WLA Discussion Paper

Social gaming and lotteries

World Lottery Association

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Foreword

The WLA aims to provide its membership with information and data on contemporary issues that is both useful and relevant to the global lottery industry. In so doing we look to complement and augment services that are already provided by the regional associations with services that are pertinent to the international lottery community as a whole.

The WLA Executive Committee has therefore directed the WLA, in alignment with its forward-looking strategy, to engage with professionals from within and outside the lottery and sports betting industries on the production of three discussion papers. The topics of these papers are "Online gaming for lotteries", "Social gaming and lotteries", and "Sports integrity and lotteries".

These discussion papers will be further refined and finalized as WLA position papers. Our ultimate goal is to establish new industry standards and best practices on each of the topics covered.

This particular paper, "Social gaming and lotteries", offers a precise and comprehensive definition of social gaming. It delineates the global market for social gaming and outlines existing monetization models. The paper provides insight into how social gaming is currently viewed from a regulatory perspective and which regulatory developments may be seen in the future. Finally, it advises lotteries on what to consider before implementing a social gaming strategy.

As WLA members you are on the frontline of day-to-day business, in which theory becomes practice. We respect you as the "true" experts in our industry, and would like to en–courage your active participation on the further evolution of these discussion papers. Should you wish to share your thoughts with us on the development of this document, we would like to hear from you. Please send your comments by e-mail to WLA Communications Coordinator Paul Peinado at pp@world-lotteries.org.

We look forward to hearing from you.

Jean-Luc Moner-Banet   *Jean Jorgensen*
WLA President   WLA Executive Director

Executive summary

Played on an established social media platform, such as Facebook, a social game has freemium access that allows players to play the basic game for free but charges a premium for enhancements. It also uses symbolic rewards and encourages interaction between the players about the game outside of the game. This social interaction is used by the game operators for promotion, retention and enhancement of the overall game experience. Currently, there are three monetization models for freemium social games. One is the advertising model, which has been limited until now but is starting to have some traction. Another is subscription, which is not currently a major source of revenues. The third is virtual goods, which are essentially gameplay advantages or customized enhancements for the game for a fee. Today, the virtual goods model is the largest generator of revenues for the social games industry.

- It is estimated only around 3–5% of regular social gamers worldwide pay for in-game virtual goods, with 56% of these making a second purchase and 25% making three or more. Women represent the majority of those who purchase virtual goods. Among the highest spenders, women also vastly outnumber men.

The social gaming industry has grown rapidly and exponentially alongside the social media boom. Currently at 61%, the number of social network users who play social games continues to rise. In fact, by 2019, the global social game market size is expected to reach US$17.4 billion.

In many ways, lotteries are well positioned to take advantage of the opportunities offered by entering social gaming.

- Social gambling-type games are already a significant part of the social gaming industry with around 50-million monthly users and generating 12% of social gaming revenues.

- The gaming motives of social gamers are consistent with those of lottery players, with fun and excitement (57%), competitive spirit (43%) and stress relief (42%) named as the top three reasons people play social games.

- Both sectors have similar target segments. Just as with lotteries, the age groups between 30 and 59 are over-represented in social gaming compared to the total global population. Among scratch players, 75% play social games on the computer, 65% play Smartphone games and 52% play tablet games.

- As of 2013, women represented the majority of the social gaming population, holding a share of around 54%. This demand for games by women is driven by the widespread use of smartphones and the ability to play at small intervals several times a day.

Social games would offer lotteries the ability to tap into new market segments, in particular the attractive community of players aged 18–30, women and new emerging markets. It would also help them strengthen their relationship with their traditional customer segment by providing a longer and richer game experience.

The opportunity is not without its challenges, however:

- Already highly competitive, the social game industry is likely to become even more fiercely competitive as it attracts new players, including possibly major ones from other sectors also trying to enter.

- With the advent of Connected TV, this could include such contenders as Amazon, Google and Apple.

- As well, the technological expertise to both create new social games and develop and maintain the technological ecosystem they require are currently out of the realm of lotteries' in-house resources, although the industry has options, including licencing games.

Regardless of whether lotteries decide to enter or not, the reality is the lottery and social gaming sectors are increasingly converging and there are strong signs that players in the social gaming sector are already considering entering the world of lotteries.

Should lotteries decide to enter into the social gaming sphere, there are key issues they will need to consider:

- We foresee many advantages in social gaming for lotteries, including a window to new customers, generating a more personal and stronger relationship with existing and new customers and providing a high-quality experience that satisfies the needs of lottery players.

- Lotteries could leverage their existing brands and presence and exploit synergies as well as economies of scale for a lower-cost online platform than currently available to operators that are exclusively in social games.

- The key skills to succeed in the field involve the development of creative and ever-evolving games, a competence lotteries do not possess.

- The cornerstone of success is the ability to develop customer intimacy and centricity. Will lotteries be able to attract and retain talent with the analytical skills required to achieve this?

- From a technology viewpoint, operators face a number of key challenges, including managing the technology ecosystem as the environment becomes more complex.

- Expect regulators to step up. It is only a matter of time until some jurisdictions start regulating the industry as the differences between social gaming and lotteries continue to fade. Lotteries need to establish regulation intelligence if entering this field.

- Lotteries will need to carefully craft an entry strategy, whether it is developing social games in-house, investing in talent teams or licensing games.

- Social games represent an attractive shift of paradigm for lotteries, offering far more hours of enjoyment and engagement than the lottery ticket experience.

- Who's looking at lotteries? Social games Zynga has shown an appetite for entering the lotteries sector. Others can be expected to follow as well.

Part 1

Social gaming: a new concept to leverage the power of social networks that shares similarities with lotteries' current products

1.1   A very specific definition of social games

A social game is a game with very specific characteristics. It has freemium access, which offers the basic game for free and charges a premium for in-game products or enhancements, uses symbolic rewards and is played on an established social media network account such as Facebook that facilitates and encourages communication between the players. It uses this social interaction for promotion, retention and gameplay changes as well as to enhance the overall game experience.

1.2   The convergence of the gaming industry

We are observing an increasing convergence of the gaming industry on many different levels:

• The offerings of lotteries are getting closer to those of casinos while casinos are increasingly offering games that resemble those typically offered by lotteries: some lotteries offer typically casino games such as roulette, Black Jack and Poker online while casinos offer bingo and keno games – which are also offered by casinos. This shift is evolving slowly but is expected to continue.

• Typical lottery players are overwhelmingly adopting social games as well: among scratch players, 75% play social games on the computer, 65% play Smartphone games and 52% play tablet games[1].

• There is little difference between traditional video game players and social gamers. In the US, for example, the vast majority of video gamers (between 50% and 88%, depending on the source) are also social gamers[2], regardless of platform *(figure 1)*.
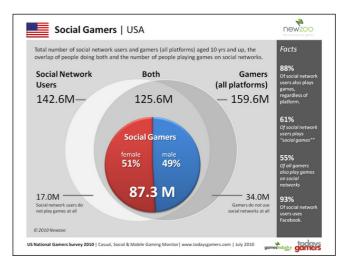
Figure 1 – social gamers

• Recent events point to an increase in the number of lotteries entering the social games field. For example, in 2012, UK-based TWLV Gaming Ltd. introduced its new social network lottery game, TWLV, that combines various elements of social games such as the social interaction, a high level of interaction. Fifty percent of the lottery's proceeds go to the World Wildlife Fund.

• In many ways, social games are similar to lottery games as both are easy to learn, even for new players and are more likely to attract the average consumer who is hesitant about engaging in "real" gambling.

• Social gambling games are already a significant part of the social gaming industry with around 50-million monthly users and 12% of social gaming revenues generated by gambling-type games[3].

1.3   Social gamers and lottery gamers share similar needs and desires

The needs and desires of social gamers are consistent with those of lottery players, with fun and excitement (57%), competitive spirit (43%) and stress relief (42%) named as the top three reasons people play social games[4].

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1   Aird, J., iLottery 2.0: expand the game, Karma Gaming, 2014.

2   Tackys Gamers

3   H2 Gambling Capita, "Cited by Morgan Stanley (2012) ," *Social Gambling: Click Here to Play Blue Paper,* Morgan Stanley Research, 2012.

4   Information Solutions Group, "2011 PopCap Games Social Gaming Research," 2011.

REASONS FOR PLAYING SOCIAL, CASUAL & MOBILE GAMES - US 🇺🇸

	LOTTERY	REGULAR SCRATCH	SOCIAL GAMER (ONLINE COMPUTER)	MOBILE GAMER	ONLINE GAMBLER
Keeps my brain active	48%	47%	50%	46%	40%
Lets me kill time	46%	45%	46%	46%	34%
Provides a distraction from life	37%	37%	38%	36%	28%
The thrill of winning	37%	39%	35%	35%	44%
I like trying to figure things out	30%	31%	33%	30%	32%
Lets me compete against myself	26%	27%	26%	25%	30%
Lets me be competitive against others	26%	28%	26%	25%	36%
Gives me a sense of accomplishment	22%	25%	24%	23%	33%
Lets me connect with other people	21%	22%	22%	21%	32%
Lets me be creative	18%	20%	20%	19%	30%

Figure 2 – reasons for playing games

There are, however, slight differences between social games and lottery players as highlighted in the table below: social games players are looking to keep their brain active, desire to "figure things out," and need to be creative, highlighting the intellectual component of social games, and the much higher engagement than with traditional lottery *(figure 2)*.

Part 2

The fast-growing social gaming market

The outlook of the social gaming market offers tremendous opportunities for lotteries, both in size and in growth prospects.

2.1 Global market size with healthy growth to reach US$17.4 billion by 2019 or 1.5 billon players

Although projections on the size of the future market vary, Transparency Market Research's new Market Report Social Gaming Market[5] *provides a good indication of its future direction.* It highlights that the global social gaming market is expected to reach a value of US$17.40 billion by 2019, growing at a CAGR of 16.1% from 2012 to 2019 *(figure 3)*.

These numbers might not seem like a large opportunity for lotteries, but *the number of players they represent will also be a major factor in attracting lotteries in this arena.* Research has suggested that between a quarter and half of Internet users (depending on the source of information) worldwide play social games every week.[6] By 2015, we expect social gaming penetration to encompass *almost 21% of world population, or 1.5 billion players (figure 4).*

In addition, players spend a significant amount of time playing online. They spend approximately 9.5 hours playing social games a week; 14% of all social gamers play at work for at least one hour per day.[7] This offers the opportunity for gaming companies to increase the number of touchpoints.

2.2 Strong market drivers and opportunities

The demand for these games is expected to see robust growth driven by the following factors:

Social network growth
The growth in Internet and social network access has hugely benefited the social games industry. Currently at 61%,
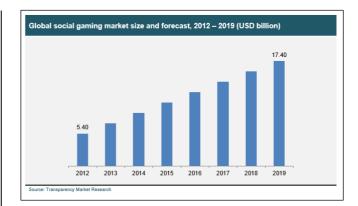
Figure 3 – global social gaming market size
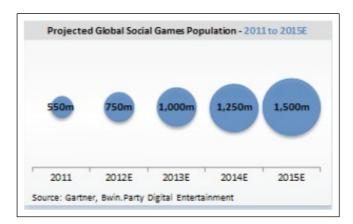
Figure 4 – projected global social games population

the number of social network users who play social games continues to rise. The report, The Social Networking Market Opportunity,[8] found the number of users is set to reach 1.9 billion by the end of 2015. By 2015, 66% of the total North American population, 65% of the Western European population, 53% of the Central and Eastern European population, 32% of the Central and South American population and 24% of the Asian population will be using social networks.

Growing demand and use of smartphones
Social games benefit from the decrease in the prices of mobile devices, particularly tablets and smartphones, as well as wide access to the Internet.

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5   Transparency Market Research, "Social Gaming Market – Global Industry Analysis, Size, Share, Growth, Trends and Forecast, 2013–2019," 2014.

6   Information Solutions Group, "2010 PopCap Games Social Gaming Research," 2010.

7   Infographicjournal.com

8   Researchandmarkets, "The Social Networking Market Opportunity," 2010.

Growth of mobile gaming
Banks have advertised and developed mobile banking solutions, resulting in an increased level of comfort among customers with these new technologies. This favors greatly the social gaming industry and in particular in-app purchases.

Emerging markets boom
Emerging markets also hold tremendous promise. We expect the Asia Pacific to be the largest contributor in the social gaming market by 2019. We expect this trend will only accelerate as the population is gaining access to better broadband Internet connectivity, safe and secure payments.

The rise in the number women players
As of 2013, women represented the majority of the social gaming population, holding a share of around 54%. This demand for games by women is driven by the widespread use of smartphones, the ability to play at small intervals several times a day (which fits the schedules of both working and stay-at-home women and an increased acceptance of social games in society). We expect this trend to continue as recent numbers all point out to women massively entering the gaming market at large.

Heavy promotion from content providers
Content providers have heavily invested in advertising, both on and off-line, resulting in widespread awareness of the social gaming concept. This investment in some cases has been fueled by successful IPOs, such as the one by King Digital Entertainment (the maker of popular game Candy crush).

Emerging platform opportunities
The immense success of tablets has allowed the public to have easy access to gaming apps, spreading the habit of casual gaming, which benefits the social gaming sphere.

Social games convergence towards "lottery-type" games
The fastest growing social game categories on Facebook[9] are role-playing games and casual games *(figure 5)*. In the past few years, the share of role-playing games has been decreasing to the benefit of casino games and TV-related games. This could represent an opportunity for lotteries as players get accustomed to games in which luck plays a role.

2.3   Market restraints or threats

There are a few threats to the development of social games and those are likely to play quite a significant role for lotteries looking at entering the market.
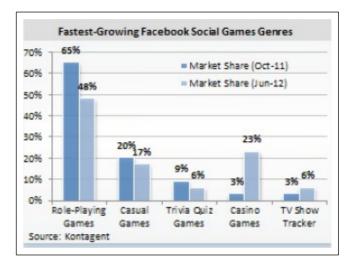
Figure 5 – fastest-growing Facebook games genres

Concerns over trust and security
Despite the growing acceptance of online banking and purchasing, many people still have trust concerns when it comes to handing over credit card details online for virtual goods.

Legislation
Expert opinion is mixed on the future of regulation globally. Some estimate that much of global legislation is aimed at liberalizing online gaming; however, many observe the opposite is happening. While parts of Europe and Australia seem to be liberalizing, legislation is tightening in other parts of the world such as Asia, the United States and South America. In September 2014, for example, Korea announced a ban on social games on Facebook.

Reputation and privacy concerns
As the public increasingly scrutinizes privacy issues, we expect governments and regulators will start paying close attention to the data collected by social gaming companies, and how this gets monetized.

User experience
Social games that are developed to maximize compulsive behavior in order to capitalize on it can trigger defensive reactions and distrust among user – as well as potential users.

Social networking fatigue
In recent years both social media experts and the mainstream media have begun debating if major platforms such

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9   Kontagent, 2011

as Facebook have reached their saturation or if users in regions with established social media usage have started switching to other social media platforms. This debate on "social networking fatigue" continues but we believe that users are simply switching to newer platforms (e.g., Instagram, Tumblr and Whatsapp).

Highly competitive market environment
We can assume industry competitiveness will rise rapidly as the social games arena is attracting hundreds of new developers who are hoping to profit from the industry's rapid growth.

Restrictions on viral opportunities
Over the years, Facebook has periodically introduced new restrictions on social gaming on its platform. For example, in 2012, Facebook removed the ability of developers to push users from its network to outside websites. This restricted cross-platform viral opportunities.

Ban on social networking sites in regions such as the Middle East and China has limited the growth of the market
Facebook has been blocked by a number of countries including China, Iran and Syria. Despite this, Transparency Market Research's March 2014 report[10] estimated Asia Pacific alone accounted for 45% of the social gaming market in 2012.

Threat of new entrants
We expect major new entrants. One of them is possibly Amazon, which has been building its gaming capabilities. In April 2014, Amazon released its Fire TV system, joining Apple, Google, Samsung and Roku as well as gaming console giants such as Nintendo and Xbox in the next massive technology: Connected TV. Global information services Experian estimates almost half of all US adults and 67% of young adults watch streamed or downloaded videos at least once a week. While it's still very early days and not much is known about how leading social networking developers and social gaming platforms will use Connected TV, the shift could also represent an opportunity for lotteries to connect with older adults, who are more likely to use a TV than younger generations.

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10   Research and Markets, "Social Gaming Market – Global Industry Analysis, Size, Share, Growth, Trends and Forecast, 2013 – 2019".

Part 3

Social gamers profiles would offer the lottery industry the ability to reach attractive new market segments

Social games would offer lotteries the ability to tap into new market segments, and in particular, the attractive community of players aged 18–30, women and new emerging markets.

3.1 Middle-aged groups represent the majority of gamers, but 18–30 year olds represent the growth prospects

Contrary to common perception, social gamers represent an older generation than most people imagine. The age groups between 30 and 59 are over-represented in social gaming compared to the total global population. In contrast, younger and older groups are under-represented *(figure 6)*.

We expect the number of older users will increase as social networks continue to draw in older generations with higher disposable income. For the traditional teen market, computer game subscriptions represent a substantial proportion of their disposable income but for middle-aged consumers, the cost is negligible. In fact, it is not unusual to see executives playing the popular game Candy Crush during meetings. This offers an opportunity for lotteries to market games to a customer segment they know well.

Meanwhile, the 19–25 year old age group has been one of the greatest contributors to the rise of social games. With greater access to the Internet in homes, schools, colleges and universities, as well the increase in mobile technology, this group is expected to grow at a CAGR of 17.3% between 2013 and 2019. This trend will be particularly attractive to lotteries trying to rejuvenate their players base.

Business Insights estimates also that more than 110 million children play online social games[11]. This will mean that lotteries will have to keep in mind how to protect this segment of the population.
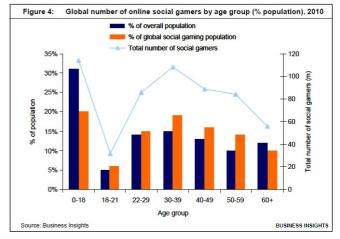
Figure 6 – global number of gamers by age group
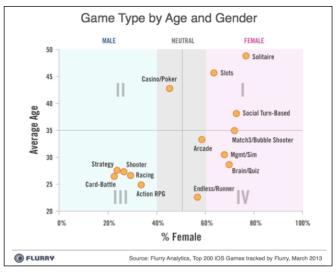
Figure 7 – game type by age and gender

Age distribution varies widely depending of the type of game played. For example, as far as casino/poker or slot games are concerned, they tend to attract an older segment of the population *(figure 7)*.[12]

3.2 Women make up the majority of social game players

As previously mentioned, social network gaming is majority female. Research suggests that 56% of players world-

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11 "The Future of Social Gaming," Busines Insights, 2011.

12 Flurry Analytics, "Top 200 IOS Games tracked by Flurry," March, 2013.

wide are female, compared to 50% of the global population *(figure 8)*.[13]

3.3   Anticipated growth in new geographical markets

The majority of social gamers today are concentrated in developed markets, with the exception of China, which is expected to be the source of the greatest number of player numbers by 2015, with 273 million players vs. 150 million in the US. In the developed world, the total ranges from 19% in Italy up to 41% in South Korea. By the end of 2015, more than 50% of all people in Japan, South Korea and the UK will play social games *(figure 9)*.

The potential for growth in China, India and Russia, where less than 10% of the total population currently plays online social games, is very significant.
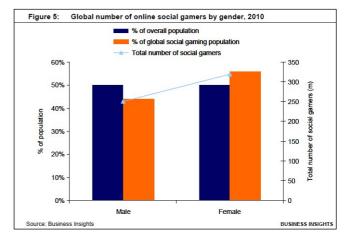
Figure 8 – global gamers by gender
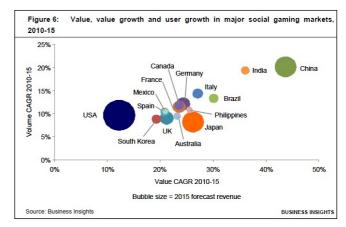
Figure 9 – value, value growth & user growth by major markets

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13   Business Insights, "The Future of Social Gaming," 2011.

Part 4

Social gaming monetization models/revenue analysis

4.1 Three monetization models for the freemium business model

The *freemium model* is a method of monetization used by game developers in which users of a game are able to access the core product (the game) for free, but are strongly encouraged to pay for additional game components.

Social games can generate revenues through three main models, which can be used in parallel or independently: *advertising/sponsorship; the sale of virtual goods; and pay-to-play or subscription-based content.*

On Facebook, 21% of social games revenues are derived from advertising; 20% from offers; and 60% from virtual goods *(figure 10)*.[14]

4.2 The advertising model is currently limited, but this is changing

The market for advertising on social games was limited until 2012. However, this is changing:

• Advertisers realized that in-game advertising is more widely accepted by players as long as it does not interrupt the game play. When done well, advertisements are placed within the game and allow players to opt in or out. When they opt in, additional benefits are added to their game. Paul Capriolo, co-founder and CEO of Social Growth Technologies, stated, "Gamers are excited to engage with advertising because they have the value-added benefit of receiving in-game rewards for interacting with branded marketing actions."[15]

• Tablets offer additional possibilities for advertisers, such as location-based ads.

• Games are heavily loaded with emotional content. MediaBrix has reported that performance of social and mobile gaming ads spiked by 30% and 15%, respectively, when they leveraged emotional targeting. "In social and mobile games, brands can reach game players during

Figure 10 – monetization of social gaming industry

Breakthrough Moments™ (BTMs™), or different emotional moments such as when a player gets a new high score or is in need of help."[16]

• Social gaming ads show a higher CTR as online ads. According to Ari Brandt, CEO of Medievrix, "social gaming ads see average CTR of 3.8% on the web and 3.2% on mobile – 19X higher than averages for standard online banner ads and 8X higher than mobile ads. Plus, social gaming value exchange ads see average CTR of 9.5% on the web and 9.7% on mobile – 47X higher than averages for standard online banner ads and 24X higher than mobile ads."

We can expect advertisers will be quick to latch onto the trend. The Entertainment Software Association estimates the in-game advertising market reached $1 billion globally by 2014 *(figure 11)*.[17]

14 Casual Games Association, "Casual Games Association Sector Report: Smartphone & Tablet Gaming 2013," 2013.

15 Dietrich, Liane, "Fun & Games: How To Win Big With In-Game Advertising." *Marketing Land,* November 1, 2013.

16 The MakeGood, "MediaBrix Reports Cross-platform Social Gaming Ads Garner Higher Performance," *The MakeGood,* April 11, 2014.

17 Entertainment Software Association, "In-game Advertising," Entertainment Software Association, 2012.

4.3 Virtual goods represent the majority of monetization

The most important revenue generator for social gaming is found in the virtual goods model, which comes in the form of either a gameplay advantage for the player over players who have not paid or through customized enhancements.

It is estimated only around 3–5% of regular social gamers worldwide[18] pay for in-game virtual goods. Of those who spend money on virtual goods, "56% will make a second purchase, and 25% will make three or more purchases." [19]

Women represent the largest opportunity for virtual goods since 58% of purchasers in social games are female and 42% male. Of the top spenders, 70% are female and 30% are male.

4.4 Subscription-based model not a major source of revenue

In the early days, it was commonly assumed that subscription-based, pay-to-play would drive the revenues in the industry. However, it is currently not a major source of revenue for social games companies.

4.5 Future ARPU growth

Today, the Average Revenue Per Use (ARPU) for paying and non-paying social games players globally is $2.60 a year. By 2015, this is expected to reach $3.70 a year. However, some 15% of players are what is known in the industry as a "whale," because their spending is particularly high. Typically, the benchmark for a whale is $25. Most whales concentrate their spending on one-to-two games.

Although the ARPU is expected to be larger than this in individual developed nations as the number of users increases, it will be offset by an adverse revenue mix by the much larger increases in developing nations with low ARPU (figure 12).

According to Business Insights, the US has by far the highest ARPU, at US$7.06, while other developed countries range between US$2.50–US$4. China and India both have ARPUs below US$1, although they are expected rise to US$1.92 and US$1.14 respectively by 2015.
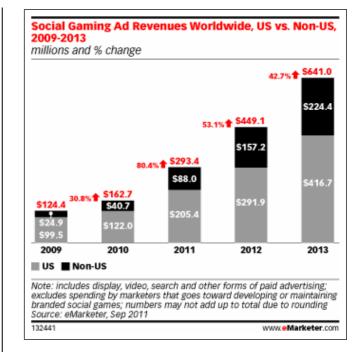
Figure 11 – global gaming ad revenues
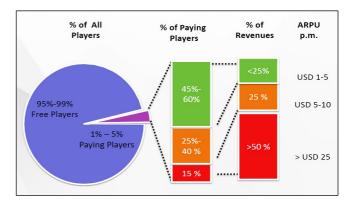
Figure 12 – ARPU for paying vs. non-paying players

With 5–10 cents expected in average daily revenue per daily active user (DAU), casino, poker and role-playing games have the best monetizing average of all social games categories, according to The Casual Games Association Sector Report. This number compares to 3–7 cents for hidden object, adventure and tournament games and 1–5 cents for puzzle, arcade, caretaking and simulation games.

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18 H2 Gambling Capital, "Cited by Morgan Stanley (2012)," *Social Gambling: Click Here to Play Blue Paper,* Morgan Stanley Research, 2012.

19 Church-Sanders, 2011

4.6 The business model challenge for lotteries

The current social gaming business model (no stake, non-monetary prizes) differs today from the lotteries' current model. When considering a potential entry, lotteries would have to find a way to anchor both businesses in order to establish a sustainable and profitable business model. For example, they would have to answer the following questions: Can the access to new customer segments be leveraged to convince them to purchase the existing, more typical lottery products and if so, are there any ethical boundaries? Can lotteries develop the expertise to develop a long-term sustainable advertising-based business model?

Part 5

A highly competitive market

5.1 Mapping of the supply highlights three roles in the social games chain, each currently dominated by one player

Facebook dominates gaming platforms
Facebook is the most important single social networking platform with 1.28 billion monthly active users as of March 31, 2014. It has a dominant position in the US and Canada, as well as a strong position in Europe and Asia. In fact, it still has no real global competitor, as other networks with large market shares are confined to specific countries *(figure 13)*.

As social gaming continues to grow, the number of platforms involved is expected to fragment further. Zynga, for example, allows users to log in directly via its own websites, bypassing Facebook.

Although China's market might seem more difficult for western companies to penetrate, it remains an attractive market and its leading players are doing well. Tencent (the parent company of QQ Games), for example, had revenues of US$9.6 billion in 2013.

PayPal dominates as a payment provider
In order to monetize social gaming, an effective payment processing system is needed. PayPal is the most obvious example of a payment provider for online purchases. However, increasingly social networks are trying to move into the payment space as well. For instance, Facebook has rolled out its Facebook Credits virtual currency, which is now available on most of the leading games. QQ has created the Q coin, a virtual currency purchased by paying QQ in cash. Not only are Q coins popular in the virtual world, they also became so popular on Chinese online stores to purchase non-virtual merchandise that in 2013 the Chinese government banned their use outside of social games.

Zynga dominates as a social game developers
The top four games developers to dominate the Facebook social games rankings are Zynga, EA, CrowdStar and Playdom. Zynga vastly outpaces its competitors, with 195-
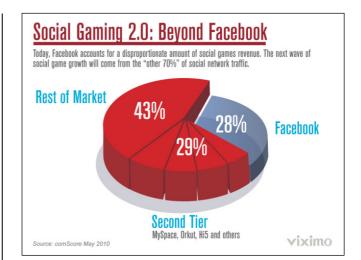
Figure 13 – Facebook's market share
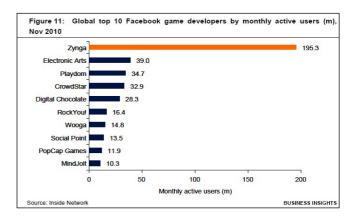
Figure 14 – top 10 Facebook game developers

million active users for all its games combined compared to EA, which only has 39 million users *(figure 14).*[20]

Revenues vary widely, although Zynga also dominates the market with an estimated US$873 million in revenues in 2013 *(figure 15).*

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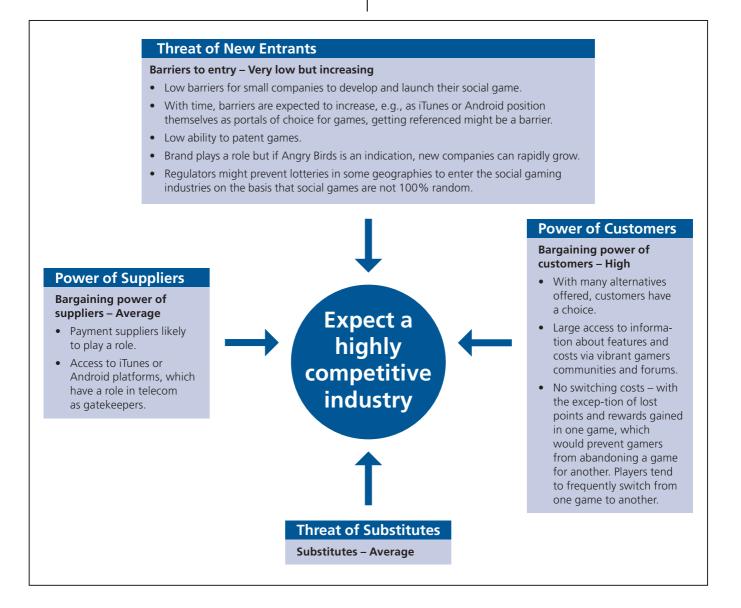
20 "The Future of Social Gaming", Business Insight, 2011.

Company	MAU (Million)	ARPU (est.)	Monthly Revenue (M)	Yearly Revenue (M)
Zynga	276.4	$0.22-0.32	60.8-88.4	729.7-1061.4
CrowdStar	41.5	$0.22-0.32	9.1-13.3	109.6-159.4
Electronic Arts	35.8	$0.22-0.32	7.9-11.5	94.5-137.5
Playdom	25.1	$0.22-0.32	5.5-8.0	66.3-96.4

Figure 15 – revenues of top four platforms

5.2 A highly competitive industry and competitive environment to be expected

Threat of New Entrants

Barriers to entry – Very low but increasing

- Low barriers for small companies to develop and launch their social game.
- With time, barriers are expected to increase, e.g., as iTunes or Android position themselves as portals of choice for games, getting referenced might be a barrier.
- Low ability to patent games.
- Brand plays a role but if Angry Birds is an indication, new companies can rapidly grow.
- Regulators might prevent lotteries in some geographies to enter the social gaming industries on the basis that social games are not 100% random.

Power of Suppliers

Bargaining power of suppliers – Average

- Payment suppliers likely to play a role.
- Access to iTunes or Android platforms, which have a role in telecom as gatekeepers.

Expect a highly competitive industry

Power of Customers

Bargaining power of customers – High

- With many alternatives offered, customers have a choice.
- Large access to information about features and costs via vibrant gamers communities and forums.
- No switching costs – with the excep-tion of lost points and rewards gained in one game, which would prevent gamers from abandoning a game for another. Players tend to frequently switch from one game to another.

Threat of Substitutes

Substitutes – Average

Part 6

How quickly will regulators pay attention to social games?

6.1 Social games do not enter the definition of a lottery – yet – but are getting close

Regulation has focussed its attention on lottery games, defined as a "type of gambling in which winners are chosen by drawing of lots from among those who have paid money to participate."

Social gamers today do not fall into this category, as they do not request a stake to enter the game. However, as the differences between social games and lotteries decrease and their definitions become increasingly similar, is it reasonable to not expect regulators to start paying closer attention? For example, even if no wager is required at the beginning of the game (freemium model), players rapidly have to pay to acquire the right to access superior levels of the game. The fact that a player has to buy an app could be considered a disguised form of wager.

In January 2014, Zynga announced it was giving a test drive to bitcoin in its social games. It partnered with Bit-Pay, a bitcoin payment processor. This raises questions. For example, since bitcoin is being accepted by retailers for the purchase of real goods and services, does this qualify as earnings?

6.2 It is unclear whether regulators will allow lotteries to enter the social gaming industry

In addition, in some jurisdictions, regulators might not at first allow lotteries to enter the social gaming industry, as the games are not 100% random.

6.3 Insights about current regulation

As long as social games do not enter gambling, or lottery in its "pure" definition, then there is a legal vacuum, and such secondary laws as Consumer Rights, E-Commerce Directive Data Protection Directive, E-Privacy Directive, Unfair Commercial Practices, and Distance Selling Directive will apply.

Consumer rights directives are particularly clear on:

- Information requirements – clear and comprehensible in advance of contract.

- Ordering process – button:
  "Order with obligation to pay".

- Providers have to acknowledge receipt on durable medium.

- Right of withdrawal
  (unless user's consent to forfeit this right).

6.4 A few areas of potential concern for regulators

We have identified a few areas that need attention:

- Overspending *(micro-transactions)*.

- Grooming (funnel to real money gambling). Because of its obvious money-making potential, the conversion of social games to real-money gaming is an attractive objective for traditional gambling companies. If this grooming proves successful, it will lead to ethical questions, especially as far as the younger generation is concerned.

- Gambling mechanics *might lead to* loss of control.

- Players' capital. There is the potential risk for a social game operator to devalue the capital of some players if it significantly increases the amount of free virtual currency it provides to other players on an ad-hoc basis. This could result in the vendor violating its responsibilities under consumer protection legislation in various jurisdictions since the vendor is typically responsible for ensuring consumers are well informed when making their purchasing decisions.

- The possibility of exchanging desirable in-game items of value for monetary gain is of concern. This could create a gambling opportunity where adolescents can attempt to obtain in-game credits through available activities with chance-based outcomes, with the aim to exchange such credits for real money.

- Attracting or targeting underage gamblers. Currently, most children who are spending money on in-app purchases are not playing casino-style games and we think it's reasonable to assume this will remain the case in the future.

- Misleading, aggressive commercial practices.

- Payments taken from account holder knowledge, express authorisation or informed consent.

- Direct exhortations aimed at children to buy advertised virtual goods or attempt to persuade their parents.[21]

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21 Yin-Poole, Wesley, "Now European Commission investigates free-to-play games." *Eurogamer.net,* February 28, 2014.

Part 7

Considerations for lotteries

Consideration 1:

We foresee many advantages in social gaming for lotteries, and in particular a window to new customers.

- *Generating a more personal relationship* with your customers through personification of your brand.

- Providing a *high-quality experience* that satisfies the needs of the lottery players.

- *Allowing your customers to develop a more personal relationship with each* other through the social aspect of games , improving the gaming experience.

- *Giving your users ownership of your brand* by giving them a voice for future product developments.

- Allowing users to be *rewarded for their loyalty*.

- *A lead-generation model,* to identify and reach players, who have not yet played lottery.

- *Heavy engagement.*

- *A younger customer base.*

Consideration 2:

Lotteries could leverage their existing brands and presence and exploit synergies.

Lotteries could leverage the current marketing presence, brand and reputation, to launch an online platform with a lower cost structure than "pure" players by benefitting from economies of scale, particularly in the areas of marketing and communication.

Consideration 3:

The key skills to succeed in the field involve the development of creative and ever-evolving games, a competence lotteries do not possess.

Social games developers need to have the ability to create an effective storyline. They also need strong analytical skills as they must be keenly attuned to users' behavior, emotions and social drives.

Lotteries would have to develop new games, rather than adapting their existing games to the social gaming environment. The quality of those games would be measured across to all or a subset of the following criteria:

- Storytelling – i.e., a story line that progresses through levels requiring the attainment of different virtual goods and gets users involved.

- Changing the reward mechanisms of games: how can it be changed to have new ways of winning?

- Social apps can be developed to incorporate the use of other social channels in order to engage new customers.

Lotteries today do not possess the skills required to develop such games.

In addition, the speed of new game introduction might be a challenge for lotteries. For example, one of the existing players, Big Fish, developed and distributed over 250 games in 2013 alone.

Consideration 4:

The cornerstone of success is the ability to develop customer intimacy and centricity. Will lotteries be able to attract and retain the analytical skills required?

Retention has always been core to lotteries' marketing objectives. As well, lotteries have been developing the analytical skills to understand how to leverage players to online casual games. But social games have slightly different mechanics involved to ensure retention is core to the game than lotteries. The design of the storyline, ownership, daily bonuses, missed opportunities, play frequency are all complex and require highly experienced analytical analysts as well as behavioral scientists. Are lotteries up to the challenge?

Consideration 5:

From a technology viewpoint, operators face a number of key challenges.

- Managing the technology ecosystem as the environment becomes more complex.

- Integrating additional products and services into an already complex architecture.

- Supporting technical integration of new payment service providers.

Consideration 6:

Expect regulators to step up

Although not regulated today, social games are developing characteristics that could be interpreted as stakes, including the cost of acquiring the application to be able to pay and

the micro-payments unlocking parts of the game. It is only a matter of time until some jurisdictions start regulating the industry (Korea announced in September 2014 a ban on all financial transactions directed to Facebook games as part of Korea's plan to regulate the social gambling industry).[22] Lotteries are well used to regulations, and have developed ethical frameworks, so they might be well positioned to respond to this new trend with responsible gaming initiatives. However, it might lower the enthusiasm for games, in particular for the younger generation.

Lotteries need to establish regulation intelligence if entering this field.

Consideration 7:

Need to carefully craft an entry strategy

Operators can decide to develop social games in-house, to invest in talent teams via financing or acquisition, or to license games.

Developing games in-house
Developing popular social games in-house will require deep social-games industry expertise that lotteries do not necessarily possess. The social gaming market is potentially more lucrative for the businesses that offer the underlying technology, software and solutions, rather than the consumer-end providers looking to yet enter the field. In-house game-development is not a recommended approach.

Invest in talent via financing or acquisitions
Alternatively, a cross-platform strategy would allow lotteries to develop their social games in parallel for Facebook and MySpace, for example. Depending on whether or not they'd want to localize their gaming strategy, it is possible to target the countries where Facebook does not yet dominate.

License games
This is an attractive proposition for lotteries as it would provide the opportunity for them to gain rapid access to the market using an existing brand.

Consideration 8:

Social games represent an attractive shift of paradigm for lotteries

When players experience the disappointment of losing, if they're also playing and enjoying a game that continues past the loss, the disappointment is quickly replaced by pleasure. Players spend hours of enjoyment with a social game and interacting with others, compared to the lottery ticket experience which is short-lived.

Consideration 9:

Who's looking at lotteries?

The convergence of the gaming industry feeds the appetite of lotteries for social games, but one can expect this is a double-edged sword phenomena. As social games build expertise, and aim to monetize their products, it is highly likely they will in turn look at the lottery industry and develop products that will compete directly with lotteries' offerings. Already, Zynga has shown an appetite for this. Others can be expected to follow as well.

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22   PoKerNews, "Korea Shuts Down All Facebook Games In Attempt To Regulate Social Gambling," *PoKerNews,* September 2014.

Summary: SWOT analysis

With a strong industry brand and reputation, lotteries are well position to leverage their marketing presence if entering the social games market. What's more, lotteries are already very familiar with the market segment that is most likely to use social games: older adults. As the lines between social gaming and lotteries continue to blur, regulators will likely get more involved. If that happens, lotteries will be in a strong position to navigate through regulatory issues that may arise due to the years of experience with regulatory bodies and the strong ethical frameworks the industry has already established.

On the other hand, lotteries do not have a strong presence in the social media space and more importantly lack the very specific in-house expertise to develop successful social games and provide the technical support required. In contrast to current social gaming companies, lotteries lack the in-house expertise to manage the ever-changing technology ecosystem required for social gaming, including payment.

The opportunities social gaming represent for lotteries are significant. With rapid growth in the number of people using social games, not just in developed nations but in developing markets such China, the social gaming industry is expected to grow in leaps and bounds. While strengthening their relationship with its current primary customer segment, social gaming would also allow lotteries to reach younger adults, who are behind much of the expected growth in the market.

The social gaming industry is already highly competitive, but it is expected to become even more so as it attracts new players. Social media is in constant flux. For example, Facebook has made changes over the years to ensure its platform cannot be used by social games to go viral outside of Facebook. As well, more recently, experts have begun discussing whether or not social media has reached its saturation in developed nations and if we're starting to see "social media fatigue."

It's possible, however, that even if lotteries choose not to enter the competitive environment of social gaming, they will find themselves competing against it. As the lines between the two industries fade, there are already signs that current players in the social gaming sector are eyeing the opportunities for them in entering the lottery industry. In fact, one of the larger players, Zynga, has already begun to move in that direction.

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Glossary

Average Revenue Per Paying User (ARPPU)
Total monthly revenue/paying active user, measured as revenue per thousand DAU (US$/KDAU).

Average Revenue Per User (ARPU)
Total monthly revenue/active user, measured as revenue per thousand DAU (US$/KDAU).

Betting
Betting – wagering, mostly on sports – can be done with real money or virtual prize determining whether it qualifies as gambling (see 'gambling').

Customer Lifetime Value (CLV)
The net present value of the cash flows attributed to a customer.

Casino Games
Blackjack, Roulette, Poker, Slots – can be done with real money or virtual prize determining whether it qualifies as gambling (see 'gambling').

Daily Active Users (DAU)
The number of unique users that have used an application at least once over the course of a day.

Facebook Credits
Virtual Facebook currency that can be converted into game-specific currency. The credits are bought using credit cards, PayPal, by completing special offers or by purchasing credit vouchers at 12,000 retail locations in the US.

Freemium
Offering a game, product or service free of charge while charging a premium for advanced features, functionality or related products and services.

Gambling
All real money-related products (games of chance – Poker, Blackjack, Dice + betting). Currently, Facebook does not permit gambling on its platform. Gambling must include consideration (something at stake), chance and a real-value prize. Facebook casino and betting games remove the prize element, so they do not qualify as gambling.

Lead generation
The creation of consumer interest in products or services of a business.

Lifetime value (ltv)
Total amount that a player will spend with a particular game during his or her lifetime with the game.

Monthly Active Users (MAU)
The number of unique users that have used an application at least once over the course of a month.

Virtual goods
Gameplay enhancing in-game good and services such as character customization and items which unlock special game features or speed play.

Whale
A player whose spending is particularly high. This definitional threshold can vary, but >$25 is a generally accepted benchmark.

Impressum