

HALFBRICK STUDIOS PTY LTD
SENATE INQUIRY SUBMISSION – VIDEO GAME DEVELOPMENT INDUSTRY

Submitted 18 September 2015

INTRODUCTION

Halfbrick Studios Pty Ltd welcomes the opportunity to respond to the Senate Environment and Communications References Committee's (SECR) inquiry into The Future of Australia's Video Game Development Industry.

In this submission we have provided a brief description of Halfbrick, and the challenges and opportunities faced by our company as a global leader in electronic games, plus our observations and recommendations for the future of the Australian games industry.

SUMMARY OF RECOMMENDATIONS

A summary of the recommendations we make is as follows:

1. Tax incentives and rebates:

- (a) Capitalise on the success of the EMDG scheme by:
 - Extending the EMDG program from 8 grants per company to 12 per company
 - Increase the expense threshold for the EMDG program from \$300,000 AUD to \$500,000 AUD
 - Allow digital marketing efforts and user acquisition costs to be included in the criteria for marketing expenses as long as the marketing efforts can be attributed to a global audience (excluding Australia and New Zealand)
- (b) Offer tax rebates and incentives for qualifying expenditure and companies:
 - Open up the Screen Australia Producer Offset to the video games industry to give a tax offset for production costs of up to 40% for labour
 - Alternatively, implementing a Production Offset incentive for video games companies like the UK and Canada have done to encourage investment in Australia which leads to the creation of more jobs
 - Offer start-up tax incentives for new companies looking to establish their business in Australia provided they can employ Australian residents – this can be in the form a reduction in corporate tax rate for a prescribed number of years
 - Offer continuing tax incentives for existing companies that employ Australian residents (at least 80% plus) – this could also come in the form of a corporate tax break for a prescribed number of years
- (c) ESOP Tax Relief:
 - Remove arbitrary time restrictions on the scheme and replace with thresholds that more accurately assess the qualification of the company as a 'start-up'.
- (d) GST on digital goods
 - Exclude GST from game apps that are developed digitally thereby making the pricing more attractive for Australian consumers.

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2. Building talent:

- (a) Immigration
 - Improve the immigration process for foreign workers highly skilled in the games industry
- (b) **Innovation precinct in Brisbane**
 - Co-operate with State and local government to create a digital/games innovation precinct in Brisbane

3. Lifting barriers to export market

- (a) China cultural / internet restrictions
 - The Australian government should open discussions with the Chinese Government to relax the restrictions on Australian game developers in China, and in particular to remove the requirement for foreign game developers to exclusively license their games to a Chinese partner, before they can be published.
- (b) Bringing Australia in line with global best practice for Privacy
 - Australian government to review *Privacy Act (1988)* Cth in light of current policy movements in USA, Europe and UK with a view to drawing into alignment with these key territories, and thereby future proofing Australian businesses, using global best practice to protect data citizen, and to best leverage opportunities within the data innovation space.
 - Australian government move away from compulsory data notification, as this is a Band-Aid solution with little demonstrated consumer benefit, yet a significant regulatory burden on business.
- (c) Improved in-market support for games exporters:
 - Austrade to invest in upskilling key officers to improve knowledge of global opportunities within the digital economy, and the games industry in particular.
 - Improve access for the games industry to Australian overseas trade missions and government trade delegations

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SECTION 1: BACKGROUND

Who is Halfbrick?

Halfbrick started about 14 years ago in the front bedroom of (Halfbrick CEO and owner) Shainiel Deo's house in Brisbane. At the time there was a group of 5 passionate young gamers with the goal of making video games they wanted to play. As the games industry in Australia dwindled, we remained resilient.

In 2010, Halfbrick released its flagship game Fruit Ninja to global acclaim. Fruit Ninja eventually went on to achieve over 1 billion downloads and the status of second highest selling game of all time on the iOS platform. Age of Zombies kicked off the Barry Steakfries story and franchise which spawned the games Jetpack Joyride and Monster Dash in 2010 and 2011 respectively.

As a result of such phenomenal success, Halfbrick expanded operations into Spain and United States in 2012. In 2014, the company established a presence in Bulgaria to manage the European operation of the business. Also in 2014, Halfbrick entered into a strategic partnership with Chinese company iDreamsky (NASDAQ:DSKY) and as at the end of 2014/15, the revenue derived from the market represents 40% of total revenue.

Halfbrick currently employs 107 staff, with 90 in its Brisbane studio, 6 in Sydney, 2 in Adelaide, 7 in Spain, 1 in Bulgaria and 1 in California.

What does Halfbrick do?

We make games! Fantastic electronic games that we release onto platforms like Android (Google & Amazon), iOS (Apple) and xBox (Microsoft).

But we create much more than just awesome game play: using cutting edge technology and management techniques, beautifully imaginative creativity, enduring humour and special Halfbrick-brand irreverence, we evolve the whole universe into which our fans immerse themselves. Creating a fun, dynamic and multi-layered experience.

We use global distribution services such as the Apple App Store, Amazon, YouTube and Google Play to access our fans.

In addition to developing globally successful games, our team collectively developed a complex global gaming business ecosystem which combines cutting edge technologies, international distribution, publishing and development partnerships, and savvy investments in international game-relevant businesses. This business ecosystem provides the backbone to Halfbrick's enviable and instantaneous access to hundreds of millions of consumers worldwide.

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SECTION 2: Tax Rebates / Incentives

(a) Export Marketing Development Grant (EMDG)

The current EMDG is a financial assistance program available for 8 years to aspiring small to medium sized Australian business that focus on developing export markets for their products and services.

The video game development industry has a huge export focus with most products developed now available digitally world-wide. With the digital revolution and the advent of smartphones, tablets and new generation consoles, games are now readily available for digital download anywhere in the world once the switch is flicked on by the game developer. With the influx of social media into the marketing sphere it gives developers another avenue of marketing their digital products to a whole new segment of consumers.

The EMDG has been beneficial for small to medium sized companies that do not have a huge marketing budget. The cost of marketing and promoting digital products is significant given the number of game applications out in the market currently. The iOS App Store has over 1.2 million apps available for download and the Google Play Store also has over 1.2 million apps available for download as well.¹

The growth and overcrowding of both App Stores makes it extremely difficult for newcomers with great games to get noticed as there is so much noise on the platform. To get noticed in the app stores, developers must spend money to get chart position (called User Acquisition). These costs continue to rise making it difficult for Australian game developers to complete.² The cost of acquiring good quality users for your game can be anywhere between \$2 to \$3 USD. With a potential lifetime value of a customer ranging anywhere between \$5 to \$100 USD, the market is potentially lucrative, but the risk is high given that most games are either free to play (with the option to purchase in-app items) or \$0.99 USD.

Most Australian game developers would find it difficult to compete in the User Acquisition space given that the USD is not favorable in terms of costs. The alternative is to use social media marketing tools such as Facebook advertising, You-Tube game trailer videos, Twitter feeds or Instagram posts to promote your game and hope that the viral nature of the game leads to downloads and new users. These methods of promoting the game come under the banner of marketing and the audience is once again global for these ventures.

Given the challenges faced by Australian game developers in the marketing space, we are proposing some changes to the EMDG program that will assist in ensuring that small and medium sized companies can be competitive on the global stage.

Recommendations

- Extend the EMDG program from 8 grants per company to 12 per company
- Increase the expense threshold for the EMDG program from \$300,000 AUD to \$500,000 AUD
- Allow digital marketing efforts and user acquisition costs to be included in the criteria for marketing expenses as long as the marketing efforts can be attributed to a global audience (excluding Australia and New Zealand)

¹ <http://techcrunch.com/2014/06/02/itunes-app-store-now-has-1-2-million-apps-has-seen-75-billion-downloads-to-date/>

² <http://mobiledevmemo.com/why-mobile-marketing-costs-rising/>

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(b) Production Tax Offset

The Australian games industry does not currently have any kind of tax credit or offset in respect of the development of games in Australia. If you compare the incentives available to new and existing game development companies in Canada and UK, Australia is a long way behind in offering any incentives to game development companies. We have a production offset in Australia that is geared towards benefiting film and TV production companies whereby they are able to apply for production related rebates/offsets. The offset is administered by Screen Australia and 40% of Australian production expenditure is eligible for this offset. We believe that whilst games developed for consoles or smartphones/tablets may not be “big screen” production, it does offer great value entertainment and the amount of time spent on smartphones/tablets will soon surpass the amount people spend watching TV/film.³

The production time taken for the development of video games is significant, be it console games or games for the smartphone/tablet. Given the level of competition in the marketplace for great games, it is important for games studios to deliver high quality, polished and fun games that resonate with the consumer. For this to be achievable, games studios need to spend significant production time to enhance the quality of the game to ensure that the game stands out in a myriad of apps that are released on a daily basis on the store fronts. Production time in this instance involves proto-typing for ideas, programming, designing the game and creating digital art and animation assets for the game. This is as involved as the production of a film/TV series therefore we don't see any reason why the two genres should be treated differently.

Canada offers very generous incentives for the production of video games⁴. They offer rebates on labour of up to 50% for new and existing companies that are based in Canada and employ local talent. This is one of the main reasons why the major players in the video gaming industry are based in Canada. UK has taken similar steps to encourage existing and new game developers to base their operations in UK and contribute to the economy by offering production rebates of up to 20%⁵. For Australia to be competitive in the video game development space, we need to be able to match, or at least start offering, incentives that will make our country a more viable proposition in terms of being a pipeline for new and sustainable business ventures and labour supply for this, and related, industries.

Recommendations

- Open up the Screen Australia Producer Offset to the video games industry to give a tax offset for production costs of up to 40% for labour
- Alternatively, implement a Production Offset incentive for video games companies like the UK and Canada have done to encourage investment in Australia which leads to the creation of more jobs
- Offer start-up tax incentives for new companies looking to establish their business in Australia provided they can employ Australian residents – this can be in the form a reduction in corporate tax rate for a prescribed number of years
- Offer continuing tax incentives for existing companies that employ Australian residents (at least 80% plus) – this could also come in the form of a corporate tax break for a prescribed number of years

³ <http://www.bbc.com/news/technology-32067158>.

⁴ <http://www.pwc.com/ca/en/industries/entertainment-media/publications/film-video-tax-incentives-canada.html>,

⁵ <http://www.wsj.com/articles/britain-bets-tax-breaks-will-lure-game-developers-1427746924>

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(c) ESOP Tax Relief

We are pleased to see the new rules for employee share schemes that came into effect in July 2015. This is mainly geared towards start-up tech companies. Whilst this is a great incentive for new companies in ensuring that they can attract quality talent and offer them attractive compensation in terms of shares and options in the start-up companies, there seems to be nothing in the new rules to assist existing companies that have been part of the industry for a number of years. For example, Halfbrick Studios Pty Ltd is 15 years old in January 2016 and it is only recently at the stage we are actively considering an ESOP scheme. But the benefits of the new scheme can not be accessed by us due to the time limitation set out the scheme. An arbitrary timeframe is unhelpful: consideration needs to be given to existing companies that have not been able to extend employee share schemes to their staff pool due to the complex nature of the set-up of such arrangements as well as the legal and tax costs involved.⁶

Recommendations

- Remove arbitrary time restrictions on the scheme and replace with thresholds that more accurately access the qualification of the company as a true 'start-up'.

(d) GST on digital goods

The legislation coming into place in July 2017 where all digital goods will have GST imposed on them could be detrimental to the sales of video games in Australia as we envisage that all video games will be available on a digital download platform. As it is currently, the cost of digital game apps in Australia is high given the current exchange rate with the US dollar. Most prices on the both the iOS and Google Play App stores are based off the US dollar therefore making the prices quite steep for consumers. The games on these app stores are created in Australia and then put on platforms that are run out of the US or UK. By imposing GST on the base price of these items, it inflates the price of these digital items even more making the sale an unattractive proposition.

Recommendations

- Exclude GST from game apps that are developed digitally. This makes the pricing more attractive for Australian consumers.

⁶ http://www.brw.com.au/p/business/mid-market/new_rules_for_employee_share_schemes_zg1dl5KhjcFJs53wdA7FPQ.

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SECTION 3: Building Talent

(a) Immigration

Over the years, we have experienced a number of difficulties in the immigration process. With that, due to the closure of many games studios, we have noticed a significant reduction of local talent. Talent that existed has either been absorbed by the remaining companies, relocated overseas or abandoned the games industry. This significantly hinders our access to new industry knowledge vital to strategies and growth.

A byproduct of this has been the need for Halfbrick to access the knowledge of established and successful companies in the northern hemisphere to continue to develop our organization as an industry leader, while the marketplace continues to change. Unfortunately, the games industry has not been recognized as a career path in regards to visas and we are often involved in dragged out processes as we are trying to tailor our submissions to the existing guidelines that are rigid and out of alignment of the roles we hire for.

Recommendations

- Improve the immigration process for foreign workers highly skilled in the games industry

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(b) Innovation precinct in Brisbane

In an era of global competition, proximity can still provide industries with significant competitive benefits, such as increased industry productivity, better access to skilled employees and public infrastructure, potential benchmarking, improved networking, and overall market knowledge. In addition, the pressure of operating in close proximity to 'competitors' creates constant pressure to innovate and differentiate. Regions that have successfully implemented a digital game growth model have often done so around a major urban cluster, allowing these regions to concentrate their efforts and investments in a contained area.

In Melbourne, The Arcade, a collaborative workspace created for digital game creators, has demonstrated the value of clustering like-minded, creative and talented people. The facility encourages interaction and knowledge sharing, and the success of the initiative is evident in the large number of products that have been released to the global market from resident businesses, and the amount of new intellectual properties conceived and developed in the space. At the time of writing, 25 companies comprising 85 individuals are established in The Arcade, and 32 games have shipped from the facility in its two-years of operation.

Additionally, The Arcade has become a centralised space for visiting companies, including Kickstarter, Facebook, Google and Apple, as a means of reaching a large number of content creators in one location. These same companies share strategies, ideas and extend support with the local sector – invaluable relationships. The Arcade also hosts regular skills development workshops with invitations extended to games practitioners and creative outside of the games sector.

The development of innovation clusters is a strategy that has been used with success in many of the Scandinavian countries, including Finland, which boasts seven regional games clusters, many funded by support through the European Union. Hubs are currently in in Turku, Tampere, Oulu, Kajaani, Joensuu, Kotka and Kouvola and there are also plans to set up clusters in Jyväskylä and Rovaniemi.

Additionally, digital game development clusters need not be located in major cities nor restricted solely to interactive games development. Appropriate regional areas can be provided with a potential economic boost, attracting local employment (particularly youth employment) and innovation through technology-based clusters.

Recommendation

- Co-operate with State and local government to create a digital/games innovation precinct in Brisbane

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SECTION 4: LIFTING BARRIERS TO TRADE

(a) China cultural / internet restrictions

The Chinese video game industry has a revenue of approximately \$10.12B USD and this revenue is predicted to grow to \$11.38B by 2017⁷. Consequently, the Chinese market represents an enormous potential export market for Australian games developers. The Chinese market has shown strong interest in foreign developed games and there are multiple examples of foreign developers finding success in the lucrative market, our game *Fruit Ninja* included.

Halfbrick is a leader in the Australian games industry, for doing business in China. We have experienced enormous success in-market with our flag ship game *Fruit Ninja* and we continue to enjoy success for this and related titles in China. It is this success that has given us the opportunity to experience the barriers to market first hand, and the significantly detrimental effect on our revenue and brand management in the region.

A key issue for us in China, and for other Australian developers by extension, is a ban on the direct publication of a game in China by a foreign developer. In our knowledge, China is the only country where there is a direct prohibition on foreign games developers in the market. This law forces foreign publishers to grant an exclusive license for their game to a local Chinese company, before access to the market will be granted⁸. This is in addition to cultural approvals required. There are a number of consequences for this requirement, including a significant loss of revenues to the Chinese licensee, and a potential loss of control over intellectual property in China (via the exclusive license requirements).

The potential loss of control over intellectual property, is even more pertinent in the context of the significant piracy and digital theft problem in China. At the time of writing Halfbrick is pursuing more than 30 individual cases of significant piracy or intellectual property theft in China, with the collective impact of these actions being more than 10 million unauthorised downloads of our games in China alone⁹.

The Chinese government has recently showed an appetite to relax some of the controls over foreign game developers, after permitted foreign game consoles access to the market.¹⁰

Recommendations

- The Australian government should open discussions with the Chinese Government to relax the restrictions on Australian game developers in China, and in particular to remove the requirement for foreign game developers to exclusively license their games to a Chinese partner, before they can be published

⁷ <http://www.statista.com/statistics/260178/video-game-revenue-in-china/>

⁸ <http://www.chinalawinsight.com/2010/09/articles/intellectual-property/issues-foreign-video-game-developers-face-in-introducing-online-games-to-the-chinese-market/>

⁹ This information is based on the data we receive from our supplier IP Lasso based on the storefront information collected for each infringement incident. These numbers have not been independently verified.

¹⁰ <http://www.chinabusinessreview.com/china-welcomes-foreign-video-game-makers/>

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(b) Bringing Australia in line with global best practice for Privacy

The nature of a successful game in the current connected environment, is that such success brings significant access to consumer data and the consequent responsibility for privacy protection and data management. Halfbrick enjoys significant global popularity for its games, with over 60M monthly users of our games, on average. As a consequence, we have significant legal obligations in relation to the handling of that data and information under the Australian *Privacy Act 1998* (Cth) but also under the equivalent legislations in all territories in which are users are located. Given the actual reach of our brands, this is essentially every country in the world.

At present, whilst complimentary, the Australian privacy regime is not in parity with the privacy regimes of key leading markets of USA, Europe and UK. Further, there is significant work underway in USA, Europe and UK to draw into better alignment on privacy issues, and agree safe harbour provisions for the treatment of privacy and the handling of information exchange between these jurisdictions. Australia is notably absent from these discussions.

Information and data represent some of the most exciting and innovative opportunities for businesses of the future, including the games industry. To ensure that Australian companies are best placed to take advantage of these opportunities, the Australian government needs to stop proscribing laws on the basis that data ends at our borders, and enter into the bigger and more potential conversation around global privacy approaches.

- Australian government to review *Privacy Act (1988)* Cth in light of current policy movements in USA, Europe and UK with a view to alignment with these key territories, and thereby future proofing Australian businesses, using global best practice to protect data citizens, and to best leverage opportunities within the data innovation space
- Australian government move away from compulsory data notification, as this is a Band-Aid solution with little demonstrated consumer benefit, yet significant regulatory burden on companies

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(c) Improved in-market support for exporters

The Australian Government, through Austrade, has a significant and influential network for in-market information and support. Austrade should focus better on how it can provide in-market support and assistance to digital exporters, including games developers.

Whilst we have enjoyed strong support and enthusiasm from Austrade offices, the impact of their support on our business has been of little to no co-incidence. This is not to diminish the value we place on this support, and the gratitude we feel. However we do believe there is room for Austrade to improve its knowledge, understanding and networks within the global digital industry, and then helping facilitate exports by Australian game developers.

Recommendations

- Austrade to invest in upskilling key officers to improve knowledge of global opportunities within the digital economy, and the games industry by extension.
- Improve access for the games industry to Australian overseas trade missions and government trade delegations