igda international game developers association

IGDA Business Committee
- Best Practices in Finance -

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www.igda.org/biz

The IGDA Business Committee

The IGDA Business Committee's mandate is to empower the development community with business knowledge and in the process allow developers to make better games.

The goals of the Business Committee are as follows:

- Enable developers to build stronger, more successful companies
- Provide knowledge and business support resources
- Increase the perception of game development as a credible business and raise the profile of game developers as viable companies
- Improve the publisher/developer relationship
- Improve the retailer/developer relationship

Additional information on the IGDA and the IGDA Business Committee can be found at

http://www.igda.org/biz/

http://www.igda.org/committees/business.php

http://www.igda.org/committees/business_members.php

The Best Practices Roundtables & Reports

The Best Practices Roundtables & Reports are one of the 2003 initiatives of the Business Committee of the IGDA. The end goal of these roundtables is to prepare a summary report on each topic for distribution to the game development community via the IGDA web site. In sharing this best-practice knowledge, we hope that developers will thereby be able to improve their human resources, schedule their projects more efficiently, work with their publishers to optimally market and promote their games, improve quality assurance testing on their games, and bring greater financial stability to their companies. The five topics covered in 2003 were:

- Best Practices in Human Resources
- Best Practices in Resource Management/Scheduling
- Best Practices in Promotion/Marketing
- Best Practices in QA/Testing
- Best Practices in Finance

Additional information on the Best Practices Roundtables can be found at:

http://www.igda.org/biz/best_practices.php

Overview

This roundtable on best practices in finance was held in two separate sessions at GDC 2003 (March 6, 2003 and March 8, 2003). The roundtables focused on issues developers face in running the financial side of their game development studio.

The main focus of discussion was on the importance of cash flow and methods that a development studio could use to prevent cash flow problems.

The best practices that were discussed are each organized around the following format:
- "Name" of the best practice
- Description of the best practice
- Pros
- Cons
- Other successful alternatives or variations

Best Practices

Take steps at the contract phase to ensure timely payments

Description: Take the time in the contract negotiation phase to ensure that you will be paid in a timely manner by the publisher.
- Create milestones and a contract that clearly defines that work will stop if payment is not received. Be willing and able to back that up. Ensure that you create a structure that gives you some leverage with the publisher.
- Know who you are doing business with by checking references with contacts at publishers and other developers and pulling a financial report on publisher to see what their track record is of paying on time.
- Have a termination fee in the contract.
- Milestones currently worked on need to be paid
- Have arbitration clause in the contract to defer cost of legal battle and then get lawyer to take it on contingency

Pros:
- Gives developer leverage with publisher
- Creates a cost to publisher (game is late) of not paying on time
- Creates right expectation with publisher about importance of being paid on time and willingness of developer to walk away if it is not being paid.
- Don't get into projects that can end up costing money instead of making money

Cons:

- Difficult to get publisher to agree in contract
- Potential of creating an adversarial environment in the beginning of a new relationship
- What do you do with your team (and how will you pay them), if you threaten to stop work?
- Cost of litigation if necessary to enforce contract

Other successful alternatives of variations:

- Build up 3 –6 months of cash reserves that allow you to weather work stoppages and late milestone payments
- Have a credit line that you can tap for shortfalls.
- Use factoring on receivables. "Factoring" is credit mechanism, whereby a third-party company release "locked up" funds, as cash is advanced against your outstanding invoices. Cash is advanced against your existing invoices, so that you could receive a substantial portion of the invoice before it is fully paid off.
- Last milestone is not at completion but close to it so the publisher is anxious to get final product
- Split the advance payments into milestone and "run-rate" portions: Take a percentage of the total amount and put it into a monthly payment and make it outside of milestones.

Create alternate revenue streams to cover time between projects

Description: Since developers are constantly struggling with what to do with their team in the time between projects, it is important to look for ways to bridge the inevitable gaps with will occur. Some ways of doing this include:

- Build an additional 10% into the project cost to cover the gap time.
- Run multiple staggered projects.
- Diversify studio work so as to have revenue coming from things other than work for hire development work.
- Pursue lower cost games like mobile.
- Attempt to license technology that studio has created.

Pros:

- Don't become overly reliant on any one project or any one game
- Lessens risk by diversifying work
- Ways to develop more junior members of the team
- Build portfolio of work; build the studio

Cons:

- Takes away focus on getting game work
- Less synergy with staff's other work
- Decrease in employee morale if work is not what is expected or desired

Other successful alternatives of variations:

- Negotiate with publisher to have work and money during in between phases
- Have multiple title deal with publisher
- Find angels to invest in projects – offer investment in the company in exchange for funding; have a pre-set rate at which you can buy the stock back.
- Look at funding from game "investment" funds
- Pursue government money
- Secure bridge financing from outside investment companies

Evaluate different corporate structures as to their implications for the financial condition of your company

Description: When deciding which corporate structure you are going to use, consider the financial implications it will have on your company. Consider:

- Double taxation
- Stock for employees
- Ability to bring in outside investors
- Voting vs. non-voting stock
- Maximum number of investors

Pros:

- If you understand all the options there is less chance of having to undo an incorrect decision
- Needs of company may change as company grows – understanding the roadmap in advance will be helpful in strategic planning

Cons:

- Expensive to get extensive legal and financial advice
- Situation may change
- Difficult to decide on specific structure if you are not sure where company will go in the future and if structure will need to change or not

Other successful alternatives of variations:
Go with cheapest and easiest structure until needs dictate a change.

Outsource non core work

Description: To keep monthly burn and head count down, outsource work to contractors.

Pros:

- Allows company to focus on what they are best at ('core competencies')
- Generates potential cost savings

- Works most optimally for art
- Creates ability to quick reduce head count and cash burn rate
- Build core team of highly qualified people
- Hire anyone in the world and take advantage of lower wage rates in different territories
- Not forced to hire people that do not meet quality standards
- New tools like Webex make it relatively easy to manage remote vendors
- Need chief of architecture on-site

Cons:
- If they move on, they take their knowledge base with them
- Does not work as well for programming or design
- More difficult to manage
- Difficult to protect IP
- Inconsistent quality of work

Other successful alternatives or variations:
- Hire employees as contractors rather than full-time employees
- Have probationary periods with employees before they become full time

Diversification through multiple projects with multiple publishers

Description: Have different sources of revenue

Pros:
- Balance out cash flow
- Create deeper relationship with publisher
- Publisher has greater interest in overall financial health of the developer

Cons:
- Company is still not fully diversified if all work is in game business
- Difficulty of managing multiple teams
- Monthly cash burn of studio goes up as new teams are added

Other successful alternatives or variations:
- Pursue revenue opportunities outside of the game business

Keep residual rights to generate additional cash streams.

Description: When negotiating contract with publisher try to keep rights that will allow you to create additional revenue after the game is mastered. These rights can include:
- Keep the rights to countries that the publisher does not distribute in
- Exclude vertical channels (for example golf shops for a golf game) that a publisher does not have access to

- Online rights

Pros:
- Get revenue based on the work you have done
- “Win-win” situation as it does not cannibalize the publisher’s income

Cons:
- May require additional work or staff to handle

Other successful alternatives or variations:
- Build in options into the contract that allow the publisher to buy additional rights from developer or vice versa

Build profit into your royalties

Description: Make money on the development budget and don’t count on backend for profit.

Pros:
- Takes into account the lack of developer profits typical of most games
- Gives you profits you need to weather through missed milestone payments and time between projects

Cons:
- Publishers don’t want pay for profit margins
- Makes your studio too expensive
- Decreases profitability (via decreased royalty rates to balance out increased advances) in case the game is successful

Other successful alternatives of variations:
See other best practice on multiple projects.

Plan for worse case scenario in cash flowing planning

Description: Look at the estimated case (per the contract) and then assume the worst case on when they will pay

Pros:
- Increase the likelihood of your studio surviving in the case things do not go as planned
- Projections are often too optimistic

Cons:
- May result in less than best use of your cash

Other successful alternatives or variations:

- Build up cash 3-6 months of cash reserves

Other topics to be covered at future IGDA roundtables

- Publisher financial models
- Make contract on reserves mirror SEC filings

List of Participants

(Note: more people attended the sessions than are listed below, but not all filled out the sign-in sheet)

Name	Title	Company
Daryl Pitts	President	NGRAIN
Mark Noseworthy	Student	Aspen School of Business
Andy Kriaz	Director of Business Development	Its Games
Todd Hollenshead	CEO	Id Software
Bonnie Burman	CFO	Belly Fire Games
Marek Tyminski	CEO	City Interactive
Florian Dhesse	Game Designer	Independent
Daniel D. Christensen	Director of Business Development	VU Games
Gregory Larson	CEO	CITL
Hank Howie	President	Blue Fang Games
Conor Pattersen	Managing Director	Protean Vision Quest
Gur Genshemsh	Director	Crystal Productions
Cindy Ball	CEO	Fringe City Electric
Alber Lael	Co-Founder	F8

About the IGDA

The International Game Developers Association is the independent, non-profit association established by game developers to foster the creation of a worldwide game development community. The IGDA's mission is to build a community of game developers that leverages the expertise of our members for the betterment of the industry and the development of the art form.

Visit www.igda.org for more information.