementation methodology**

	Total	Independents	Publishers
Small team takes ideas on an ad hoc basis	64%	50%	83%
Prototype is developed	50%	50%	50%
Concept is taken to publishers for feedback	21%	38%	0%

In over 60 per cent of cases, the game, once green lit by the studio, is taken by a small team to the next stage, which in some cases is a prototype, and in the remainder is a concept, to show to a publisher.

### **Innovation practice – innovation strategy (Question 20d)**

GIC is thus in a position to describe companies' innovation processes as follows:



# The industry survey

**Table 55: Innovation strategy**

	Total	Independents	Publishers
Periodic	50%	63%	33%
Formal assessment	50%	50%	50%
Informal	43%	50%	33%
Continuous	36%	25%	50%

The picture that emerges is that slightly more than half the sample conducts innovation for new game IP sporadically, with a more continuous process adopted by most of the remainder. The output of this process of innovation is reviewed formally by half our sample and on a more ad hoc basis by the other half.

**Other comments about innovation (Question 21)**

Of the other comments about innovation that GIC captured, only one was repeated by a number of respondents:

**Table 56: Other comments on innovation**

	Total	Independents	Publishers
XBLA is a good opportunity	71%	88%	50%

There was a generally strong opinion that Xbox Live Arcade offered good opportunities for companies, particularly among independents but also among publisher studios.

**Innovation in technology (Question 22)**

Interviewees were asked whether their innovation process differed greatly for technology as opposed to games IP, and The following is a selection of the most common responses:

**Table 57: Technology innovation**

	Total	Independents	Publishers
Continuous process	77%	75%	80%
Dedicated team	62%	63%	60%
Driven by games in progress	54%	50%	60%
More formal	54%	50%	60%

For three-quarters of our sample, the innovation process is one that iterates every working day, unsurprising given the numbers of staff dedicated to creating and maintaining technology that were indicated in Question 9 (page 52). Many reported having a dedicated team working on tools, engines and middleware full time. In just over half the sample, that innovation process is driven by games development in progress. One example is a game engine that progresses as a game is developed. Just over half the sample described an innovation process that was more formal than that for games IP.



# The industry survey

## Skills and recruitment

### Skill sets (Question 23)

Interviewees were asked which skill sets they needed to recruit to keep creating new original IP. The following is a selection of the most common responses, which were graded (between one and three) in order of preference:

**Table 58: Most important skill sets**

	Total	Independents	Publishers
Design	1.43	1.75	1.00
Project management	1.07	0.88	1.33
Programming	0.86	0.88	0.83
Art	0.36	0.63	0.00

Design tops the list of skills, although several companies added the proviso that they were unimpressed with the quality of graduates from degrees in games design. The design skills required are in gameplay and level design. Project management comes in second place and reflects the increased complexity of the production process. Programming underpins all games development and it is significant that this everyday skill is given over twice the emphasis as art. Below the top four, a wide range of other required skills were mentioned by individual companies, including looking outside the industry for new skills and creative leaders and the need to find people passionate about games.

### Ease of recruitment (Question 24)

Interviewees were asked how easily they can access new staff. The following is a selection of the most common responses:

**Table 59: Ease of recruitment**

	Total	Independents	Publishers
Good – fair amount of talent if you know where to look	40%	38%	43%
Poor – very difficult to find talent	27%	25%	29%
medium – can be difficult but no problems filling roles	20%	25%	14%
Excellent – lots of talent and easy to find it	0.0%	0%	0%



# The industry survey

The results reflect studios at the higher end of games development in the UK, and 40 per cent have no problem finding candidates. However, nearly 50 per cent report some level of difficulty in finding staff, and this position is expected to be worse for games companies than for less high end companies. Many complained of a lack of more experienced staff, and several reported unease about headhunting, particularly concerning salary inflation. Here is Sony Worldwide Studios on recruitment:

*With regards to recruitment, there are lots of candidates but really good people are always hard to find. We consistently need more high end programmers, and good designers. We also need a new generation of scriptwriters and will need to expand our search outside the industry. When it comes to a brain drain, if anything we're seeing an influx of talent into the UK from Europe.* **Shawn Layden, Vice President, Sony Computer Entertainment Worldwide Studios Europe**

### Additional comments on recruitment (Question 24b)

Some interviewees commented on recruitment as follows:

**Table 60: Other comments on recruitment**

	Total	Independents	Publishers
Have links to universities	47%	50%	43%
All staff need better project management and communications skills	20%	25%	14%
Need to acquire more studios	20%	0%	43%
Seeing influx of talent from Europe	13%	0%	29%
Low-quality graduates from games degrees	13%	25%	0%
No headhunting	13%	25%	0%

A number of companies have formal links with university courses, mostly in their studios' locale. These range from getting involved with degree courses through internships, workshops and lectures, to milk runs to hunt for new hires.



## The industry survey

One fifth of respondents reported that all their staff need better communications and project management skills. A handful commented that the UK is “draining brains” from Europe, and that university degree courses were producing low-quality graduates. A handful of publisher head offices simply said that growth is best obtained by acquiring promising studios. A number of independents were vociferous about not using headhunting.

### Investment in skills and training (Question 25)

Interviewees were asked what steps they took to induct and train new staff. The following is a selection of the most common responses:

**Table 61: Investment in training**

	Total	Independents	Publishers
Mentoring	60%	63%	57%
In at the deep end	47%	38%	57%
Established training path for new hires	27%	13%	43%
Dedicated academy and training staff	13%	13%	14%

The most common methodology for training new hires is to appoint (or allow new staff to find) mentors who guide them through the six-month induction / probationary period. Over 40 per cent adopt a more Darwinian “sink or swim” approach of throwing new hires into work immediately, assuming that staff will learn most effectively on the job. A more refined version of that is establishing a path for new hires to work their way through lower end tasks towards actual games development, but only one-fifth of respondents utilised this method. A handful run formal academies with dedicated training staff, one of which (EA's) has received much press and turns out scores of staff every year.

### Company valuations (Question 29)

Interviewees were asked what percentage of any company value lay in their company's various key assets. Independents but too few publishers responded to make splitting out the results useful, but since those who responded included recently acquired studios as well as independents, the aggregates are useful and thus are reported here:



# The industry survey

**Table 62: Company valuations**

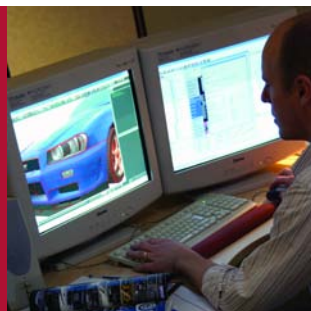
	Total
IP	31%
Production team	26%
Technology	24%
Contracts in hand	5%
Management	5%
Reputation	4%
Knowledge of outsourcing	4%

IP takes the largest share, but by no means dwarfs the values of the production teams and technology. In part this may reflect the market for acquisitions where, as we have seen, publishers buy companies for their resource as well as for their IP. However, it is also the natural response of managers of successful companies involved in a creative industry, who say that high-performing teams are extremely important in terms of creating IP. Technology comes in third place, and in previous questions we have seen its importance to developers working for hire.

## IP creation in the UK

### The state of IP creation in the UK today (Question 30)

Interviewees were asked how they viewed the state of the development market and new original IP in the UK today. These questions produced the most kaleidoscopic of responses, and we cannot list them all here, but the following is a selection of the most common responses:



# The industry survey

**Table 63: IP creation in the UK today**

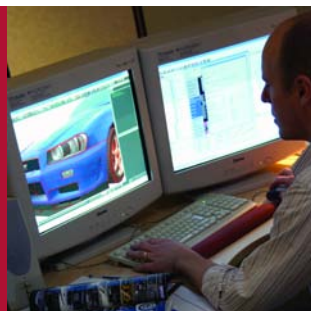
	Total	Independents	Publishers
Independents have a hard time getting distribution for new original IP	93%	88%	100%
New platforms are opening up opportunities for new original IP	83%	81%	86%
New original IP is shrinking	57%	69%	43%
New original IP creation in the UK is weak to nearly non-existent	43%	38%	50%
Work-for-hire dominates, reducing new original IP	40%	38%	43%
Publishers buy promising developers to reduce revenue sharing	30%	13%	50%
Publishers buy new original IP rights quickly but share revenues with independents	27%	38%	14%
Poor access to capital means less original IP creation	27%	25%	29%
Consoles are too expensive for new developers to work on new original IP	27%	38%	14%

There was strong agreement across the board that independents struggle to get new original IP distributed in the current market, with publisher head offices clearly saying that it is very hard for independents today. Here is Blitz on barriers to entry for new original IP:

*The cost of the new generation of consoles is staggering. There are no developers able to fund such a game alone. In fact, few can afford to put £1 million into a game prototype when you need an additional £5-6 million from a publisher to finish the game. Publishers want to see prototypes before agreeing to fund a full game. The sheer cost makes it hard to bring new original IP to market. **Philip Oliver, MD, Blitz***

Many independents voiced their opinions that publishers raise barriers to entry for new original IP, and that new original IP that does get funded and published tends to under-perform. Another strong opinion is that new distribution channels, particularly those catering for casual games on current generation online consoles, offer all games companies opportunities to see their products distributed more widely. Publisher studios and head offices were very keen on new platforms while independents saw opportunities to specialise in creating new original IP for new platforms that made the most of them. In third place, a medium strength opinion was that IP creation is in decline in the UK, under pressure from rising development costs, publisher risk aversion to new third party IP and their concentration on producing fewer games with higher production costs.

Almost as strong an opinion was that IP creation in the UK is almost non-existent, and this opinion is stronger in publisher studios and head offices. Here respondents pointed to a lack of AAA IP coming out of the UK, particularly new original IP from independent studios.



## The industry survey

Work-for-hire is cited by some as a reason why new original IP fails to break out – simply because independents are too busy on the treadmill of working on somebody else’s IP to create their own. Some see the cost barrier to entry for current generation consoles as a driving factor behind the lack of new original IP. Publisher head offices are keen to say that they need the independent sector to generate new original IP, and, while no independents stated this directly, it is likely that this is a given for most companies. Finally, some cited the lack of access to finance as a major barrier towards being able to deliver IP.

### The state of IP creation in the UK in five years’ time (Question 31)

Interviewees were asked how they think the development market and level of new original IP being derived in the UK will look in five years’ time. Again, these questions produced many responses, which cannot be listed here, but the following is a selection of the most common responses:

**Table 64: IP creation in the UK in 2012**

	Total	Independents	Publishers
Independents struggle to get new original IP published	77%	63%	93%
New platforms offer opportunities for new original IP	73%	88%	57%
Very few new original IPs will break through	43%	44%	43%
Lots of new IP will come from independents and publisher studios	27%	25%	29%
Lots of platforms and publishing partners bring opportunities to independents	23%	44%	0%
Publishers will buy new original IP rights fast but will share revenues with independents	23%	25%	21%



# The industry survey

**Table 64: IP creation in the UK in 2012 (cont)**

	Total	Independents	Publishers
The UK faces terminal decline	23%	6%	43%
Some new original IP will come from independents, but mostly will be owned by publishers	20%	6%	36%
Level playing field of current generation consoles makes things easier	20%	38%	0%
Most developers do work-for-hire but fail to retain IP	20%	13%	29%
Most of the good creative forces will remain publisher-owned	20%	0%	43%

The general tone of responses was that the prospect for IP creation in the UK looks fairly bleak. Here is Revolution on the problem:

*The problem with all the work-for-hire that currently dominates most studios' revenues is that it's heavily influenced by price. As Eastern Europe gets more experienced, we'll come under heavy competition from studios that can undercut our rates for work-for-hire while generating high-quality products. So if we don't generate new original IP, the UK's games industry will be in trouble.*  
**Charles Cecil, MD, Revolution**

Most (including a strong majority of publishers) agree that independents will continue to find it difficult getting new original IP published, although this pessimism is slightly offset (driven by a strong majority of independents) by the expected rise in new platforms such as direct-to-consumer digital distribution. Many believe that new original IP will struggle to break through from independent UK studios, and that, without intervention, the UK's games development market is in terminal decline. Again, a wide spectrum of opinion is found but the strongest themes are that publishers will acquire the rights to the best IP via acquisition or negotiation, and that their studios will be where most of the creativity occurs. Although some chinks of light are proffered by a few respondents about the number of platforms opening up opportunities for independents to specialise, on the whole respondents are gloomy. Not that respondents are short of ideas about how to remedy the situation. Here's Codemasters on the future for UK IP:



# The industry survey

*It's been a tough few years for new IP. However, I see developers becoming less despondent. They should form strategic alliances, collaborate to use art and animation from a single source offshore and then rent the publisher. I see more collaboration and consolidation coming. If we don't innovate (and I don't mean more sequels), the industry will face terminal decline.*

**Rod Cousens, CEO, Codemasters**

A small number think that the best developers will remain those in publishers' hands and that most work-for-hire developers are not creative and will fail to retain IP.

## Government assistance

### How can government help? (Question 32)

Interviewees were asked how the government can help the industry. The following is a selection of the most common responses:

**Table 65: How can government help?**

	Total	Independents	Publishers
Tax breaks to encourage investment in games development, particularly early stage	87%	88%	86%
Prototype fund, with commercial rules	60%	63%	57%
Help with protecting start-ups when they're most vulnerable	27%	13%	43%
Anything to help British companies reduce the cost of their bids for work	20%	25%	14%



# The industry survey

**Table 65: How can government help? (cont)**

	Total	Independents	Publishers
More consistency and generosity with R&D tax credits	20%	13%	29%
Mentoring from industry experts	13%	0%	29%
Academy	13%	0%	29%
Help protect the larger companies not just the small ones	13%	25%	0%

The sample speaks with a very strong and unified voice in asking for tax breaks for encouraging investment in games development, often for the earliest and riskiest stages of a game's development where access to external finance is almost impossible, but also for games production in general. Here is Swordfish (Vivendi) on tax breaks:

*Tax breaks for early stage prototypes are needed to provide stimulation for new original IP to be generated by independents. After publishers become interested, then financing is not too difficult, because there are enough sources available. But the initial hurdle – creating working prototypes – is often too high for most independents. Fred Gill, CTO, Swordfish*

Most frequently cited as justification for this request were: the effect that the current government's tax breaks for film production had on the UK film industry; and the rise of Canada (and other territories) that have begun to attract key companies and staff away from the UK, thanks to generous government incentives for both the emigrating employees and the employing companies. Slight variations existed for respondents' ideas about tax breaks, but with most focused on trying to encourage investors to put risk capital into early stage or prototype games, and all involved the need to level the playing field against massive subsidies from competitor territories.

Fairly close behind tax breaks is a call for a prototype fund. Many (fearing a new breed of professional grant-winners who lack market viability) thought it should work along commercial lines, with profit sharing reinvested back into the fund, and a panel comprising industry experts, especially from publishers, who would help allocate funds. Mention of the Great Canadian Games Competition won broad approval as a model. Here is Team 17 on prototype funding:

*It's very difficult to protect developers who in the early days of their new original IP can get beaten up in negotiations with publishers. If there were funding available to ring fence the developer at the prototype stage, it might stop them being forced to sign away the rights to the IP. You'd need a good industry panel to judge which projects are worthy of getting support.*

**Martyn Brown, Studio Director, Team17 Software**

Less well-supported ideas were the need for funding to protect start-ups in the earliest stages of their lives when they are most vulnerable (either to financial collapse or to selling their IP rights for low cost), and the need to extend R&D tax credits to encompass more of the development process than it does now.



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Finally there were additional requests for more help mentoring early stage games companies by those with specific experience in the games industry; a games academy to furnish high-quality graduates with hands-on experience of games development via internships; and a call from larger, more established games companies to assist them rather than just protect the start-ups.

### Government support in other territories

#### Government aid in other territories (Question 33)

Interviewees were asked which territories they were aware of offering aid to the games industry. Their most common responses were as follows:

**Table 66: Government aid overseas**

	Total	Independents	Publishers
Canada (Québec)	100%	100%	100%
France	67%	63%	71%
Australia	47%	38%	57%
Singapore	20%	25%	14%
Switzerland	13%	0%	29%
China / Hong Kong	13%	25%	0%
Malaysia	13%	13%	14%

Canada is the clear winner, with 100 per cent of respondents aware of the drive of Québec and BC to tempt companies to locate or relocate there.



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France and Australia come in second place, and the remainder have much lower profile for respondents.

## Setting up subsidiaries overseas (Question 34a)

Interviewees were asked whether they had set up new studios in new territories. The following is a selection of the most common responses:

**Table 67: Setting up overseas**

	Total	Independents	Publishers
Have done already	33%	25%	43%
Maybe	27%	25%	29%
No	27%	38%	14%
Acquired studios in new territories	7%	0%	14%
Intending to do so	7%	13%	0%

Forty per cent of respondents operate studios overseas. One-third of respondents have already set up a subsidiary, nearly a quarter are considering doing so, and one either acquired a studio in new territories or intends to set up overseas. Clearly, these questions are predictable for international publishers, but both UK publishers and a number of independents have announced that they are expanding overseas. Here is Eutechnyx on overseas expansion:

*In five to ten years' time, we think that the UK will still be the home of good project management, technology and creativity, but mass production will take place in Asia. That's why we have opened production offices in Hong Kong and Western China. Darren Jobling, Director of Business Development, Eutechnyx*

## Subsidiaries' locations (Question 34b)

Interviewees who had already set up or were considering setting up subsidiaries in new territories were asked where they had set up their new studios. The following is a selection of the most common responses:

**Table 68: Locations of overseas subsidiaries**

	Total	Independents	Publishers
Canada	47%	38%	57%
Australia	13%	0%	29%
China / Hong Kong	13%	13%	14%
Malaysia	7%	0%	14%
Eastern Europe	7%	0%	14%
US	7%	13%	0%

Again, Canada is the clear first choice in terms of attracting UK-based companies to locate, relocate or acquire studios overseas. Australia and Hong Kong are second choices, based on the language match.



# The industry survey

## Success of locating overseas (Question 35)

Interviewees who had already set up subsidiaries in new territories were asked how their new studios had fared. However too few were in a position to respond to give meaningful data.

## Government assistance received (Question 36)

Interviewees who had set up overseas (40 per cent of total respondents) were asked what governmental assistance they had received either overseas. The following are a selection of the most common responses:

**Table 69: Government assistance received**

	Total	Independents	Publishers
Tax credits	40%	50%	33%
Grants	40%	50%	33%
Canadian salary subsidies	40%	0%	67%
Canadian tax free income for foreign experts	40%	0%	67%

Although the sample is small, tax credits and grants have clearly been available to some respondents. Several have benefited from Canadian salary and income tax assistance. Among others, lomo had some strong comments about R&D tax credits as implemented in the UK:

*R&D tax credits are a good starting point but they need to be consistently implemented, more generous and come with better guidelines.* **John Chasey, VP Global Games, Infospace**

## Benefits of locating overseas (Question 37)

Interviewees were asked what the perceived benefits of setting up in new territories were. The following are a selection of the most common responses:

**Table 70: Benefits of locating overseas**

	Total	Independents	Publishers
Cost	87%	75%	100%
Shelter from the weak dollar	20%	38%	0%
Access to talent (Canada)	13%	13%	14%

The clear driver for opening up subsidiaries or studios overseas is cost. Beneath that headline, respondents were impressed by lower salary costs, higher subsidies against salary costs available in markets like Canada, income tax incentives for foreign experts, generally lower cost of living (including leasing real estate) and the wealth of incentives available for a number of territories. Some studios, mostly independents whose margins are getting hammered by the strength of the pound, wanted shelter against the weak dollar.



# The industry survey

A couple of respondents were enthusiastic about the amount of talent to be found in Canada.

### Risks and benefits of locating overseas (Question 38)

Interviewees were asked what the perceived benefits of setting up in new territories were. The following is a selection of the most common responses:

**Table 71: Demerits of locating overseas**

	Total	Independents	Publishers
Cost isn't everything, it's about creativity	20%	25%	14%
Difficulty of managing remote offices and communications	20%	13%	29%
Quality of staff	20%	13%	29%
Competition for staff	20%	0%	43%

The strength and unity of response and opinion were much reduced compared to this question's immediate predecessor, and a range of opinions was voiced. Some raised concerns about a lack of creativity found in new markets, and said that cost is not everything when it comes to games development.

Others (mostly those who had already set up in new territories) voiced concerns about the difficulty of managing staff at a distance and communications problems which had added to the costs of locating overseas. Quality of staff was also suggested as a major issue, particularly in newer markets or, as another group said, after the best had been taken by Ubisoft and Electronic Arts in Canada. Several mentioned the wage inflation found in Shanghai for experienced staff.

### Impact of overseas government aid on UK industry (Question 39)

Interviewees were asked about the impact of aid schemes such as those offered in Canada, France or elsewhere on the UK games industry. The following is a selection of the most common responses:

**Table 72: Impact of overseas government aid on UK industry**

	Total	Independents	Publishers
No level playing field, UK less competitive	73%	75%	71%
UK companies will slow their growth, stop hiring	40%	50%	29%
New original IP will falter in UK	33%	25%	43%
Talent is more important than cost	20%	13%	29%
Brain drain	20%	13%	29%



## The industry survey

Over two-thirds of respondents felt that the UK was much less competitive than competitor territories. They cited the lack of government support, higher salary, property and living costs as putting the UK at a severe disadvantage to territories where each of those factors is either lower or subsidised. Many publishers spoke about man month costs in the UK as being a critical decision factor against continued expansion here. Others emphasised the key finding in *Monograph 3, Commercial Models* about the crisis in financing games production, saying that financing production is the single most important issue in games development, whether seen from the cost of production or the availability of financing – both of which are significantly assisted by Canadian provinces bent on building large games industry hubs. Here is Eutechnyx on the uneven playing field:

*If you go to a trade show, you'll see French games companies with €250,000 worth of working demos for new original IP funded by by French government grants. The British companies lity of funding in France and other parts of the world makes the playing field uneven for UK companies. The French and Canadians therefore have a huge competitive advantage, and they raise expectations from publishers who begin to expect to see full working prototypes. So, we need a commercially focused prototype fund which helps developers create new products, and takes a percentage of revenues to plough it back into other new exciting IP projects.*

**Darren Jobling, Director of Business Development, Eutechnyx**

Half of independents and 40 per cent of the total sample think that the availability of aid in other territories will, if unaddressed by the UK government, result in UK companies slowing their growth as they expand overseas. One third, and importantly over 40 per cent of publisher studios and head offices, think that this will slow or stop the creation of new original IP in the UK.

A bullish minority believe that the talent is here and that higher costs will not impact the UK's development industry. This opinion was backed up by the example of Hollywood whose high costs have not seen its relocation over the border to Vancouver<sup>131</sup>. A number of respondents said that talent would move to Canada.

### Brain drain (Question 40)

Interviewees were asked whether a brain drain of UK talent overseas had occurred. The following is a selection of the most common responses:

**Table 73: Brain drain**

	Total	Independents	Publishers
Yes	87%	88%	86%
Maybe	7%	0%	14%
No	0%	0%	0%

This question received a high number of responses (93 per cent of the sample) and almost all respondents agreed that a brain drain had occurred (although a couple of respondents claimed that the UK drained talent from Europe, see Question 41). Several said that they had already seen a brain drain in action, such as Kuju:

*We have already lost staff to Canada. Jonathan Newth, CEO, Kuju*

<sup>131</sup> This argument fails to acknowledge the success that Vancouver has had in drawing film and TV production to British Columbia following tax breaks, making it one of the largest such locations in the world



# The industry survey

## Beneficiaries of a brain drain (Question 41)

Interviewees were asked which territories had drained talent from the UK. The following is a selection of the most common responses:

**Table 74: Beneficiaries of brain drain**

	Total	Independents	Publishers
Canada (Quebec)	47%	50%	43%
US	33%	50%	14%
Canada (Vancouver)	27%	38%	14%
To UK from Europe	13%	0%	29%

The most popular location for draining talent from the UK was perceived to be Canada, which 53 per cent of the total sample<sup>131</sup> thought had drained talent to either the east or west coast. A number said that they had already lost staff to Canada, all of those to Montreal. One-third expected the USA to benefit, with several mentioning that a fair number of US studios and publishers were run by British people. Two respondents said that their UK studios were filled with talent from across Europe.

<sup>132</sup> Respondents could nominate more than one location

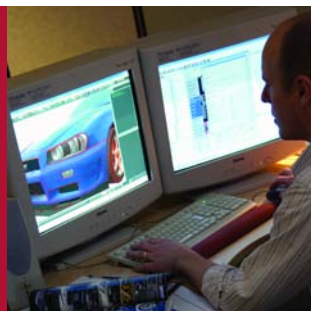
## Impact of globalisation

### Impact of outsourcing and globalisation (Question 42)

Interviewees were asked what impact, positive or negative, the practice of outsourcing has on UK companies and games IP, and what measures were taken to exploit opportunities or protect against the threats of globalisation. The following is selection of the most common responses:

**Table 75: Impact of globalisation**

	Total	Independents	Publishers
Build game abroad, create it here	73%	75%	71%
Cheaper costs	67%	50%	86%
Enables team to scale up and down as required	33%	38%	29%
Cheap labour will tempt publishers but managing outsourcing is a key skill	20%	25%	14%
Strengthen processes	20%	38%	0%



# The industry survey

**Table 75: Impact of globalisation (cont)**

	Total	Independents	Publishers
Use more contractors, emulate film model	20%	13%	29%
Outsourcers were used initially, now they have opened subsidiaries	13%	13%	14%

Outsourcing has been firmly embraced by 87 per cent of the total sample, for whom it is standard operating procedure. Within this came a range of response, the most popular of which was the idea that games should be originated and designed in the UK (architect role) but produced overseas (builder role). Two-thirds of respondents reinforced the earlier finding about the primacy of production costs by saying that the main driver was cheaper costs in other territories. One-third wanted the flexibility to scale production up and down as their production pipeline demands. Others spoke about the need to understand how to manage outsourcers, the role that outsourcing plays in strengthening production processes, and the need to work from smaller core teams and build temporary large production teams using contractors and outsourcers. A few said that they started using outsourcing but decided to open subsidiaries in the Far East. Only one respondent rejected outsourcing as destructive of IP, skills and position in the value chain, with a disastrous impact on the UK's ability to create new original IP.

## Closing questions

### One measure to help UK companies (Question 43)

Interviewees were asked to choose one measure to assist UK companies in creating new games IP:

**Table 76: One measure to help UK companies**

	Total	Independents	Publishers
Tax breaks to incentivise investment in and development of new original IP	60%	50%	71%
Fund for incubating games companies or IP	20%	13%	29%
Prototype fund	13%	25%	0%

Again tax breaks were high on the list, although the emphasis was lower due to some companies discussing how unlikely such tax breaks are. Here is lomo (Infospace) on the need to make the playing field more level again:



# The industry survey

*A major USA publisher said recently that the UK had a brilliant reputation for games design, innovation and high-quality products, but that the Eastern Europeans are winning hands down on cost. Can grants solve this problem? Probably not, since they could simply prop up poor quality companies. However, tax incentives would help, as they do in Canada and France. This kind of assistance makes for an uneven playing field for our industry and we need to even that out. Any tax break should not be a blank cheque. It should be for original IP developed and retained by UK companies, providing an incentive for UK firms to be chosen for new original IP.*

**John Chasey, VP Global Games, Infospace**

Several companies thought that a fund, perhaps sourced from the Lottery or publishers could be set up to incubate new games companies. A few thought that a prototype fund would be their single choice.

## **Trends that will impact the creation of new game IP (Question 44)**

Interviewees were asked what impact, positive or negative, the practice of outsourcing has on UK companies and games IP, and what measures were taken to exploit opportunities or protect against the threats of globalisation. The following is a selection of the most common responses:

**Table 77: Trends that impact IP creation**

	Total	Independents	Publishers
Going direct-to-consumer digitally	40%	75%	0%
Online communities and user-created content	20%	0%	43%

With this very open question, a surprisingly large number of respondents (three-quarters of independents) cited going direct-to-consumer as a revolutionary change in the industry, opening up new distribution channels for independents. In parallel to that, some thought that the YouTube / MySpace phenomenon of online communities and user-created content would change the way games companies interact with consumers. Again, a wide array of opinions were expressed, including:

- The weak dollar is causing havoc to UK developers
- Microsoft's new "open source" games coding toolset, XNA, will bring innovation just as such initiatives did with older platforms like Commodore Amiga



## The industry survey

- Advertiser funded games are going to revolutionise the industry for developers
- Publishers and their investors need to be focused on quality as opposed to quarterly targets
- Developers must look to alternative sources of finance to retain stronger control of their IP
- Major media companies such as Fox and Warner Brothers will soon enter the games industry
- Ubiquitous computing means ubiquitous gaming, thus presenting opportunities for new original IP from independent games developers



## Appendix: Detailed commercial models

The following are detailed descriptions of the commercial models for a range of different platforms.

### Independent IP models – Advance model (part-funded)

The following are estimates of average deal terms<sup>21</sup> for different platforms, with a brief commentary on how the model works and where it leaves independent developers.

### Current generation console: Xbox 360 / PlayStation 3

**Introduction:** The scale and cost of developing for these platforms have sharply increased since the last generation, particularly for the more complex PlayStation 3 (PS3). Teams of 35-80 people are needed over 18-24 months, and in many cases outsourced art and even animation will be required to keep the project on budget. Xbox 360 (360) is the leading current generation console with a year's worth of market lead, and is forecast by some to remain the market leader for the next two years. Although PS3 is expected to take the lead by 2008, until then it is likely to spend much time in distant third place behind the 360 and the Wii.

**Platform viability:** 360 – low-medium through 2007, medium-high from 2008. 10.4 million 360s worldwide by end of 2006, 13-15 million by mid-2007<sup>22</sup>. PS3 – low through 2007, medium from 2008. One million PS3s in North America at end of 2006, six million worldwide targeted by Sony by end of Q1 2007, 13 million forecast by end of 2007<sup>23</sup>, 20 million by end of 2008.

**Developer net revenue share:** 25 per cent of net receipts (after cost of goods and retail margin).

**Developer risk level:** high. To utilise this model, the developer must be very well funded, given the cost of prototype development. However, the break-even point for independents is well above the average sales point, and so overages are rare.

**Publisher net revenue share:** 75 per cent of net receipts (after cost of goods and retail margin).

**Publisher risk level:** low. The publisher target of 210,000 is viable, especially with the developer reducing the production budget by US\$1million, which frees up capital for other projects.

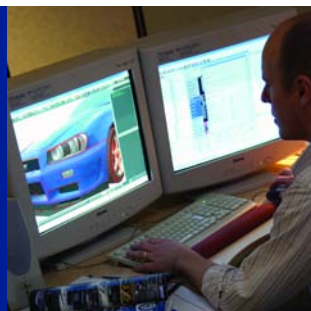
**Average unit sales:** 400,000 (360)<sup>24</sup> and 300,00 (PS3)

<sup>21</sup> Production budgets are indicative of average games and are not designed to reflect AAA titles whose budgets can be triple those indicated. Marketing costs are calculated on a per unit basis

<sup>22</sup> IDG, 2006

<sup>23</sup> IDG, 2006

<sup>24</sup> Based on Wedbush Morgan figures for top 20 titles



## Appendix: Detailed commercial models

**Table 8: 360/PS3 average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share (US\$) <sup>25</sup>	\$7.56	\$22.69
Revenue share (%/net)	25%	75%
Advance <sup>26</sup>	-	\$4,000,000
Developer investment	\$1,000,000	-
Additional production cost <sup>27</sup> (\$)	-	\$100,000
Total development cost	-	\$4,100,000
Marketing cost (\$ / unit)	-	\$3.03
Break-even <sup>28</sup> (units)	528,926	208,519

### Current generation console: Nintendo Wii

**Introduction:** The Wii has launched and begun selling faster than any other current generation console, and this platform offers intuitive interfaces, reduced average development costs (US\$ four million), smaller team sizes (25-45), lower production durations (nine to fifteen months) and easier technology. However, this is balanced by a new interface and Nintendo's poor track record of support for third party development.

**Platform viability:** medium through 2007, medium-high from 2008. Accurate sales projections are not available, but Wii is forecast to have sold four million by end of year 2006 and six million by end of Q1 2007<sup>29</sup>.

**Developer net revenue share:** 25 per cent of net receipts (after cost of goods and retail margin).

**Developer risk level:** high. The break-even point (at over 500,000 units) for independents is a high target.

**Publisher net revenue share:** 75 per cent of net receipts (after cost of goods and retail margin).

**Publisher risk level:** low. The publisher's target of 200,000 units is under the average sales for this platform, making this a viable investment (as long as Nintendo supports the publisher).

**Average unit sales:** 250,000<sup>30</sup>

<sup>25</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$55 after sales tax

<sup>26</sup> Assumes developer takes 7.5 cent margin on the advance

<sup>27</sup> Assumed to be mostly localisation costs

<sup>28</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

<sup>29</sup> Nintendo, Jan 07

<sup>30</sup> Based on Wedbush Morgan figures for top 20 titles, 10 06



# Appendix: Detailed commercial models

**Table 9: Wii average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share <sup>31</sup> (\$)	\$6.19	\$18.56
Revenue share (%/net)	25%	75%
Advance <sup>32</sup>	-	\$3,200,000
Developer investment	\$800,000	-
Additional production cost <sup>33</sup> (\$)	-	\$80,000
Total development cost	-	\$3,280,000
Marketing cost (\$ / unit)	-	\$2.48
Break-even <sup>34</sup> (units)	517,172	203,885

## Offline PC game

**Introduction:** PC development, although well understood, has suffered from a shrinking market in recent years<sup>35</sup>, only finally achieving neutral or positive growth in 2006. Most publishers ensure that PC games are ported to one or more console platforms. Team sizes are smaller than for console titles, with 25-40 staff required over 12-18 months, but these numbers are ever increasing.

**Platform viability:** medium through 2009. The healthy number of PC gamers – 150 million in total<sup>36</sup> – is countered by the reduction in number of titles being purchased by gamers. Gaming on PC may well revive under Microsoft’s Games for Windows initiative which, with the launch of Windows Vista and DirectX 10,

may push PC games up to current console quality and improve the retail presentation of PC games.

**Developer net revenue share:** 25 per cent of net receipts (after cost of goods and retail margin).

**Developer risk level:** medium. The break-even point of over 420,000 units for independents is just above most games’ sales. PC games are more susceptible than console games to substantial retail price erosion which in turn reduces publishers’ net receipts per unit sold.

**Publisher net revenue share:** 75 per cent of net receipts (after cost of goods and retail margin).

**Publisher risk level:** low. Publishers’ unit break-even point of 166,000 units makes this a viable market, especially if the title is ported to other platforms. Price erosion, while damaging, is more likely to occur after publishers have broken even.

**Average unit sales:** 400,000

<sup>31</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer’s royalty) and retail for title retailing at US\$45 after sales tax

<sup>32</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>33</sup> Assumed to be mostly localisation costs

<sup>34</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer’s initial investment

<sup>35</sup> By an average of 12 per cent per annum since 2002, NPD

<sup>36</sup> Microsoft, May 2006



# Appendix: Detailed commercial models

**Table 10: Offline PC game average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share <sup>37</sup> (\$)	\$7.59	\$22.76
Revenue share (%/net)	25%	75%
Advance <sup>38</sup>	-	\$3,200,000
Developer investment	\$800,000	-
Additional production cost <sup>39</sup> (\$)	-	\$80,000
Total development cost	-	\$3,280,000
Marketing cost (\$ / unit)	-	\$3.04
Break-even <sup>40</sup> (units)	421,746	166,265

## Online PC game (MMOG)

**Introduction:** MMOG development and publishing is the hardest, riskiest, most technologically challenging and most expensive of all types of game development. The potential profits are high, but development cycles are three- to five years, costs are extremely high due to the massive teams needed to create and maintain vast worlds and multiple servers, and to service technology that manages tens of thousands of concurrent players. Break-even points for all concerned are rarely reached, MMOGs are often cancelled close to launch and revenues may not cover the high costs of ongoing maintenance. While the market for MMOGs has grown in the west, it has largely been booming in Asia.

The following figures are a deliberate simplification<sup>41</sup> of the highly complex commercial models utilised in MMOG development and publishing.

**Platform viability:** medium through 2008. Although the target market for such games is small (between seven and nine per cent of the total gaming audience<sup>42</sup>), MMOGs reach a higher proportion of the boxed online PC game market. While PC games lose retail market share, MMOGs have been growing<sup>43</sup>.

**Developer net revenue share:** 25 per cent of net receipts (after cost of goods and retail margin on the initial boxed product).

<sup>37</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax

<sup>38</sup> Assumes developer takes 7.5 per cent margin on the advance

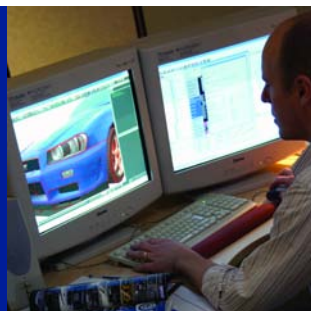
<sup>39</sup> Assumed to be mostly localisation costs

<sup>40</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

<sup>41</sup> To maintain consistency between models for different games and platforms, this model has assumed a three-year build cycle, that all purchasers of the retail product subscribe for six months at US\$15 per month, and that server / account management costs amount to US\$500,000 per annum. Actual costs are expected to differ significantly with each project

<sup>42</sup> The Entertainment Software Association, 2006 Essential Facts

<sup>43</sup> MMOGs have been lifted by World of Warcraft (eight million subscribers worldwide) in the west and games such as Kart Rider, Maple Story, Audition and Ragnarok (each with well over ten million users in Asia alone). "44 per cent of the most frequent game players say they play games online, up from 19 per cent in 2000" The Entertainment Software Association, 2006 Essential Facts



## Appendix: Detailed commercial models

**Developer risk level:** high. Any advance would ensure that some risk was covered, but project cancellation rates for MMOGs are very high. Despite the low break-even point, maintaining subscriber rates is extremely difficult, and MMOG development remains the most challenging form of development.

**Publisher net revenue share:** 75 per cent of net receipts (after cost of goods and retail margin on the initial boxed product).

**Publisher risk level:** high. Rewards are high, but few major publishers have succeeded in maintaining profitable MMOGs – indeed many have failed, or pulled out of the market. The distribution model cuts out much of retail's share of ongoing revenues, and Asian MMOG developer/publishers often bypass retail altogether.

**Average unit sales:** 200,000 + 150,000 monthly subscribers

**Table 11: MMOG PC game average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share <sup>44</sup> (\$)	\$28.09	\$84.26
Revenue share (%/net)	25%	75%
Advance <sup>45</sup>	-	\$7,200,000
Developer investment	\$1,800,000	-
Additional production cost <sup>46</sup> (\$)	-	\$1,660,000
Total development cost	-	\$8,860,000
Marketing cost (\$ / unit)	-	\$11.24
Break-even <sup>47</sup> (units)	256,342	121,324

### Handheld

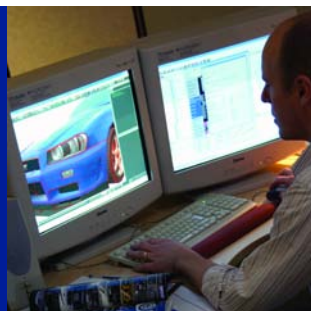
**Introduction:** Nintendo's DS has been one of the best performing console launches of all time, and is the most popular current generation handheld globally. Sony's PlayStation Portable (PSP) trails some way behind, as yet featuring few games created specifically for the platform, but it has potential to make up for lost ground after price discounts.

<sup>44</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax, plus US\$82 after sales tax in subscription fees over six months

<sup>45</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>46</sup> Assumed to be mostly localisation, serving and account management costs

<sup>47</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



## Appendix: Detailed commercial models

The DS platform demands innovation, and studios that simply port games from other platforms typically fail to generate strong sales. Studios have benefited from a very intuitive interface (stylus and voice-activation inputs) which encourages different kinds of gaming. Team sizes can be kept low – under 20 people over six months. Average game budgets vary widely, with DS budgets spreading between US\$ 200-US\$ 1 million, and PSP between US\$ 400-US\$ 1.2 million.

**Platform viability:** High through 2008. Nintendo has sold 28 million DS globally, with North America projected as 9 million by end of 2006, 15 million by end of 2007 and 20 million by end of 2008. Sony had shipped 16 million PSPs globally by Nov 2006. DS games dominate the charts, attracting new demographics. Unlike standard games, some DS games (like Brain Age and Nintendogs) have taken eight to ten weeks to reach the top of the charts and then stayed there for months, a sales profile exhibited by many mass market games targeting a broader demographic.

**Developer net revenue share:** 25 per cent of net receipts (after cost of goods and retail margin).

**Developer risk level:** low. Break-evens, at around 145,000 units, are very achievable.

**Publisher net revenue share:** 75 per cent of net receipts (after cost of goods and retail margin).

**Publisher risk level:** medium. Break-evens are easily achievable. However, in practice Nintendo's own software takes a disproportionately large share of the market for DS games, which has led to publishers complaining that there is too small a market left for them.

Average unit sales: 250,000

**Table 12: Handheld game average deal terms (advance model part-funded)**

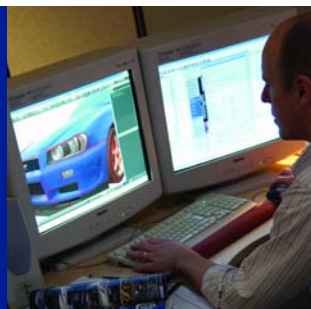
	Developer	Publisher
Revenue share <sup>48</sup> (\$)	\$4.40	\$13.20
Revenue share (%/net)	25%	75%
Advance <sup>49</sup>	-	\$640,000
Developer investment	\$160,000	-
Additional production cost <sup>50</sup> (\$)	-	\$16,000
Total development cost	-	\$656,000
Marketing cost (\$ / unit)	-	\$1.76
Break-even <sup>51</sup> (units)	145,455	57,343

<sup>48</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$32 after sales tax

<sup>49</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>50</sup> Assumed to be mostly localisation, serving and account management costs

<sup>51</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



## Appendix: Detailed commercial models

### Current generation console casual

**Introduction:** Each of the current generation consoles now offer large numbers of smaller games from dedicated areas within their online services. Making a game for these platforms varies widely in cost depending on whether the game is newly made for the platform (a comparative rarity) or whether it is a port of a game made up to decades ago for an earlier console or PC. Development commonly involves a team of around five people working over six months, and technical hurdles are low.

**Platform viability:** Varies by platform, but generally high (if the channel manager agrees to the game). See distribution channels section of the report.

**Developer net revenue share:** 40 per cent of net receipts (after the console platform owner's royalty).

**Developer risk level:** low. Break-evens, at around 40,000 units, are easily achievable, although deck placement often means that sales will front-load in early weeks before declining rapidly.

**Publisher net revenue share:** 60 per cent of net receipts (after the console platform owner's royalty).

**Publisher risk level:** very low. These games are good opportunities for both parties, but as the deck becomes more crowded, publishers' costs will rise as marketing (currently relatively rare for this type of game) becomes more important.

**Average unit sales:** 200,000

**Table 13: console casual game average deal terms (advance model part-funded)**

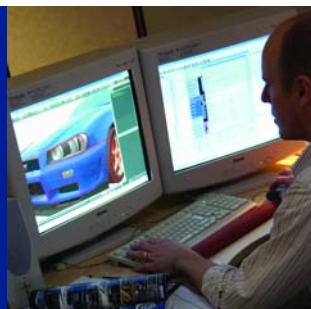
	Developer	Publisher
Revenue share <sup>52</sup> (\$)	\$3.80	\$5.70
Revenue share (%/net)	40%	60%
Advance <sup>53</sup>	-	\$160,000
Developer investment	\$40,000	-
Additional production cost <sup>54</sup> (\$)	-	\$3,200
Total development cost	-	\$163,200
Marketing cost (\$ / unit)	-	\$0.00
Break-even <sup>55</sup> (units)	42,105	28,632

<sup>52</sup> Revenue share indicates US dollars per unit for a title retailing at US\$14 after console owner's royalty and sales tax

<sup>53</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>54</sup> Assumed to be mostly localisation costs

<sup>55</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



## Appendix: Detailed commercial models

### Mobile games (Java)

**Introduction:** The over-hyped mobile sector has been under-performing, delivering strong revenues to only a few companies who have aggregated content from small developers (often via acquisition). Mobile games development is a cheap but technically intricate task due to the large (300+ on average) number of handsets that require supporting. Typically, teams of five to ten staff take between four and six months to develop a title. The network operator distributes the game via a “deck” of games in its walled garden of content, and takes a large amount of revenue from either a one-off download fee (predominately in the west) or a subscription to a basket of games (predominately in the east), both of which are charged to the customer’s bill via a premium SMS or direct-to-bill payment.

**Platform viability:** low-medium through 2008, medium through 2010. Low customer penetration (well below ten per cent in the west) combined with network operators reducing the number of publishers they will deal with, and poor quality content, will continue to suppress this market.

**Developer net revenue share:** 50 per cent of net receipts (after cost of goods, operator costs and sales tax).

**Developer risk level:** low. Break-even points are within reach of most developers, and overages are more common in mobile development than on other platforms.

<sup>56</sup> Revenue share indicates US dollars per unit for a title retailing at US\$5 after network operator’s royalty and sales tax

<sup>57</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>58</sup> Assumed to be mostly porting costs

<sup>59</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer’s initial investment

However, long delays significantly impact developers’ cash flow. Few western mobile companies have been able to grow beyond 20 staff, and several have contracted or failed of late.

**Publisher net revenue share:** 50 per cent of net receipts (after cost of goods, operator costs and sales tax).

**Publisher risk level:** low. Notably below the break-even for developers. As mobile publishers have lots of access to relatively inexpensive licenses as well as internal development capabilities, so the commercial reality is that most turn away from developer-owned IP to create or license their own.

**Average unit sales:** 150,000

**Table 14: Mobile game average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share <sup>56</sup> (\$)	\$1.50	\$1.50
Revenue share (%/net)	50%	50%
Advance <sup>57</sup>	-	\$80,000
Developer investment	\$20,000	-
Additional production cost <sup>58</sup> (\$)	-	\$53,000
Total development cost	-	\$133,000
Marketing cost (\$ / unit)	-	\$0.30
Break-even <sup>59</sup> (units)	53,333	88,667



# Appendix: Detailed commercial models

## Casual online (PC)

**Introduction:** The casual games market has enjoyed rapid growth, comprising of Simple games which are largely PC-based and accessed online. Casual games are the least expensive type of game to develop which has led to a proliferation of casual games developers and products. Distribution of casual games is via a number of potential channels including the casual games community sites, dedicated casual games download sites such as Shockwave Unlimited and Real Arcade, pay-per-play sites such as Worldwinner and King.com, MSN's casual games download service and direct from the developers' own sites.

**Platform viability:** low-medium through 2010. Although a big potential market, casual gaming experiences low revenues per title. The market remains oversupplied with both developers and titles and gameplay plagiarism is rife.

**Developer net revenue share:** 50 per cent of net receipts.

**Developer risk level:** low. Content oversupply limits the chances of commercial success although self-publishing online and a less crowded supply chain means that margins are considerably higher than most other forms of games development and thus break-evens are lower.

**Portal net revenue share:** 50 per cent of net receipts.

**Portal risk level:** low. Portals face a glut of content from small developers, and will only rarely pay for a game in this way. However, the portals' below the line costs, such as hosting, serving, promotion, account management, fulfilment etc. are significant.

Average unit sales: 100,000 paid-for downloads

**Table 15: Casual online PC game average deal terms (advance model part-funded)**

	Developer	Publisher
Revenue share <sup>60</sup> (\$)	\$9.00	\$9.00
Revenue share (%/net)	50%	50%
Advance <sup>61</sup>	-	\$30,000
Developer investment	\$30,000	-
Additional production cost <sup>62</sup> (\$)	-	\$6,200
Total development cost	-	\$36,200
Marketing cost (\$ / unit)	-	\$0.00
Break-even <sup>63</sup> (units)	3,333	4,022

<sup>60</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$18 after sales tax

<sup>61</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>62</sup> Assumed to be mostly localisation, serving and account management costs

<sup>63</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



# Appendix: Detailed commercial models

## Independent IP models – Advance model (100 per cent self-funded)

The following are estimates of average deal terms for different platforms, with a brief commentary on how the model works and where it leaves independent developers. Please note that the production and marketing budgets are indicative of average games and are not designed to reflect AAA titles whose budgets can triple those indicated.

### Offline PC game

**Introduction:** Most titles in this category are budget titles. The lack of funding amongst independent developers reduces the average budget for a PC game to US\$1million, but team sizes and average build times remain the same.

**Platform viability:** medium through 2009. See advance model (part-funded).

**Developer net revenue share:** 60 per cent of net receipts (after cost of goods and retail).

**Developer risk level:** medium. The break-even point of 55,000 units for independents is achievable for most games, but is still dependent on successful marketing and distribution by the publisher.

**Publisher net revenue share:** 40 per cent of net receipts (after cost of goods and retail).

**Publisher risk level:** low. Publishers' low unit break-even point of 2,000 units is balanced some modest marketing costs, but this, although comparatively rare due to the paucity of funding for independent developers, is a very low risk model for a publisher.

Average unit sales: 200,000

**Table 16: Offline PC game average deal terms (advance model fully-funded)**

	Developer	Publisher
Revenue share <sup>64</sup> (\$)	\$18.21	\$12.14
Revenue share (%/net)	60%	40%
Advance <sup>65</sup>	-	\$0
Developer investment	\$1,000,000	-
Additional production cost <sup>66</sup> (\$)	-	\$20,000
Total development cost	-	\$20,000
Marketing cost (\$ / unit)	-	\$3.04
Break-even <sup>67</sup> (units)	54,915	2,197

<sup>64</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax

<sup>65</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>66</sup> Assumed to be mostly localisation costs

<sup>67</sup> This figure represents the break-even point for the developer's initial investment



# Appendix: Detailed commercial models

## Online PC game (MMOG)

**Introduction:** Again, the average budget for a self-funded MMOG plummets due to the lack of access to capital in the independent sector. In the west, titles in this category rarely if ever get a retail release, but are distributed digitally by their developers, who effectively act as their publishers. In the west, there have been very few successful MMOGs in this category. Development cycles approach five years and team sizes are low (ten to fifteen people) in the west. But budgets and teams sizes are much higher in the east but are not modelled here.

**Platform viability:** medium through 2008. See advance model (part-funded).

**Developer net revenue share:** 100 per cent of net receipts.

**Developer risk level:** high. Despite low break-evens, funding is almost impossible to find for self-published MMOGs. MMOG development is still the most expensive, risky, lengthy and complex game development model; and self-publishing is the riskiest of all.

**Publisher risk level:** Typically there is no publisher associated with this kind of development, and thus no boxed product.

**Average unit sales:** 30,000-150,000 monthly subscribers

**Table 17: MMOG PC game average deal terms (advance model fully-funded)**

	Developer
Revenue share <sup>68</sup> (\$)	\$55.00
Revenue share (%/net)	100%
Advance <sup>69</sup>	-
Developer investment	\$1,000,000
Additional production cost <sup>70</sup> (\$)	\$520,000
Total development cost	\$1,520,000
Marketing cost (\$ / unit)	\$5.50
Break-even <sup>71</sup> (units)	30,707

## Handheld

The major differences in this model to the advance model (part-funded) is that the developer gets 60 per cent of net receipts, and that the low costs make this very viable for developers and publishers alike.

<sup>68</sup> Revenue share indicates US dollars of US\$55 in subscription fees (after sales tax) over six months

<sup>69</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>70</sup> Assumed to be mostly localisation, serving and account management costs

<sup>71</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



# Appendix: Detailed commercial models

**Table 18: Handheld game average deal terms (advance model fully-funded)**

	Developer	Publisher
Revenue share <sup>72</sup> (\$)	\$10.56	\$7.04
Revenue share (%/net)	60%	40%
Advance <sup>73</sup>	-	\$0
Developer investment	\$160,000	-
Additional production cost <sup>74</sup> (\$)	-	\$3,200
Total development cost	-	\$3,200
Marketing cost (\$ / unit)	-	\$1.76
Break-even <sup>75</sup> (units)	15,152	606

### Console casual

The major difference between this model and the advance model (part-funded) are that the developer goes direct to the console owner, gets 100 per cent of net receipts, and that the low costs make this viable for developers with moderate funding.

<sup>72</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$32 after sales tax

<sup>73</sup> Assumes developer takes 7.5 per cent margin on the advance

<sup>74</sup> Assumed to be mostly localisation costs

<sup>75</sup> This figure represents the break-even point for the developer's initial investment

**Table 19: Console casual game average deal terms (advance model fully-funded)**

	Developer
Revenue share <sup>76</sup> (\$)	\$9.50
Revenue share (%/net)	100%
Advance	-
Developer investment	\$200,000
Additional production cost <sup>77</sup> (\$)	\$4,000
Total development cost	\$204,000
Marketing cost (\$ / unit)	\$0.00
Break-even <sup>78</sup> (units)	21,474

### Third party IP – Work-for-hire (buy-out) model

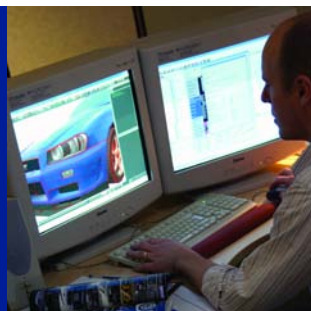
The following are estimates of average deal terms<sup>79</sup> for different platforms, with a brief commentary on how the model works and where it leaves independent developers.

<sup>76</sup> Revenue share indicates US dollars per unit for a title retailing at US\$14 after console owner's royalty and sales tax

<sup>77</sup> Assumed to be mostly localisation costs

<sup>78</sup> This figure represents the break-even point for the developer's initial investment

<sup>79</sup> Production budgets are indicative of average games and are not designed to reflect AAA titles whose budgets can triple those indicated. However, they are higher for work-for-hire projects than for new IP projects because publishers normally regard them as more important. Marketing costs are calculated on a per unit basis. These costs are taken off the wholesale receipts to the publisher to calculate the break-even point, but this methodology means that the up-front nature of publishers' marketing costs are not reflected in the break-even figure, or the total cost



## Appendix: Detailed commercial models

### Current generation console: Xbox 360 / PlayStation 3

The major differences between this model and the advance model (part-funded) are that the budgets are much higher, the developer gets 0 per cent of net receipts, publishers have no revenue share liability, and only slightly higher break-even points than with a revenue share.

**Table 20: 360/PS3 game average deal terms (buy-out model)**

	Developer	Publisher
Revenue share (\$) <sup>80</sup>	\$0.00	\$30.25
Revenue share (%/net)	0%	100%
Advance <sup>81</sup>	-	\$8,000,000
Developer investment	-	-
Additional production cost <sup>82</sup> (\$)	-	\$160,000
Total development cost	-	\$8,160,000
Marketing cost (\$ / unit)	-	\$3.03
Break-even (units)	0	299,725

<sup>80</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$55 after sales tax

<sup>81</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>82</sup> Assumed to be mostly localisation costs

### Current generation console: Nintendo Wii

The major differences in this model to the advance model (part-funded) is that the budget is higher, the developer gets 0 per cent of net receipts, and the low break-even point makes this an attractive platform. Nintendo's poor record of support for third party publishers will deter some publishers from adopting this platform wholeheartedly.

**Table 21: Wii game average deal terms (buy-out model)**

	Developer	Publisher
Revenue share <sup>83</sup> (\$)	\$0.00	\$24.75
Revenue share (%/net)	0%	100%
Advance <sup>84</sup>	-	\$6,000,000
Developer investment	-	-
Additional production cost <sup>85</sup> (\$)	-	\$120,000
Total development cost	-	\$6,120,000
Marketing cost (\$ / unit)	-	\$2.48
Break-even (units)	0	274,747

<sup>83</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$45 after sales tax

<sup>84</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>85</sup> Assumed to be mostly localisation costs



# Appendix: Detailed commercial models

## Offline PC game

The major differences between this model and the advance model (part-funded) are that the budget is higher and the developer gets 0 per cent of net receipts.

**Table 22: Offline PC game average deal terms (buy-out model)**

	Developer	Publisher
Revenue share <sup>86</sup> (\$)	\$0.00	\$30.35
Revenue share (%/net)	0%	100%
Advance <sup>87</sup>	-	\$6,000,000
Developer investment	-	-
Additional production cost <sup>88</sup> (\$)	-	\$120,000
Total development cost	-	\$6,120,000
Marketing cost (\$ / unit)	-	\$3.04
Break-even (units)	0	224,053

## Handheld console (Nintendo DS)

The major differences between this model and the advance model (part-funded) are that the budget is higher and the developer gets 0 per cent of net receipts. The variation in break-even between this model and the work-for-hire (revenue share) model is a matter of a few thousand units, so issues such as ease or time of development and familiarity with the developer also come into play in the decision whether to share revenue.

**Table 23: Handheld game average deal terms (buy-out model)**

	Developer	Publisher
Revenue share <sup>89</sup> (\$)	\$0.00	\$17.60
Revenue share (%/net)	0%	100%
Advance <sup>90</sup>	-	\$1,000,000
Developer investment	-	-
Additional production cost <sup>91</sup> (\$)	-	\$20,000
Total development cost	-	\$1,020,000
Marketing cost (\$ / unit)	-	\$1.76
Break-even (units)	0	64,394

<sup>86</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax, plus US\$82 after sales tax in subscription fees over six months

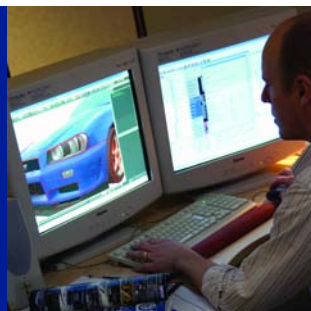
<sup>87</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>88</sup> Assumed to be mostly localisation, serving and account management costs

<sup>89</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$32 after sales tax

<sup>90</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>91</sup> Assumed to be mostly localisation, serving and account management costs



# Appendix: Detailed commercial models

## Current generation console casual

The major differences between this model and the advance model (part-funded) are that the budget is higher, and the developer gets 0 per cent of net receipts. Given reduction in break-even and increase in revenues, it makes more sense for publishers to use licence contracts for important casual console IP.

**Table 24: Console casual game average deal terms (buy-out model)**

	Developer	Publisher
Revenue share <sup>92</sup> (\$)	\$0.00	\$9.50
Revenue share (%/net)	0%	100%
Advance <sup>93</sup>	-	\$250,000
Developer investment	-	-
Additional production cost <sup>94</sup> (\$)	-	\$5,000
Total development cost	-	\$255,000
Marketing cost (\$ / unit)	-	\$0.00
Break-even (units)	0	26,842

<sup>92</sup> Revenue share indicates US dollars per unit for a title retailing at US\$14 after sales tax

<sup>93</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>94</sup> Assumed to be mostly localisation costs

## Mobile games (Java)

The major differences between this model and the advance model (part-funded) are that the budget is greater, and the developer gets 0 per cent of net receipts. Given reduction in break-even and increase in revenues, it makes more sense for publishers to avoid sharing any revenue for important mobile IP.

**Table 25: Mobile game average deal terms (buy-out model)**

	Developer	Publisher	Platform owner royalty
Revenue share <sup>95</sup> (\$)	\$0.00	\$3.00	\$2.00
Revenue share (%/net)	0%	100%	40%
Advance <sup>96</sup>	-	\$125,000	-
Developer investment	-	-	-
Additional production cost <sup>97</sup> (\$)	-	\$65,000	-
Total development cost	-	\$190,000	-
Marketing cost (\$ / unit)	-	\$0.30	-
Break-even (units)	0	63,333	-

<sup>95</sup> Revenue share indicates US dollars per unit for a title sold at five dollars after sales tax

<sup>96</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>97</sup> Assumed to be mostly porting costs



# Appendix: Detailed commercial models

## Casual Online (PC)

The major differences between this model and the advance model (part-funded) are that the budget is greater, and the developer gets 0 per cent of net receipts. Given reduction in break-even and increase in revenues, it makes more sense for publishers to use licence contracts for important casual PC IP.

**Table 26: Casual online PC game average deal terms (buy-out model)**

	Developer	Portal
Revenue share <sup>98</sup> (\$)	\$0.00	\$18.00
Revenue share (%/net)	0%	100%
Advance <sup>99</sup>	-	\$75,000
Developer investment	-	-
Additional production cost <sup>100</sup> (\$)	-	\$6,500
Total development cost	-	\$81,500
Marketing cost (\$ / unit)	-	\$0.00
Break-even <sup>101</sup> (units)	0	4,528

<sup>98</sup> Revenue share indicates US dollars per unit sold at US\$18 after sales tax

<sup>99</sup> Assumes developer takes 17.5 per cent margin on the advance

<sup>100</sup> Assumed to be mostly localisation, serving and account management costs

<sup>101</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

## Third party IP – Work-for-hire (revenue share)

### Platform variations

The following are estimates of average deal terms<sup>102</sup> for different platforms, with a brief commentary on how the model works and where it leaves independent developers.

### Current generation console: Xbox 360 / PlayStation 3

The major differences between this model and the advance model (part-funded) are that the budget is larger and the developer gets 15 per cent of net receipts.

<sup>102</sup> Production budgets are indicative of average games and are not designed to reflect AAA titles whose budgets can triple those indicated. However, they are higher for work-for-hire projects than for new IP projects because publishers normally regard them as more important. Marketing costs are calculated on a per unit basis. These costs are taken off the wholesale receipts to the publisher to calculate the break-even point, but this methodology means that the up-front nature of publishers' marketing costs is not reflected in the break-even figure, or the total cost



# Appendix: Detailed commercial models

**Table 27: 360/PS3 game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share (\$) <sup>103</sup>	\$4.54	\$25.71
Revenue share (%/net)	15%	85%
Advance <sup>104</sup>		\$7,500,000
Developer investment	\$0	-
Additional production cost <sup>105</sup> (\$)		\$150,000
Total development cost		\$7,650,000
Marketing cost (\$ / unit)	-	\$3.03
Break-even <sup>106</sup> (units)	1,652,893	337,190

### Current generation console: Nintendo Wii

The major differences between this model and the advance model (part-funded) are that the budget is larger, and the developer gets 15 per cent of net receipts. The advance covers costs plus a medium-sized margin, and the distant break-even means that overages are unlikely.

<sup>103</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$55 after sales tax

<sup>104</sup> Assumes developer takes ten per cent margin on the advance

<sup>105</sup> Assumed to be mostly localisation costs

<sup>106</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

**Table 28: Wii game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>107</sup> (\$)	\$3.71	\$21.04
Revenue share (%/net)	15%	85%
Advance <sup>108</sup>	-	\$5,600,000
Developer investment	\$0	-
Additional production cost <sup>109</sup> (\$)	-	\$112,000
Total development cost	-	\$5,712,000
Marketing cost (\$ / unit)	-	\$2.48
Break-even <sup>110</sup> (units)	1,508,418	307,717

### Offline PC game

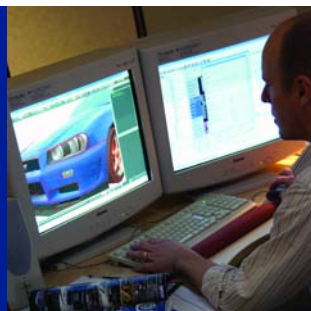
The major differences between this model and the advance model (part-funded) are that the budget is larger, and the developer gets 15 per cent of net receipts. The advance covers costs plus a medium sized margin, and the distant break-even means that overages are unlikely.

<sup>107</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$45 after sales tax

<sup>108</sup> Assumes developer takes ten per cent margin on the advance

<sup>109</sup> Assumed to be mostly localisation costs

<sup>110</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



## Appendix: Detailed commercial models

**Table 29: Offline PC game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>111</sup> (\$)	\$4.55	\$25.80
Revenue share (%/net)	15%	85%
Advance <sup>112</sup>	-	\$5,600,000
Developer investment	\$0	-
Additional production cost <sup>113</sup> (\$)	-	\$112,000
Total development cost	-	\$5,712,000
Marketing cost (\$ / unit)	-	\$3.04
Break-even <sup>114</sup> (units)	1,230,093	250,939

### Online PC game (MMOG)

The major differences between this model and the advance model (part-funded) are that the developer gets 15 per cent of net receipts. Few major publishers have succeeded in maintaining profitable MMOGs – indeed some have failed, or pulled out of the market.

<sup>111</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax

<sup>112</sup> Assumes developer takes ten per cent margin on the advance

<sup>113</sup> Assumed to be mostly localisation costs

<sup>114</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

Those who succeed – such as Vivendi, Sony Online Entertainment and the number of Korean and Chinese companies who self-publish – have produced very profitable games. The distribution model cuts out much of the retail problem, with Asian MMOG developer/publishers ignoring retail altogether.

**Table 30: MMOG PC game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>115</sup> (\$)	\$16.85	\$95.50
Revenue share (%/net)	15%	85%
Advance <sup>116</sup>	-	\$6,700,000
Developer investment	\$0	-
Additional production cost <sup>117</sup> (\$)	-	\$1,634,000
Total development cost	-	\$8,334,000
Marketing cost (\$ / unit)	-	\$11.24
Break-even <sup>118</sup> (units)	397,567	98,905

<sup>115</sup> Revenue share indicates US dollars per unit after cost of goods (distribution) and retail for title retailing at US\$45 after sales tax, plus US\$82 after sales tax in subscription fees over six months

<sup>116</sup> Assumes developer takes ten per cent margin on the advance

<sup>117</sup> Assumed to be mostly localisation, serving and account management costs

<sup>118</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



# Appendix: Detailed commercial models

## Handheld

The major differences between this model and the advance model (part-funded) are that the budget is larger and the developer gets 15 per cent of net receipts. The advance covers costs plus a medium-sized margin, and a viable break-even means that overages are more likely, if such a deal can be cut (see next).

**Table 31: Handheld game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>119</sup> (\$)	\$2.64	\$14.96
Revenue share (%/net)	15%	85%
Advance <sup>120</sup>	-	\$950,000
Developer investment	\$0	-
Additional production cost <sup>121</sup> (\$)	-	\$19,000
Total development cost	-	\$969,000
Marketing cost (\$ / unit)	-	\$1.76
Break-even <sup>122</sup> (units)	359,848	73,409

## Current generation console casual

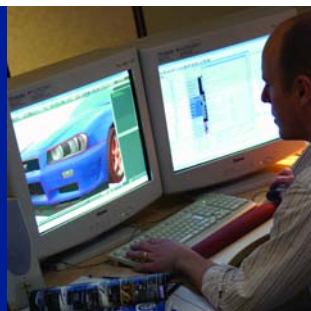
The major difference between this model and the advance model (part-funded) is that the developer gets 15 per cent of net receipts. The advance covers costs plus a medium sized margin, and the relatively achievable break-even means that overages are reasonably likely for developers. However, a low break-even for publishers means that there is little incentive to share revenue at all.

<sup>119</sup> Revenue share indicates US dollars per unit after cost of goods (distribution and console manufacturer's royalty) and retail for title retailing at US\$32 after sales tax

<sup>120</sup> Assumes developer takes ten per cent margin on the advance

<sup>121</sup> Assumed to be mostly localisation, serving and account management costs

<sup>122</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



## Appendix: Detailed commercial models

**Table 32: Casual console game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>123</sup> (\$)	\$1.43	\$8.08
Revenue share (%/net)	15%	85%
Advance <sup>124</sup>	-	\$230,000
Developer investment	\$0	-
Additional production cost <sup>125</sup> (\$)	-	\$4,600
Total development cost	-	\$234,600
Marketing cost (\$ / unit)	-	\$0.00
Break-even <sup>126</sup> (units)	161,404	29,053

### Mobile games (Java)

The major difference between this model and the advance model (part-funded) is that the developer gets 15 per cent of net receipts. Overages arrive at well over the average unit sales for a mobile game, so overages reach the developer only if the game is well marketed and distributed by the publisher.

<sup>123</sup> Revenue share indicates US dollars per unit for a title retailing at US\$14 after sales tax

<sup>124</sup> Assumes developer takes ten per cent margin on the advance

<sup>125</sup> Assumed to be mostly localisation costs

<sup>126</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment

The publisher break-even point is very close to the average sales point, and the likely sales curve means that this kind of revenue sharing is relatively rare, because any premium paid for a licence game without revenue sharing is quickly recouped.

**Table 33: Mobile game average deal terms (work-for-hire model revenue share)**

	Developer	Publisher
Revenue share <sup>127</sup> (\$)	\$0.45	\$2.55
Revenue share (%/net)	15%	85%
Advance <sup>128</sup>	-	\$115,000
Developer investment	\$0	-
Additional production cost <sup>129</sup> (\$)	-	\$64,700
Total development cost	-	\$179,700
Marketing cost (\$ / unit)	-	\$0.30
Break-even <sup>130</sup> (units)	255,556	70,471

<sup>127</sup> Revenue share indicates US dollars per unit for a title retailing at US\$5 after network operator's royalty and sales tax

<sup>128</sup> Assumes developer takes ten per cent margin on the advance

<sup>129</sup> Assumed to be mostly porting costs

<sup>130</sup> This figure represents the point where overages are paid, not the break-even point for the advance plus the developer's initial investment



# UK Trade & Investment



UK Trade & Investment (UKTI) is the government organisation that helps UK-based companies succeed in an increasingly global economy. Our range of expert services is tailored to the needs of individual businesses to maximise their international success. We provide companies with knowledge, advice and practical support.

We also help overseas companies bring high-quality investment to the UK's vibrant economy – acknowledged as Europe's best place from which to succeed in global business. We provide support and advice to investors at all stages of their business decision-making.

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For further information about how the Creative & Media Team at UK Trade & Investment can help you, visit:

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# Partner organisations

## TIGA



Tiga is the national trade association representing the interests of UK games software developers.

Our objective is to keep the UK as one of the top most important global centres for business and creativity.

UK is the fourth largest producer of games software. UK is the third largest retail market for entertainment software worth £1.37 billion (£2.3 billion inc. hardware).

Tiga has 157 members, 130 of which produce part or all of a game, and is funded mostly from subscriptions.

### Our principal roles are:

- To interface with government and ministers on all issues that affect the sector across a wide area: R&D, finance, skills and education, employment, trade, and industry profile.
- To help develop and implement strategies for the sector that make the UK the place of choice to do 'games' business with our members.

To contact Tiga please call: +44 (0)845 094 1 095  
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[www.tiga.org](http://www.tiga.org)



## Partner organisations

### ELSPA



ELSPA (the Entertainment & Leisure Software Publishers Association) was founded in 1989 to establish a specific and collective identity for the British computer and video game industry.

Since then, the membership has steadily grown from 12 to nearly 60 companies, including almost all the major companies concerned with the publishing and distribution of interactive entertainment and leisure software in the UK. ELSPA works to protect, promote and provide for the interests of its members.

#### The association's key policy areas are:

- Economic importance and fiscal support
- Age ratings
- Anti piracy
- Use of games in education and the workforce for skills development
- Health and wellbeing
- Convergence

ELSPA has always been dedicated to informing consumers about age suitability ratings, clarifying misconceptions about the games industry and promoting the industry to the press, public and retailers. The launch of the consumer and press website [www.askaboutgames.com](http://www.askaboutgames.com) continues to build on this work.

ELSPA also plays a key role in two of the UK's largest video game festivals – the Edinburgh Interactive Festival and the London Games Festival. For further information please contact:

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# Partner organisations

## Games Investor Consulting

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CONSULTING LTD

Founded in 2003, Games Investor Consulting (GIC) is a specialist games research, strategy and corporate finance consultancy, with 11 consecutive years' experience, an extensive contact network and an in-depth understanding of both the games and finance industries. With a portfolio of over 40 international clients, GIC typically consults at board level on market assessment, corporate strategy, market entry and development, fundraising, investment and acquisitions. GIC also provides specialist analysis of the games industry, authoring or editing a broad range of research reports published by Screen Digest. GIC covers all facets of the rapidly growing global games industry but has particular specialisation in online gaming and digital distribution; outsourcing and production, tools and middleware; current and emerging commercial models; media convergence; and company, technology and content IP valuations. GIC provides:

### Research and strategy consulting services

- Market Data: GIC tracks the global games industry, maintaining extensive databases covering the industry. GIC has surveyed over 200 games companies

- Research and Strategy Consulting: GIC provides market forecasting, competitive intelligence, market entry and growth strategy planning, and company, market and IP due diligence
- Investment Support: Market validation, opportunity identification and introduction, due diligence, games company and IP valuation

### Corporate finance consulting services

- Mergers and Acquisitions: GIC assists both buyers and sellers find and transact with targets
- Private Equity Fundraisings: GIC maintains strong links to the venture capital community
- IPOs and Public Market Fundraisings: GIC helps clients achieve public market listings

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