

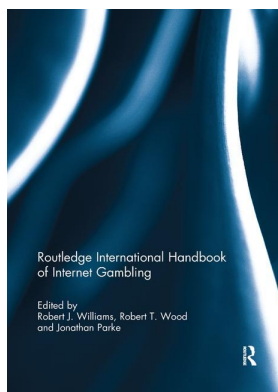
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Robert J. Williams, Robert T. Wood, Jonathan Parke

The Internet Gambling Industry

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Robert J. Williams, Robert T. Wood, Jonathan Parke

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3 The Internet gambling industry

Lorien Pilling and Warwick Bartlett

The growth of the Internet gambling sector is closely linked to the development of Internet technology and e-commerce in general. As download speeds have quickened and the penetration of Broadband Internet technology in consumers' homes has increased, so the quality of e-gaming products has been improved. By comparison with the current games' graphics, speeds, and features, those early versions seem slow and basic. No doubt the same will be said of today's games in the next decade as technology moves on, particularly as three-dimensional graphics are incorporated into online casino and poker games.

There is a strong correlation between Broadband Internet penetration and the growth of Internet gambling. In 2009 global Broadband subscription stood at 7.0 per cent of the total population (ITU, 2010), while e-gaming's share of the total gambling market (including all products online and land-based) was 7.1 per cent, as measured by gross gaming yield (GGY) – the amount that customers lost to operators¹ (GBGC, 2010a). These low penetration rates suggest there is still substantial potential for growth in the e-gaming market over the next decade.

Given this correlation between Internet technology and e-gaming, it is not surprising that some of the most developed e-gaming markets have high levels of Broadband Internet usage in their general populations, for example: Denmark, Finland, Hong Kong, Singapore, Sweden, and the United Kingdom (UK).

In 2009 the Internet accounted for 90 per cent of global interactive gaming revenues, with the remainder being made up of revenues from mobile devices and interactive television (GBGC, 2010b). But the launch of new mobile devices such as Apple's iPhone and iPad, as well as the ongoing improvement in handset design and mobile Internet technology, means that mobile devices will take a greater share of the e-gaming market in the coming decade. Already in 2009 and 2010, a number of key Internet gambling brands have unveiled betting applications and games for the iPhone, such as Betfair, Ladbrokes, Paddy Power, and William Hill.

In May 2011 there were approximately 2,438 gambling websites offering a range of betting and gaming services, from sports betting through to lotteries (see Chapter 1). The market is very competitive, with operators working on tight margins, and various websites serve to increase competition by providing comparison services of the best odds and bonuses available.²

Table 3.1 Interactive gambling's share (%) of total global gambling

<i>Year</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Share (%)	5.8	6.3	7.1	7.5

Source: GBGC, 2010a.

Table 3.2 Global interactive gambling (GGY) (US\$ billion), 2004–10

Year	2004	2005	2006	2007	2008	2009	2010
GGY	11.70	15.41	19.92	20.74	23.95	26.12	29.31

Source: GBGC, 2010b.

Online gambling products

The main categories of online gambling products are:

- sports betting,
- casino games,
- poker,
- bingo,
- skill games,
- lotteries.

In 2009 the total interactive gambling market was estimated to be worth US\$26.12 billion in GGY. This was an increase of 9 per cent from the \$23.95 billion recorded in 2008. By 2011 Global Betting and Gaming Consultants (GBGC, 2010b) forecasts that the global interactive gambling market will have almost trebled in size from \$11.70 billion in 2004.

In the last decade the e-gaming sector has shown strong growth in revenues every year except for 2007, when overall growth was 4 per cent and global Internet casino and poker revenues actually fell compared with 2006. The reason for this decline in revenues was action by the US government at the end of 2006 to prohibit financial transactions linked to Internet gambling and passing legislation that deemed Internet gambling to be unlawful. Many of the major Internet gambling firms that had been targeting customers in the United States ceased operating in the country almost overnight once the law was passed. This was particularly the case for companies such as PartyGaming, Sportingbet, and 888 Holdings, which are listed on the London Stock Markets and had the interests of their shareholders to consider (888 Holdings, 2006; PartyGaming, 2006; Sportingbet, 2006).

It is a measure of the resilience and entrepreneurialism of these companies that they were able to survive the loss of their main market and readjust their operations to develop their European businesses. Despite the new law and the withdrawal of most of the major e-gaming firms, Internet gambling still thrives in the United States and is served by privately owned companies licensed in jurisdictions outside the USA, such as Costa Rica, Kahnawà:ke (Canada), and the Isle of Man.

Sports betting

Sports betting is the dominant online product in terms of gross win (same as GGY)³ and accounted for 41 per cent of global e-gaming. This is partly because of the popularity of sports and the fact that betting on sports constantly challenges the customer's opinion against the odds set by the bookmaker. Online betting on horse racing and sports is regarded as more acceptable by governments than other forms of gambling, so is more widely permitted in certain markets. For example, monopoly operators such as the Japan Racing Association and Hong Kong Jockey Club have sizeable online betting operations.

The strong competition for customers between Internet sports betting firms has had the effect of driving down the gross win margins to which online sports books operate. Internet

sports books aim for a gross win margin of between 7 and 10 per cent, while their land-based counterparts in the betting shops aim for 16 to 19 per cent. Sports betting also contains the most risk for the operator with the level of gross win being dependent on sports results. A run of winning favourites can have a detrimental impact on the gross win margin. If all the leading soccer teams win their matches over a single weekend, it can cause what is known as a ‘wipe-out’ for bookmakers.

The introduction of betting exchanges in the year 2000 revolutionised the sports betting model (Clarke, 2009). Betting exchanges use Internet technology to allow gamblers to bet directly with each other (peer-to-peer [P2P] betting), thus cutting out the need for traditional bookmakers. Betting exchanges also let the customers set their own odds and, unlike a traditional bookmaker which keeps its customers’ losing bets, the betting exchange operator instead takes a commission for facilitating the betting process. The commission level is usually between 2 and 5 per cent of net winnings. This commission-based model is a much less risky business model because the betting exchange operator earns its commission regardless of the result of the sports event. The dominant operator in the betting exchange sector is Betfair,⁴ although there are several others operating, including: WBX⁵ and Betdaq.⁶ Betfair, Betdaq, and WBX all hold licences from the UK Gambling Commission.

Betting exchanges have courted some controversy because it has been argued that they allow customers to act as unlicensed bookmakers by laying bets without being liable for the associated betting tax. It is also the case that individuals with insider knowledge or some ability actually to influence the outcome of a sporting event could potentially benefit from the relative anonymity of betting exchanges to place their bets.

Betfair was granted a licence by the Tasmanian government in 2005 but the state of Western Australia tried to implement a ban on citizens in the state from using Betfair in 2007. This ban was successfully appealed by the company, although Australian state governments are still opposed to the concept of betting exchanges. In Europe, the new French regulation concerning interactive gambling activities, which became operational in June 2010, also prohibits betting exchanges, as the government seeks to protect its domestic horse racing industry and the associated betting and tax revenues derived from the state-owned monopoly *Pari Mutuel Urbain (PMU)*.

Betfair, however, has contributed to innovation and improvement within the Internet betting sector. The company was one of the pioneers of in-running betting (also called ‘in-play’ betting) which allows customers to continue betting after an event has started, particularly horse races. Typical in-play bets include: next goal scorer, number of goals scored in the first half, total corners, player to win the current set/game, runs scored in the next ‘over’. Most sports books now offer numerous in-running markets on a range of sports such as football, golf, cricket, and tennis. This type of betting has become incredibly popular, with up to 70 per cent of bets on some games placed in-play. In-play betting really broke through as a product during the World Cup soccer tournament in South Africa in 2010 and has also been spurred by many sports books now broadcasting live sports events on their website (GBGC, 2010b). In-play betting tends to operate to a lower gross win margin than pre-match betting. In-play margins are in the range of 3 to 5 per cent of stakes, compared to 7 to 10 per cent for pre-match bets.

Casino games

Online casino websites operate in much the same way as a land-based casino and offer many of the same casino games including: roulette, blackjack, baccarat, and slot machines. The

games include a *house edge* which is the operator's gross win. Depending on the game, the operator's gross win margin can range from around 3 to 10 per cent. Betfair, however, does have a 'Zero Lounge Casino' which has removed the house edge from its games, e.g. its roulette wheel has no *zero*. This means that, based on optimal player strategy, the payout to customers is 100 per cent.

At the time of writing, the latest development in the online casino sector is *live dealer* casino games.⁷ The improvements in Broadband Internet download speeds and Internet video streaming technology have enabled e-gaming firms to stream live casino games on their websites. Players watch a dealer deal a game live via a web-cam and place bets through the website. Games suitable for live dealer casinos include roulette, blackjack, baccarat, and Sic Bo. The appeal of live dealer casinos for players is that they remove the random number generator (RNG) of online casino games, which some cultures, particularly in Asia, do not trust. Other players, however, dislike live dealer casino because the games are slowed down too much. To ensure all players at the table have time to place their bets, there are defined betting periods before each spin or draw, which means that players do have to wait longer between bets than for RNG-based games.

Poker and other skill games

Planet Poker claims the title of being the first Internet poker room to offer poker games for real money in 1998. This website was closely followed by competitor websites such as Paradise Poker and PokerRoom. The television series *Late Night Poker* aired its first series in the UK in 1999 and is credited with raising the profile, popularity, and image of the Texas hold'em poker game. The use of under the table cameras – now standard in poker broadcasts – made watching a game of poker on television more interesting because viewers could see each player's cards and assess the state of the game. The show also helped improve the image of poker, making it a more 'acceptable' game in mainstream entertainment.

The period between 2002 and 2004 was when online poker really exploded and established itself as a major Internet activity. There were several reasons for this boom in online poker. First, Internet technology was improving and better poker software made playing the game online easier and more attractive to players. New operators were entering the market, each spending money on marketing their own Internet poker room, but with the general effect of increasing the awareness of online poker in itself.

The importance of Chris Moneymaker winning the main event at the 2003 World Series of Poker (WSOP) in promoting Internet poker cannot be overestimated. As a story, it was a perfect marketing aid to the online poker industry. Moneymaker – even his surname is ideal – qualified for the World Series of Poker by winning an online satellite tournament hosted on the PokerStars website.⁸ He paid just US\$39 to play in this online tournament and turned it into \$2.5 million by going on to win the main event at WSOP. It gave hope to the 'ordinary player' that they too might turn a small tournament fee into a life-changing prize.

In 2004 Greg Raymer also won the WSOP by qualifying for a place on the PokerStars website. These two winners helped boost PokerStars' popularity and it was becoming increasingly common for poker websites to offer seats at major land-based poker tournaments as prizes in their online games.

In the same year, 50 per cent of players at the Ladbrokes Poker Million qualified for their place in the tournament through the Ladbrokes.com poker room.

PartyGaming listed on the London Stock Exchange in June 2005, valued at GB£4.5 billion (US\$8.7 billion). It seemed to mark the arrival of Internet poker both in the corporate and

public arena. At the time, Party Poker was the largest poker website in the world, with a market share of around 48 per cent.

But a little over 12 months later, the Internet poker landscape was completely changed. The passing of the Unlawful Internet Gambling Enforcement Act (UIGEA) in the USA in October 2006 (US Congress, 2006) forced many poker websites to stop accepting customers from the USA. The move had a devastating effect on many websites because 85–90 per cent of their revenues had been generated by US players.

The balance of power now shifted to private operators who continued to take business from the USA, something that the publicly listed companies could not countenance. Those companies that continue to take revenues from the USA also are gaining an advantage in Europe too. This is because they can use their revenues from the USA to spend on marketing and business development in Europe's emerging markets such as Italy and France.

Online poker rooms generate revenues from their customers in two main ways. The first is by charging a percentage fee (*rake*) on each pot played in cash games. The amount of rake is determined by the size of the pot, the number of players, and the type of game being played. The rake tends to decrease as the limit on the table increases. It ranges from 1 to 5 per cent of the pot. The second is through tournament fees. To play in a poker tournament, the operator will charge each player a *buy-in* which is used to create a prize pool for the tournament winners and a tournament fee, which is the operator's revenue. The tournament fee ranges from 0 to 25 per cent of the buy-in amount.

As such, the business model is comparatively low risk, so long as a poker room can attract enough players (*liquidity*). The more people that an Internet poker room can attract to its website, the more games will be played and the more entrants it will get for its tournaments – both of which will generate revenues for the operators.

Liquidity is crucial for the success of an Internet poker room. When a player logs in to the website, they want to be able to find a poker game both of the type they want and at the limit level they wish to play at. If they cannot find a game quickly and easily, they will simply click to a competing website. Losing liquidity becomes a downward spiral for a poker room. As players drift away to competitors, the situation merely becomes worse for the operator because it is hosting fewer tables, meaning fewer players are able to find the kind of game they want.

Other skill games like backgammon, dominos, gin rummy, and skat operate on the same model. The operator will facilitate games and tournaments and in return will take a percentage of the stakes or tournament fees. However, to date none of the other games like backgammon or mahjong has experienced the same global popularity on the Internet as poker experienced, although they are popular in certain regions of the world like south-east Europe for backgammon and Asia for mahjong.

Bingo

Bingo is still in its infancy on the Internet with many of the online operators launching their bingo websites only from 2006 onwards. Online bingo rooms use players' stakes to fund prize pools and take a percentage of the pool as their gross win. As well as the traditional 75-ball and 90-ball bingo games, bingo rooms also offer side games such as slots and instant win games. These can generate as much revenue as the main bingo game itself.

Online bingo is helping to extend the demographic appeal of Internet gambling because the game is being targeted primarily at women, as is shown by 888.com's bingo website which has the URL of 888ladies.com.⁹ Internet bingo is also part of the trend in 2009/10 for

social gaming, with players able to chat to each other in the bingo room and encouraged to create profiles for themselves on the site.

The growth of Internet bingo has undoubtedly been spurred by the introduction of smoking bans in many countries around Europe since 2000 (GBGC, 2007). Bingo players who are now unable to smoke while playing bingo in a bingo club have chosen to move online and play in their own home, where they can still smoke.

Lotteries

Several national lotteries now allow their customers to buy lottery tickets online or via mobile phones for the main draw games. But some of the biggest lotteries – namely the state lotteries in the United States – are not currently permitted to offer ticket sales over the Internet.

The situation in 2011 is that a few state lotteries have wholeheartedly embraced the Internet as a sales channel, while the majority of lotteries are still developing their Internet strategies, if at all. Austrian Lotteries, for example, generated over 40 per cent of its total sales from online activity at its win2day.at website in 2009.¹⁰ Win2day offers a full range of e-gaming products, not just lottery games. As well as buying their lottery tickets online, Austrian citizens also can play casino games, poker, and keno on the site. The Danish lottery Danske Spil¹¹ and Swedish lottery Svenska Spel¹² also have an extended range of online games alongside their traditional lottery games. Camelot, the operator of the UK national lottery, only offers online scratch cards and ticket sales through its website, but in 2009, 9.5 per cent of its total sales were through online and mobile sales channels.¹³

One reason for some state lotteries' reluctance to move online is that they are cautious about upsetting their established retail network of lottery agents. These agents work on a commission basis of lottery ticket sales and could lose income if more ticket sales were made online.

Private firms also offer a range of lottery-related products via the Internet. There are lottery agents who will purchase tickets for the major global lotteries on behalf of their customers, and who are based in a different country from that where the draw is being held. Bookmakers and other firms will also offer fixed-odds bets based on the results of the major lotteries around the world. In some of these bets customers can win smaller fixed amounts for matching one or two numbers drawn.¹⁴ However, in general, it is difficult for a private company to generate sufficient player numbers to create a large enough Internet lottery jackpot in order to compete with the national lotteries which have formidable marketing and promotional resources at their disposal, as well as the benefit of a large retail network to create substantial jackpots.

Regulation

In the early days of the e-gaming industry it tended to be primarily small island jurisdictions that would issue licences for Internet gambling, or those nations that already had a developed offshore financial services sector and saw Internet gambling as an extension to that business. In the mid- to late 1990s such jurisdictions included the likes of Antigua and Barbuda, Curaçao, Netherlands Antilles, and Costa Rica. As the decade ended, a growing number of jurisdictions implemented legislation to license Internet gambling operators in their borders. The common theme in the profile of these e-gaming jurisdictions was that they continued to be small island nations or jurisdictions that had a specific economic arrangement. For example:

- *Kahnawà:ke Mohawk Territory, Canada*: an Indian reserve in the Canadian province of Quebec. Since 1999 the Kahnawà:ke Gaming Commission has issued interactive gaming licences and, at the time of writing, is the only jurisdiction in North America that issues Internet gaming licences to private companies.
- *Isle of Man, UK*: a self-governing British Crown Dependency which has issued e-gaming licences since 2000. The Hilton Hotel on the island played host to the first Poker Million tournament in November 2000. The Isle of Man licenses the largest Internet poker operator in Rational Entertainment Enterprises Ltd (PokerStars) and since 2008 has been attracting some of the largest Asian sports betting firms as new licensees: Celton Manx (SBO Bet), Cube Ltd (188bet), and Welton Holdings Limited (Fun88).
- *Gibraltar, UK*: a British overseas territory located on the Iberian Peninsula which has a land border with Spain. It first offered licences in 1998. Gibraltar is home to some of the biggest brands in the European Internet gambling sector, including: Cassava Enterprises (888.com), bwin, Ladbrokes, PartyGaming, Victor Chandler, and William Hill.
- *Cagayan Special Economic Zone and Free Port, Philippines*: in 2003 the Interactive Gaming Act appointed First Cagayan Leisure and Resort Corporation as the master licensor in the zone with the brief to develop and regulate Internet gambling. It remains the only jurisdiction in Asia to issue Internet gambling licences (Pilling, 2009).
- *Malta*: an island nation in the Mediterranean and member of the European Union (EU). The island's EU status has made it attractive to e-gaming firms seeking to operate across borders into other EU member states. Malta is one of the leading jurisdictions as measured by the number of licensees on the island. It began issuing licences in 2001.
- Other offshore e-gaming jurisdictions include: *Alderney (Channel Islands), Northern Territory (Australia), Panama, Seychelles, and Swaziland*.

The 'offshore' status of many of the early Internet gambling jurisdictions was ideal for the operators and helped shape the business model for the sector. After an initial, annual licence fee many of these jurisdictions charged little or no gaming tax and, in addition, had low corporate and income tax.

Consumers benefited too. The low gaming tax meant that the e-gaming companies could offer better value to their customers in the form of higher payout percentages than their land-based counterparts. Land-based casinos, betting shops, and bingo halls had no option to move offshore and were trapped by the prevailing rate of gambling tax in their jurisdiction. They also had higher operating costs associated with maintaining a 'bricks-and-mortar' property and large numbers of employees, unlike the virtual casinos and poker rooms.

Until 2007 it was not possible to obtain a specific Internet gambling licence in a major mainland jurisdiction. This changed with the 2005 Gambling Act in Great Britain, which made specific provision for 'Remote Gambling' and licences for Internet gaming – casino, poker, and bingo. The tax rate for UK-licensed companies, however, was set at 15 per cent of gross profits, which was much higher than e-gaming firms were used to paying offshore. Consequently, very few firms applied for a licence in the UK. With the exodus of William Hill and Ladbrokes' sports betting operations to Gibraltar in 2009, Bet365 is one of the few major Internet sports books licensed in the UK (White, 2009). Most operators instead chose to remain offshore in one of the 'white-listed' jurisdictions approved by the UK government. The jurisdictions are: Malta (and any European Economic Area [EEA] state), Gibraltar, Antigua and Barbuda, Isle of Man, Alderney, and Tasmania.

In 2006/7 Italy too was developing legislation that would enable companies to take an e-gaming licence in Italy itself. It was a fairly tortuous regulatory process which lasted almost

four years. Early on in the process one of the key events was the publication by the Italian authorities of a 'black list' of foreign gambling websites that Italian customers would be blocked from accessing. This blocking began in February 2006. Later the same year a licence tender process was held for both land-based and remote licences as the Italian government of Romano Prodi sought new sources of revenue to finance its budget.

The new regulations were subject to great scrutiny by the European Commission, which suggested some amendments to the proposed regulation in April 2008. Under the revised regulation, a gambling company that is licensed and based in another EU jurisdiction can apply to the Italian regulator (AAMS) for a licence provided they can demonstrate a turnover of €1.5m over the previous two years. An alternative option is to provide AAMS with a bank guarantee for the same amount. An operator's gaming servers can be located outside Italy as long as they are within the EU and are linked to the central AAMS system which validates bets and ensures the taxes are paid on Italian gambling activity.

Other EU member states have been looking at Italy's regulatory model and adapting it to their own laws. France introduced similar regulation in 2010 in time for the World Cup and Spain too is reported to be planning its own Italian-inspired Internet gambling regulation.

Many of the leading EU member states regard Internet gambling as a threat to their tax base and local vested interests. Several countries have state-owned gambling operations or state-granted gambling monopolies which are used to raise government revenues. Naturally they are keen to protect these revenues.

Legal battles between governments and Internet companies have been running almost since the industry was born and have been escalated to the European Court of Justice (ECJ). One of the key cases in Europe was Case C243/01 upon which the ECJ ruled in November 2003 and is more commonly known as the *Gambelli* case. The case concerned Mr Piergiorgio Gambelli and other plaintiffs who operated in Italy on behalf of betting firm Stanley International Betting Ltd. Stanley International took bets from retail agents in Italy which were transferred using the Internet to Stanley's headquarters in the UK. At the heart of the case was the argument that there is freedom of establishment and freedom to provide services across borders within the EU, as set out in Articles 43 and 49 of the EC Treaty.

This argument has continued to be debated since then (see Case C338/04 [2007] *Placanica*) in Italy and other EU member states. Between 2006 and 2008 the European Commission had infringement proceedings under way against 10 EU states, requesting information on the countries' gambling legislation to determine whether the restrictions were compatible with the EC Treaty.

Governments, too, have argued amongst themselves over Internet gambling services. In March 2003 the government of Antigua and Barbuda initiated a case (WT/DS285 *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*) against the United States at the World Trade Organization (WTO) concerning the US stance of prohibiting cross-border remote gambling services. Antigua argued that the restrictive policy breached international trade treaties.

Antigua had several rulings go in its favour in the case but has yet to gain any compensation and by 2011 the USA had not altered its gambling policy to make it compliant (Mendel, 2007).

Challenges and influences on Internet gambling

As the Internet gambling industry enters the next decade of its development, it will be influenced by a number of factors that will define how the industry will mature and what business models will succeed.

Existing competition

The Internet gambling market is already extremely competitive. There are already more than 2,300 websites worldwide offering gambling services and they are available at just a few clicks of the customers' mouse. However, within each sector of the market there are currently a handful of major operators that dominate, and then a mass of smaller operators. In online sports betting, for example, companies such as Bet365, Betfair, bwin, SBOBet, and William Hill are key operators. Fulltilt and PokerStars are the dominant brands in Internet poker rooms.

Two features that all the different sectors of e-gaming have in common are that they operate on very tight margins and have to work extremely hard to attract new customers and retain existing ones. Internet sports books aim for a gross win margin of between 8 and 10 per cent, but sports results can mean that margins can fluctuate greatly quarter on quarter. For example, the pre-match betting margin for Maltese-licensed Unibet in the four quarters of 2009 was: 11.3 per cent, 6.3 per cent, 6.0 per cent, and 11.9 per cent.

Internet poker rooms typically take between 1 and 5 per cent of the amount in the pot as commission or rake.

The e-gaming industry is one of the few consumer sectors that have adopted a strategy of buying its customers. All e-gaming companies offer generous sign-up bonuses to new customers and will offer incentives to dormant accounts to try to reactivate them to bet. In the online poker sector in particular there has been something of an arms race with the level of bonuses being offered reaching unsustainable levels. Some poker rooms will offer a bonus to the value of more than 100 per cent on a new player's first deposit of funds in their account. It is a measure of how competitive the market is. All these incentives, however, mean that customers have very little loyalty to gaming brands and will happily switch to another site simply to take advantage of another bonus. A new customer may choose one brand over another simply because of the free bet or bonus that is being offered.

Aside from the bonuses being offered, there is often very little difference between the websites of rival e-gaming companies. The layout of the websites looks similar and they will be offering a similar array of gambling products, in many cases powered by the same software. There is certainly an argument that all that differentiates rival companies is their corporate colours, brand, and marketing activities.

New entrants

Although the sector is already very competitive, new entrants are still keen to come into the market. In many cases these new entrants have no existing connection with the gambling industry. They have included magazine publishers, television broadcasters, and airlines.

One common feature of these new entrants is that revenues have been falling in their main activity because advertising revenues were falling or business models changing, especially during the recession of 2008/9. In the UK in particular, gambling is much more high profile than it has been, with more advertising, sports sponsorship, and poker being broadcast on television. There is the perception that it is an easy business from which to make money. This perception is not an accurate one, but there is some encouragement for new companies entering the Internet gambling arena. First, customers have no particular brand loyalty, so will be receptive to new entrants and, for customers, the cost of switching between operators is low.

The barrier of entry in the e-gaming market is relatively low too. To launch a gambling website does not require a great deal of capital. Funds are required to purchase a gambling licence and software, but it does not have to be a large sum. In the UK the application fee for

a remote gambling licence costs approximately GB£15,000, depending on the gambling services that are offered and the gross gambling yield of the company. The annual fee for an Internet gambling company generating less than GB£5.5 million in gross gambling yield is also in the region of GB£15,000.

There is a level of Internet gambling software to suit every budget, although the quality will, of course, vary. There is also the option for companies to develop their own software in-house rather than buying it from an existing supplier.

So the barriers to getting into the Internet gambling industry are relatively low, but the barriers to making a success of a new e-gaming business are high and becoming higher. The existing market is already very competitive and a substantial marketing budget is required to attract players. Established companies have the benefit of extensive customer behaviour data to plan marketing and customer relationship management. Regulatory costs involved in being able to operate in multiple European markets are rising too.

Finally, new companies coming into gambling from other sectors are often more risk-averse than they realise. This is particularly the case when it comes to sports betting where they cannot cope with the uncertainty of fluctuations in margin and periods of bad runs of results. For this reason many new entrants consider either pari-mutuel (pool betting) or lottery models which are less risky. But these models have high failure rates because they need large numbers of players to participate in order to generate sufficient prize pools and are not as attractive to gamblers as the higher payout fixed-odds models.

Suppliers

There are a number of key suppliers that can exert an influence on the direction of Internet gambling: telecommunications providers, payment providers and banks, gambling software suppliers, marketing affiliates, and media suppliers.

In many offshore jurisdictions there is a limited supply of data centres and telecommunications providers and, as a result, they exert significant influence because it is not always easy for a gaming operator to switch to a rival supplier.

The ability to move money quickly and easily between the customer and operator is crucial to a successful e-gaming business. Its importance can be measured by the fact that governments focus on payment transactions when trying to prohibit Internet gambling. The US Unlawful Internet Gambling Enforcement Act 2006 (UIGEA) is a classic example. Norway's Payment Act was passed in February 2010 and came into force in June 2010 (Parker, 2010b). It too has made it illegal to process payments for Internet gambling where the gambling operator does not hold a Norwegian licence.

Banks too have an uneasy relationship with e-gaming. However, because of the difficulties posed by banks, a number of firms such as Counting House,¹⁵ Glue Pay,¹⁶ and Neteller¹⁷ have been set up to help facilitate payments from restricted or difficult jurisdictions.

The leading gaming software firms like Microgaming and Playtech hold significant bargaining power and can afford to be selective as to which operators to license their games software. Typically this will depend on the size of the customer, its brand and reputation, its existing database of clients, and the size of its marketing budget. The more the gaming operator can bring to the deal, the greater negotiating power they have with the software firm. In the Internet poker sector, several firms have tried and failed to write their own software and the most common practice is to join an existing network to benefit from pooled liquidity of players. Playtech's ipoker, Boss Media's International Poker Network (IPN), Entraction, and Ogame are some of the leading poker networks.

Advertising and marketing are very important aspects of the Internet gambling business, so media and marketing affiliates are key suppliers to the industry. In the UK print, television, and Internet media are generally accepting of gambling adverts, but that is not the case around Europe. In July 2010, for example, the ECJ upheld Sweden's ban on advertising in the country's media for online gambling that is not licensed in Sweden (Parker, 2010a). Finland brought in a similar advertising ban in 2010.

From late 2008 the search engine Google began allowing search campaigns from Internet gambling operators licensed in the UK or Alderney, Gibraltar, and the Isle of Man. These campaigns, however, were only allowed to target the UK. Since December 2009, the social networking website Facebook has had a policy of not carrying gambling advertising, but fan pages are allowed, as are free-to-play gambling-style applications.

So there are still some restrictions on advertising Internet gambling, but the Internet also allows a number of ways around these obstacles. Affiliate websites that drive customers to the gambling sites have been a very effective mechanism for recruiting players. A good affiliate site with high volumes of traffic can hold significant influence with the e-gaming operators because they are an important source of new players. Affiliates usually work on a revenue share of players' losses or, less commonly, a fixed fee per player recruited by the affiliate.

Customers

As already stated, the gambler is in a very strong position within Internet gambling. E-gaming firms are desperate to sign them up and will offer generous bonuses to attract them. Customers are not particularly loyal and can easily switch websites and find the same games and bets elsewhere. As a result, marketing is a hugely important activity for e-gaming.

Across the sector it is not unusual for operators to spend the equivalent of 25 per cent of their revenues on marketing activities. The leading firms are spending many tens of millions of dollars each year competing with each other for customers.

Substitutes

There is always competition from new products in the e-gaming sector and games are always evolving and being improved. But there is little long-term advantage in many of these products; the early entrants have a short period of benefit, but if something proves popular it is easy for other firms to add that game to their website.

Betfair's betting exchange model was perhaps the most revolutionary substitute product to launch in Internet gambling and that was in 2000. Betfair predicted the death of the traditional bookmaker when it was launched, which has not come to pass. But it has certainly shaken up the bookmakers and had an effect on the betting margins on horse racing in the UK.

Role of government

Perhaps the greatest force that influences the e-gaming market in Europe is government. It has been the case for the last decade and will continue to be so in the next decade. Governments have an uneasy relationship with the Internet and the loss of their control and power it brings. Many governments are also not in favour of gambling in general, unless it is run under their own monopoly.

Governments around the world have adopted different approaches to Internet gambling. Some have so far chosen to ignore it, or state that existing legislation for traditional,

land-based gambling covers all the new developments in Internet gambling too. Other governments have actively chosen to prohibit Internet gambling, such as the United States and Portugal, or restrict Internet gambling to state-run monopolies, such as Hong Kong and Finland.

Since 2006 there has been some slow movement towards the regulation of Internet gambling in a number of the major economies of the European Union, such as Italy and France. Government is a very powerful influence on Internet gambling and its decisions on prohibition of products, tax rates, and licensing requirements will determine the future shape of the Internet gambling market in Europe and around the world.

Notes

- 1 Gross gaming yield (GGY) definition: stakes minus customer winnings. It is the amount that customers lose to a gambling operator. It is also known as gross win or revenues.
- 2 <http://www.oddschecker.com/>
- 3 Gross win definition: stakes minus customer winnings. It is the amount that customers lose to a gambling operator. It is also known as gross gambling yield (GGY).
- 4 <http://www.betfair.com/>
- 5 <http://www.wbx.com/>
- 6 <http://www.betdaq.com>
- 7 <http://www.vlivecasino.com/>
- 8 <http://www.pokerstars.com/>
- 9 <http://www.888ladies.com/>
- 10 <http://www.win2day.at/gaming/>
- 11 <http://www.danskespil.dk/>
- 12 <http://svenskaspel.se>
- 13 <http://www.national-lottery.co.uk/>
- 14 <https://www.mylotto24.co.uk/>; <http://sports.williamhill.com/bet/en-gb/lotto>
- 15 <http://www.countinghouse ltd.com/>
- 16 <http://www.gluepay.com/>
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