3-point turnaround

This article was originally printed in Develop, a magazine for games developers and publishers, in September 2002. It deals with the common problems faced by software developers, and strategies for survival and growth.
The games industry has moved through a console cycle in the five years since then, and much of the advice in this article has now become adopted best practice.

Three point turnaround for games companies - Harry Holmwood, Heldhand It’s never been a better time to work in the games industry. Just look at the stockmarket – Game Group, Electronic Arts, THQ, Activision – all riding high. Big titles are selling multimillions of units, we have three great new consoles on the market and, with so many games ‘millionaires’ in the newspapers’ Rich Lists, this games thing must be a license to print money. So why do I get called every week by a developer about to go bump? The conversations usually go like this..
“Do you have access to finance?”
“Er…possibly, for the right company, with the right team, the right history and the right strategy.”
“Great. How quickly can you get hold of £300,000? We need it by next week or we’re screwed.”
Wrong question. Wrong company. Wrong time. The truth is, a lot of development companies have gone bust recently. Many more will go bust in the next year or two. If you ask them why, you’ll often hear “because we were screwed over by our publishers” or “because our next title hasn’t signed” or “because this industry is just so unprofessional”. No. Companies go bust for one reason – cashflow. If you spend more money than you earn, eventually you will go bust. It’s that simple. OK, so cashflow is all-important. Why are developers finding it such a problem? The main things that have changed in the games business in the last ten years are the cost and timescales involved with development. Whereas, a few years ago, a game would cost a few tens of thousands of pounds, and take perhaps six months to develop, we’re now seeing projects costing millions and needing tens or even hundreds of man years to launch. The market has grown, but not at anywhere near the same rate. It used to be the case that money was made on ‘B’ titles, that, in nearly all cases, enough units of a game would be sold to cover development and marketing costs, and make a tidy profit for the developer and publisher. Back then, the market was ‘publisher-heavy’ – for a given game, more money was spent on marketing, manufacture, distribution and sales than on development. The result of bigger, more expensive games is publishers needing to reduce their risk. The traditional business model of the developer having an idea, getting development funded by a publisher, maintaining ownership of intellectual property and then receiving royalties when the game sells is well and truly over. More often than not, publishers are only signing up products at a playable demo, or even code complete stage. In nearly all cases now, publishers insist on owning the IP, or using a third-party license to boost sales. This is great for the publishers – their superior sales, distribution and marketing muscle still, for now, something that developers can’t compete with. But, for the developer, this leads to increased spending up-front to get the game signed, meaning cashflow and resource problems. 1. Improve Productivity
Developers generally seem to have either too many or too few people at any given time. A typical small developer might have 25 staff – all working on a product, signed to a publisher. Often, there aren’t enough people to create the new concepts, technology and demos to get a new product signed before the previous one finishes. The result is a cashflow drain once the game is complete and the publisher funding runs out. A cash-rich developer may be able to plug the funding gap – this time – but it’s easy to haemorrhage money this way. Within a very short space of time, the developer runs out of cash and faces redundancies, or even closure. Frustratingly, once a new project is signed, the developer will often have to go through the lengthy process of hiring new staff. A better approach to the labour market would recognise this problem, using a more flexible team structure, allowing smaller core teams to expand, when needed, with the use of freelancers, outsourcing companies and other talent. Since, when a developer lays staff off, they are quickly picked up by other companies (with one recruitment agency or other generally taking their pound of flesh again), clearly there is a constant demand for development talent. Put your egos to one side for a minute, and face the facts – it costs more to employ someone in the US than it does in the UK. It costs more to be in the UK than in Italy. Italy’s more expensive than Estonia and Estonia’s positively exorbitant compared to China. Cars, trainers, toys, hi-fis, even the Xbox is made in cheaper territories by people earning and spending less than we do. All the big IT companies have bases in India, with talented and highly qualified programmers costing a fraction of the UK cost. Is games really that different? Well, in some ways, it is. Games must entertain as well as meet technical criteria. The UK leads the world in creative development. It’s a hotbed of great technology, with many developers boasting fantastic engines and R&D teams. The future lies in harnessing this talent, and aligning it with more cost effective resources elsewhere. By having a core team of highly skilled technical, management and creative people in the UK, with access to equally talented but lower cost resources for programming, artwork, motion capture, sound and level creation, UK teams can lead the way in truly global games development. By having ‘on-demand’ access to a larger development pool, developers can punch above their weight and beat the big boys in terms of product quality, delivery time and cost. Consider using your ‘spare’ staff to take on outsourced work from other developers – far better to retain key staff and improve profitability, than make redundancies and have to start all over again. If you’re one of the unlucky ones who’s recently been made redundant, consider going freelance – the increasing need for labour flexibility means that the best people will always be in demand – and can charge a premium for their services. Maybe even band together with a couple of like-minded colleagues to offer your services on a contract basis to other developers or publishers.

2. Balance the Risk/Reward Ratio

One of the most nonsensical attitudes to have prevailed in the industry recently is that of break-even development. Publishers often claim that they don’t like to see developers profiting on advances, preferring them to share in the ‘upside’ when the game sells well. This may have worked when a game cost £20,000 to make, but it’s no longer applicable. If a deal’s not going to make you any money, you shouldn’t do it. Life (especially that of a games console and any technology you may develop for it) is too short to be doing loss leader development deals – you must look at every project as a profit-making exercise in its own right. You could improve your profitability by rebalancing the risk/reward ratio for a product. Say a developer spends £500,000 of its own money on technology and work-in-progress on a game, before signing to a publisher. The publisher then pays out £1,000,000 in advances to complete the game, and will spend £500,000 on marketing the product. Thus, excluding the publisher’s own overhead cost, the total amount spent on the game will be around £2 million, of which 75% is incurred by the publisher and 25% by the developer. It seems reasonable that the developer, having taken 25% of the risk, should then take 25% of the reward. Under a traditional royalty advance publishing agreement, a 25% royalty would be recouped against advances. So, if a publisher’s net receipts on a game are £12.00 per unit, the developer’s slice of this would be £3.00 per unit. So, for a £1 million development advance, the game would have to sell 333,333 units before the developer receives any royalties. Since the developer has already spent £500,000, a total of 500,000 units must be sold before the developer breaks even (500,000*3 = £1.5 million). 500,000 units is quite a lot – very few games actually achieve this. On 500,000 units, the publisher has made 500,000*12-1.5million costs = £4.5 million! In fact, the publisher breaks even after just 125,000 units. Clearly the developer needs a more attractive business model – if it can lose money on a hit product which nets the publisher millions, something is wrong. The same game, under a balanced risk/reward deal, shows the publisher and developer, in partnership, treating the money spent on development as a development fee, rather than advance. Thus, from day one of sales, the developer gets 25% of the spoils. On 500,000 sales, the developer receives (25%*500,000*12)-500,000 costs = £1million. The publisher makes (75%*500,000*12)-1.5m = £3million. In terms of break-even point, both parties break even simultaneously, on 166,666 units – a relatively small change for the publisher, but a huge one for the developer, and one which makes the difference between making the business of development a fruitful one or a waste of everyone’s time. The above example is rather crude – in reality, issues such as licenses, publisher overheads and ownership of intellectual property will alter the actual percentages that are realistic in each case. For example, if a developer has created an intellectual property, but the publisher is to be assigned it (and hence benefit from sequels etc), perhaps the developer’s slice should be higher. On the other hand, if the publisher has spent a great deal of money on localisations, voice talent and testing the developer’s percentage should be correspondingly lower. What really matters is the principle of structuring a development agreement so that it makes sense from both sides.

Attract Funding by Having a Great Business

Businesses exist to make profit – that’s all. The main reason UK development has been suffering of late is the lack of professionalism and business skills in development companies. Too many companies think that they can develop original titles without publisher interference that, if only they had the funding to get a game done on their own, would have a guaranteed hit. The trouble is, this almost never works. The industry is littered with unsigned masterpieces with hundreds of thousands, or even millions of pounds of development spend on them. Remember, you are NOT your customer. Your publisher is the customer. They are the people who will give you money – your job is to make them give you as much as possible, and you do that by giving them what they want. Yes, to pre-empt next month’s letters page, there would have been no Sim City, no Populous, no Civilisation, no Lemmings were it not for the pioneering spirits of a few talented people who kept going even when the world was against them. And if you just happen to be the one in a billion people who’s as talented and as lucky as those free spirits, then you’re laughing. For the rest of us, and certainly those wanting to grow their business by attracting inward investment, a slightly more cautious approach is needed. What’s happening is that some of the more astute developers are raising finance themselves, giving themselves the flexibility to create those playable demos, build up next-gen teams, even acquire their own licenses, in order to get better deals from publishers in the future. However, it’s a buyers’ market out there. The sad truth is there are too many developers, making too many games for the market to support. A lot of developers have raised funds – in some cases many millions of pounds, to spend on new technology, prototypes or even complete games only to find that these products are then either not picked up by publishers, or are done so on terms which don’t take into account the huge investment made by the developer.Try to get publishers on board before you spend too much on a prototype. There are always some publishers with cash to spend – on the right team. Spend your money in the right areas –use middleware where possible to lower your risk and your development time. It worked for GTA3 – so now there’s no excuse. If you just can’t get a publisher interested in a title then maybe, just maybe, it’s not very good. If it’s your pet project that can be very difficult but if you can’t persuade a publisher at an early stage, the chances are you won’t be able to later on either. Be very cautious about developing ‘free’ demos for publishers, based around their own IP. A lot of the time, you’ll be asked to do a little more, then a little more, all at your own expense, and told that “the publishing committee meets next month and wants to see a demo based around this license.” If someone wants you to pitch a game based around their concept then fine, but make sure you’re getting paid and that nobody else is in the running. If not, you’ll be lumbered with a game demo you can’t sell on to anyone else, and a hefty cashflow problem. Understand why someone would want to invest in your business – to make money. They will make money when they sell their shares in your company. This is either when someone buys you out, or maybe when you float the business. To float the business with a good valuation, you’ll need to show a track record of profitable trading, and profits going forward. If you’re looking to attract a buyer for the business, consider who this might be – a publisher, telco or media giant perhaps – and also why they would want to buy you. In the past, developers have usually been acquired on the basis of the intellectual properties they own – if this is what you plan, make sure you retain intellectual property in your work, possibly even at the expense of short-term royalty income. Take advice

The bottom line is that making games is very difficult. Making great games is harder still and making great games that launch on time is exceptionally challenging. Combining all these with running a successful business and you’re really pushing it. Make sure you have good advisors – legal, financial and strategic – to help you build the business you want, in the way you want, on a strong financial basis and with the right growth strategy.   This is still a young industry – no matter what people may claim, there are still many opportunities for new and existing developers to claim their places in the Rich Lists of tomorrow – just keep your eyes open, keep your cashflow healthy, make sure you’re taking the best, informed and independent advice and run your company as a business, not an extension of your teenage hobby.