Film Inquiry

Submission No. 41.....................

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The Secretary
House of representatives
Standing Committee on Communications, IT & the Arts
Parliament House
Canberra ACT 2600.

To the Committee,

The rising budgets of Console- and PC-game development, bloated as they are by advancing technology, license fees and the quest for lucrative new franchises, mean developers and publishers are having to assess alternative methods of funding. In the current climate, a developer seeking to attract capital from a publisher or investment from the markets in order to finance the creation of new ideas and keep itself afloat is likely have an extremely difficult time. A gap has therefore opened up for investors from outside the industry to become involved in so-called "single-project financing," eschewing the perceived risky proposition of investing in a developer itself. In an industry in which publishers and developers find it hard to come to terms with each other's business models, it is clear third parties face a similar uphill struggle. Twenty years ago, the video-games industry started up with the same model as the book industry, where a publishing house pays an author an advance to write a book, often with a royalty deal attached. But while book publishing has remained very much the same since then, the video-game sector has changed immeasurably. The larger publishers are now publicly listed companies and face immense external pressure to reduce costs. Which means developers must work that much harder to secure advances, let alone royalties.

There has been significant movement in deal structuring during the past two years, with the cost of developing for the next generation consoles (PS2, X-Box etc) rising and back-end royalties going down. Cash is tight and publishers aren't as willing to fund original game prototypes anymore, and many small developers cannot afford to self-fund the process themselves. Tight cash flow, combined with a need for steady growth without surprises – even good ones – is the main reason for the oft-criticized number of licenses, sequels and franchise games in the market. Current estimates are that such products account for three-quarters of games released by publishers. Even the big publishers may only commit to five original games a year and with the top 5% of games released in any one year making 95% of software revenues, the hits have to pay for the misses. It's becoming increasingly difficult to differentiate USP's [unique selling points]. If a developer wants to do a soccer game for example, how is it different from what's out there? The upshot of the situation is a stale market with high barriers to entry, & the days of a budding developer setting up in the garage are long gone.

The bottom line is this. The video game industry is "entertainment", and although only twenty five years old the game industry should not be seen as anything different in comparison to film, television, books, or music. In pure dollar terms, video games are every bit as big as film –if not bigger purely in terms of revenues generated per year. However, the concept of 'risk' dictates the viability of funding options, and business models should now reflect the synergy that exists between games and movies. Game and film development should now be seen in the same light in terms of finance – that is, specialized funds for high-risk projects (creation of a prototype), completion bonds for low-risk (full production). To minimize the cost of funding, developers have to recognize and minimize the level of risk involved, as that is the bottom line for the financial community. Production risks last for different periods of time. Commercial concerns are ubiquitous, while concept risk is only an issue early on. Publishers are becoming more risk averse and see themselves no longer as Bankers for the game industry.

Taking these commercial realities into account it is our firm belief that the Australian Game Development community should be well served by the implementation of a 10B type tax ruling for game development. The influx of private capital would be a welcome kick start directed towards Australian Game Development. Game development is still risky business. However, game development production costs are far less than average film production costs, and yet as an industry we generate somewhere between US$ 9 – 12 billion per annum. It is ludicrous that film media is able to benefit from a 10B ruling and that there is nothing in place in Australia for an industry that is currently outstripping the film industry in terms of revenue. Governments need to look closely at what is happening around the world and in their own constituencies to see the opportunities before us all. The mediums are essentially the same, the only major difference is that one medium is interactive while the other is not. Game development must not be confused as anything but entertainment, simply because we employ bright computer scientists and graphic artists in order to create our products. In 2003 and beyond, game development should also not be confused with the IT boom, or written off as a 'niche' area in relation to technology.

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This is an important and the most thriving facet of the entertainment industry today, and the revenues generated as industry really speak volumes.

In relation to private funding for game development, the main advantage for Publishers would be that they don't have to issue milestone payments and developers in return would retain ownership of IP allowing for even greater upside potential. Publishers no longer act the banker and instead pay one lump sum to the developer on completion and delivery of a gold disc as well as provide a minimum sales guarantee to negate the risk for VC. This also ensures the publisher is committed to the project from day one. Another boon to developers is that publishers can begin signing distribution deals before the game is completed, making the whole development process cash neutral. All aspects of project management can be carried out by a third party or the developer, leaving the Publisher to concentrate on core competencies, such as commissioning and marketing. For new developers this method also allows the developer to gain important track record status and puts the developer in the spotlight in attracting foreign investment in the form of contract development for existing publisher IP and also allows for higher royalties.

Recently, Bungarra Software PTY LTD had a distribution deal signed with one of the worlds biggest publishers, Vivendi Universal. The deal outlined that Bungarra fund the title and Vivendi would commit to a minimum marketing spend and minimum sales guarantee. Although the dollar figure of the guarantee was less than the overall development budget, it was still large enough to demonstrate that the Publisher was interested in the title and the potential upside was substantial. Hence the risk had been minimised. Despite almost 1 year of sending out IM's to potential investors it was still considered too risky from an investors point of view due to the relative unknown factors associated with the industry at this point in time amongst many VC. However a common thread amongst the rejection notices was that if there was a tax ruling in place the deal would be very attractive because a distribution channel had already been put in place.

In summary, the sooner the game development industry receives an equal standing to that of the local film industry the sooner the development community and the educational institutions providing talent for the industry will prosper and grow. Universities are now implementing game development courses, not simply as options for programming or computer art courses, but fully blown game development schools. We are assisting in one such program here in Perth right now, with Murdoch University. There is a constant concern regarding the 'brain drain' in relation to computer and science oriented industries within this country, and if we can foster industry (just a little) by way of the provision of tangible incentives such as 10B, then this would help the talent stay here in this country. In our opinion a 10B tax ruling for the game development industry will put it in line with the film industry, thereby encouraging tangible growth, creating jobs, and attract foreign investment. A 10B type tax ruling would facilitate foreign investment in the form of major publishers shifting some of their development to Australia as opposed to India and Canada, countries which already offer cheaper overheads which are significant enticements to the major labels. The film industry in Australia has already experienced upside with the move by some studios to Australia. And with game sales revenues outstripping movie revenues, now would be the ideal time to bring game development in line with it's sister industry, before it's too late.

Yours Sincerely
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http://www.gamesbiz.net/default.asp

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