



**GOVERNMENT RESPONSE TO THE SCOTTISH AFFAIRS
SELECT COMMITTEE'S REPORT ON THE VIDEO GAMES
INDUSTRY IN SCOTLAND: SECOND REPORT OF SESSION
2010-12**

Presented to Parliament
by the Secretary of State for Culture, Olympics, Media and Sport
by Command of Her Majesty

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Government response to the Scottish Affairs Select Committee Report on the Video Games Industry in Scotland

Introduction

1. The Government welcomes the Scottish Affairs Select Committee's Second Report of session 2010-12.
2. We are grateful to the Committee for its examination of the Video Games Industry in Scotland, the key issues affecting the video games sector and relevant Government policies, based on written and oral evidence from stakeholders. We welcome the consideration the Committee has given these issues.
3. The Government agrees with the Committee's assessment that the video games sector has grown rapidly over a relatively short space of time to now represent a major global industry. The predicted strong annual growth rate of the world's market for video games offers great opportunities for games businesses in the UK and for our future economy. We agree also that the UK video games sector is currently facing a number of challenges including competition for investment from countries such as Canada, concerns about the ability in coming years to be able to source enough employees with the specific mix of skills that games development studios prefer and the need for a prevalence of more sustainable business models.
4. The video games sector is undergoing an unparalleled period of change as the proportion of the general population playing games continues to expand, the move to more online content delivery progresses and new patterns emerge in terms of the type of games content consumers prefer and in the way they wish to consume it. Government aims to create the right conditions to ensure UK-based games businesses are well placed to exploit the opportunities that are emerging to develop new, more successful business models and to develop compelling propositions for original intellectual property. Many games companies for example will benefit from measures introduced in the June 2010 Budget and in Budget 2011, including reductions in corporation tax and changes to the Research and Development (R&D) tax credit scheme which will offer an increased financial incentive to many innovative games development studios.
5. The UK video games sector remains the largest in Europe employing around 9,000 people in games development in 2010 in companies located across the UK. We note that recent data from analysts Games Investor Consulting for trade body Tiga suggests there has been a welcome growth in new video games company formation in the UK since 2008, with some 145 new entrants mainly focussed on the newer markets such as mobile and social games.

6. Government has carefully considered all the recommendations made by the Committee in its Report and this document represents its response.

Conclusions and recommendations

More needs to be done to future proof age verification for video games accessed online. The industry and universities are well placed to research how best to go about ensuring children cannot gain access to inappropriate adult content. Therefore we recommend that Government look into supporting such research and ask the industry to see how they too can invest in such research as a part of their corporate social responsibility (para 20)

7. As the Committee acknowledges, significant improvements have been made by the video games industry in relation to the need to protect children from content unsuitable for their age-groups. We will continue to work with industry to encourage their endeavours to provide better information for parents on video games content and on improved parental controls on equipment.

8. Creating a safer online environment for children and young people is the core aim of the UK Council for Child Internet Safety (UKCCIS). UKCCIS brings together over 170 representatives from Government, hardware and software manufacturers, children's charities, parenting groups, internet service providers, social networks and regulatory bodies.

9. The work of UKCCIS is overseen by an Executive Board which is chaired jointly by Ministers from the Department for Education (DfE) and the Home Office. The Board sets the strategic direction for UKCCIS and determines priority areas of work for members of the Council to take forward by project groups. The decisions made by the Board are informed by the findings of the UKCCIS Evidence Group, a panel of experts led by Professor Sonia Livingstone who are building an evidence base of research relating to the safety of children online.

10. There is currently no "silver bullet" solution to prevent children and young people being exposed to inappropriate content in online environments and a multi-faceted approach to this problem is needed. At present, two UKCCIS project groups are examining how to limit the availability of age-inappropriate content in all online environments, including videogames; the Parental Controls group and the Age Verification group.

11. The Parental Controls group is examining the parental control and filtering software currently available across all internet enabled devices, looking at the level of uptake of parental controls and working towards recommendations that could be adopted by industry in order to improve the availability and uptake of parental controls. The group is looking at the evidence of how effective currently available parental controls are and

seeking solutions to common barriers to their uptake along with problems that can arise with such software for example, over-blocking.

12. The Age Verification group is seeking to identify the policy and legislative barriers to the deployment of a large-scale technical solution to verifying the age of internet users in the UK. Experts from across Europe and the USA are working alongside UKCCIS members in this group to share their experience with online age verification including examples of best practice and barriers to implementation. This group will report its findings to the UKCCIS Board and make recommendations about any changes needed to policy or legislation in the UK to facilitate a more robust method of online age verification.

We believe that a cost benefit analysis should be done of the video games industry and the film industry to see which gives the better value for money (para 50)

13. Government welcomes the Committee's analysis of the discussions and issues around the potential for a tax relief to support the production of video games in the UK. We note that the Committee is divided over the case for a tax relief for the sector and is unlikely to come to a consensus on this issue.

14. We do not see a case for carrying out a cost benefit analysis of the film and of the video games industries at present. The film and video games industries both make valuable contributions to the UK economy. However, film tax relief was not introduced exclusively to address an economic policy objective. The scheme is designed with a primarily cultural aim of promoting the sustainable production of films with British cultural content that may not otherwise be made. The scheme is approved as a State aid, under Article 107 (3) (d) of the Treaty on the Functioning of the European Union, as an aid to promote culture.

15. The case put forward for providing a tax incentive for the development of video games is to provide a competitive tax environment for the video games industry. The Government seeks to provide a competitive tax environment not just for the video games industry, but for companies in all sectors. Building on the aim to create the most competitive corporate tax regime in the G20, *The Corporate Tax Road Map*, published in November 2010, set out how the Government intends to approach reform of the corporate tax system. It is the Government's view that, in general, providing a low corporate tax rate with fewer reliefs and allowances will provide the best incentive for business investment, promoting economic growth.

16. The June 2010 Budget announced that a tax incentive for the development of video games would not be introduced. However, the Government announced phased reductions in the main rate of corporation tax which will provide a competitive tax environment for companies in all sectors, including the video games industry. Following the further reduction announced in Budget 2011, the UK's main rate of corporation tax will be 23 per cent by

2014. This will be the lowest rate in the G7, and the 5th lowest in the G20, ensuring that the UK remains an internationally competitive place to do business.

17. Additionally, Budget 2011 also announced a series of reforms to the R&D tax credit schemes and to the schemes designed to incentivise equity investment in smaller, higher growth companies- the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs). These reforms included increasing the rate of EIS income tax relief to 30% and increasing the rate of SME R&D relief to 225% by 2012. These changes will help stimulate investment in, and by, innovative companies in the games sector.

We are surprised and disappointed that the Minister for Culture, Communications and Creative Industries was only able to lobby the Treasury indirectly on the games tax relief. We expect the industry to be better represented in future. We invite the Government to explain how it will ensure that the voice of the industry is properly represented and give an undertaking that this experience will not be repeated (para 54)

18. As the Prime Minister announced on 18th January 2011, sponsorship of the video games industry is now centralised within the Department for Culture, Media and Sport (DCMS). DCMS has a clear, focussed remit to champion the video games industry in Whitehall, seeking to ensure that the sector's interests are fully taken into account in the development of Government policies.

19. The Government engaged intensively with the video games sector in the process of developing the Digital and Creative Industries *Plan for Growth*, published alongside Budget 2011. Based on evidence gathered through consultation with industry stakeholders, the Minister for Culture, Communications and Creative Industries presented his proposals for creating the best conditions for stimulating private sector growth to a ministerial group chaired by the Chancellor and the Business Secretary in February 2011. Subsequently the *Plan for Growth* set out Governments ambitions for the UK to be a world leader in the creative industries – including video games – with specific actions to tackle major barriers to growth and create the right conditions for businesses to flourish.

20. Following a roundtable with business leaders from the creative industries chaired by the Secretaries of State for Business, Innovation and Skills (BIS) and for DCMS on 8 February 2011, it was agreed that the group would continue to meet regularly as a new Creative Industries Council. The Council – which includes senior representation from the video games industry - will focus on coordinating concerted action to address major barriers to growth.

We recommend that the possibility of introducing a tax relief be kept under review, and the health of the industry be monitored for the potentially malign effects of uneven international competition. We recommend that the Government, meanwhile, undertake a full and

comprehensive assessment to determine the benefits of such a relief, as well as examining those countries whose industries continue to flourish without Government support (para 57)

21. The Chancellor of the Exchequer keeps all decisions on tax policy under review. Maintaining the competitiveness of the UK's tax system remains a priority for the Government. The *Plan for Growth*, published alongside the Budget, reaffirmed the ambition to create the most competitive tax system in the G20.

22. However, the Government recognises that tax is only one factor when looking to support growth and investment by businesses in the UK. The *Plan for Growth* also outlined the Government's ambitions to make the UK one of the best places in Europe to start, finance and grow a business; to encourage investment and exports as a route to a more balanced economy; and to create a more educated workforce that is the most flexible in Europe.

23. Working towards these ambitions will ensure that progress is made towards achieving the Government's economic policy objective of strong, sustainable and balanced growth.

24. We welcome the Committee's assessment that measures in Budget 2010 would have a positive impact on start-up companies and SMEs in the video games sector.

We recommend that the Government set out how it plans to work with NESTA on adapting the research and development tax credits so that video games companies can make full use of the scheme (para 63)

25. On 29 November 2010, the Government published a consultation on the support that the R&D tax credit schemes provide for innovation. Six consultation events were held nationally and over 80 responses were received before the closing date on 22 February 2011.

26. As an initial response, the Government announced a package of changes to improve and simplify the schemes in Budget 2011, including increasing the SME scheme rate of relief to 225 per cent from April 2012, subject to State aid approval. These changes will benefit innovative companies across the economy. We note that these announcements were welcomed by representatives of the video games industry.

27. The Government will publish a full consultation response in May 2011.

The creation and retention of intellectual property is a priority issue for the UK video games industry. We welcome the review of the taxation of IP currently being undertaken by Government. We expect Government to set out for the implementation of the recommendations of the taxation of IP review (para 66)

28. *The taxation of innovation and intellectual property*, published on 29 November 2010, announced that the Government would introduce a reduced 10 per cent rate of corporation tax for profits arising from patents, effective from 1 April 2013, and that it would consult on the support R&D tax credits provide for innovation.

29. Budget 2011 announced a package of changes to improve and simplify the R&D tax credit schemes, and that further consultations on both the Patent Box and R&D tax credits will be published in May 2011.

The Government has a responsibility to help create an economic environment in which the creative industries can flourish. Impediments for growth in the UK are emerging and we believe the Government should make the future of this industry a priority (para 30).

We recommend that proposals for more targeted support should be set out by the Government accompanied by a clear and costed action plan (para 68)

30. The Digital and Creative Industries *Plan for Growth* sets out our intended actions for supporting the future growth of these industries, including the video games sector.

We support the Government's decision to commission an independent review of education and training in the UK video games sector. We expect the Government to set out a timetable for analysis of the review and for developing its action plan for working with the Scottish Government on the recommendations (para 76)

31. Government agrees that the availability of appropriately skilled employees is a crucial issue for the UK video games industry, particularly if we are to pursue our aims of ensuring our games businesses are well-placed to exploit the fast-growing global market for interactive content. Unfortunately, as our *Plan for Growth* acknowledges, there is a shortage of skills across the wider digital and creative industries, particularly amongst graduates.

32. In February 2011, the Government welcomed the publication of the independent Livingstone-Hope Report ("Next Gen") on skills for the video games and visual effects sectors. We are grateful to the huge commitment shown to this valuable work by its leaders Ian Livingstone of Eidos and Alex Hope of Double Negative and to the efforts of NESTA, Skillset and e-skills UK towards delivering a comprehensive piece of research and analysis. The strong response from industry and the education sector to this review was unprecedented and underlines the priority that stakeholders attach to skills development.

33. The Government is in ongoing discussion with a range of stakeholders about the analysis and recommendations of the Livingstone-Hope Report. Its evidence is, for example, a useful contribution towards the National Curriculum Review which is currently underway. As the Government's *Plan for Growth* confirms, Government will respond formally to the Livingstone-

Hope Report in the summer. In the meantime, DCMS is working with the video games industry on the creation of a Steering Group to follow up the Livingstone-Hope Report. The Group will meet regularly, where possible under the chairmanship of the Minister for Culture, Communications and Creative Industries. Discussions will include consideration of how to work with the Scottish Government on skills for the video games industry going forward.

There needs to be more focus on hard skills needed for the industry such as mathematics and computer science. Other important factors necessary to ensure graduates are both trained for industry and able to find a job are the levels of engagement between higher education institutions and industry, and the incentives for industry to take on talented graduates as trainees. We recommend that the Government's strategy for addressing such issues is set out in its response (para 73)

34. These are all issues that are raised in the context of the Livingstone-Hope Report which as noted previously the Government is currently considering very carefully and will respond to formally in the summer. With regards to incentives for employers, it is worth noting at this stage that there is likely to be limited Government support due to the unprecedented financial difficulties in the public sector.

35. Government would encourage the video games industry to engage with the Higher Education (HE) sector to ensure that their skill needs are effectively expressed. It's important that the HE sector takes on board these issues to ensure that the graduates who emerge have the skills employers need. We welcome the commitment shown by many in the video games industry to take forward recommendations of the Livingstone-Hope Report that are identified as primarily for the industry. We are delighted for example to see the Video Games Ambassadors scheme announced by UKIE and STEMNET on 24th March 2011, enabling games sector professionals directly to encourage young people to study subjects such as mathematics and computer science and thus help improve the future supply of STEM graduates.

The £5m prototype scheme, to be run by Abertay University, is an excellent example of support targeted towards a priority issue for the video games industry. We expect Government to monitor the progress of scheme, and if it is successful, to explain how it will ensure it is replicated nationwide (para 74)

36. Government welcomes the Committee's positive views on the potential value of the work being carried out at Abertay University. The University's video games prototyping programme is being supported with a £2.5m grant from UK Government. Naturally grant conditions require us to monitor the roll-out of the project carefully to ensure it delivers good value for money and this includes an assessment of the economic impact it has on the UK's games sector. It is important to recognise that the prototyping fund being delivered by the University of Abertay is already nationwide as applications are invited from eligible games companies based anywhere in the UK.

37. Whilst it is relatively early days with Abertay's games prototyping programme and far too soon to make an assessment of its effectiveness, we are very pleased with progress to date. Some 57 applications were submitted to the first call for proposals. The 6 projects selected for the first round of funding are now starting to get underway and are spread all around the UK, including in Dundee, Liverpool, Bristol and Newcastle. We look forward to an equally strong response to the current and subsequent calls for proposals. This Government-supported programme is due to run on until 2013.

The innovative practices in place at the University of Abertay, such as workplace simulation, the level support given to graduates starting their own business and the level of cooperation with local industry should be replicated across the UK. We recommend that the Government set out how it will develop ways of encouraging the adoption of these practices nationwide (para 72)

38. We are already starting to promote the University of Abertay's approach to workplace simulation through the Government-funded prototype programme. Projects around the UK that are funded under the scheme will include the opportunity for talented students to work directly on the development of games prototypes.

39. There are several models of close industry and HE collaboration - the Livingstone-Hope Report rightly highlights Abertay and also the work of Bournemouth University in this area, for example - and we would expect to be looking closely with industry and universities at these as part of the follow up activity to Livingstone-Hope.

We recommend that Government should outline how it will work with universities and the industry to ensure talented graduates remain in the UK (para 78)

40. The Livingstone-Hope Report sets out a number of actions to promote industry collaboration and career opportunities in the video games sector. The video games sector is already looking at a number of possible new activities aimed at attracting talented graduates.

41. More generally, as set out elsewhere in this response we are working towards creating the right conditions in the UK that will encourage the growth of the video games sector and thus the creation of high-value, rewarding jobs in games development.

The Government has an important role to play in providing support to business in attracting finance. We invite Government to outline how business support is being tailored to video games companies (para 81)

42. Business support to video games companies in Scotland is of course the responsibility of the Scottish Government.

43. Government is improving and modernising how it provides information to businesses and how it supports and encourages those who want to start or grow their business. Our new approach will include:-

- Online business information and tools tailored to each business' needs, through improvements to the www.businesslink.gov.uk website;
- A national contact centre to help businesses who cannot find the information they need on the web or who are not connected to the internet;
- Help for start-ups through a tailored package of measures, including an expansion in the planned New Enterprise Allowance, to help the unemployed become self employed;
- A network of at least 40,000 experienced business mentors offering practical advice to existing businesses and people who want to start a business;
- Business Coaching for Growth, backing high growth SMEs to enable them to realise their potential;
- Action to raise low entrepreneurial activity among key parts of our communities, including women, Black, Asian and Minority Ethnic groups and ex-service personnel.

44. We will be working alongside the private sector and business support organisations to help small businesses – including those in the video games sector - make sense of the range and type of support available to them.

45. We recognise that there are many excellent private providers of business advice, in addition to business networks, both online and offline. Our role is not to duplicate this activity, but to intervene only where markets do not operate effectively.

We see the need for a more targeted marketing strategy to attract investment to Scotland and recommend that Government work with the Scottish Executive and trade associations on a more targeted strategy to formulate and implement such a strategy relating to the video games industry in particular. We invite it to set out how it intends to do this (para 85)

46. Government welcomes the opportunity to engage with Scottish Executive on marketing propositions and sales messages for the video games sector in the UK. UK Trade and Investment's Marketing Group and Business Group will be best placed to support this activity.

47. We are delighted to note the recent announcements by Scottish Enterprise of two major new video games inward investments in Scotland – in Dundee (Outplay Entertainment) and Edinburgh (Reloaded Productions).

This is a “golden age of opportunity” for the video games industry, with small businesses able to access global audiences. It is imperative that guidance and support is available for these companies. We recommend that the Minister for Culture, Communications and Creative Industries holds regular meetings with companies in the games industry to

develop and provide this support. We recommend that Government sets out its strategy for engagement with the video games industry and its underlying criteria to enable the video games industry to secure Government support (para 87)

48. The Minister for Culture, Communications and the Creative Industries engages separately with a wide range of individuals, companies and trade organisations in the video games sector. He also has a programme of regular, roundtables with CEOs and other key representatives from across the sector both on general competitiveness issues and specific policy areas. This includes for example, planned regular meetings with industry and others around issues raised in the Livingstone-Hope Report and a major event planned for May 2011 with NESTA which will bring together video games companies and investors.

We see an argument for a trade body representing companies in Scotland with the UK Government, trade associations and games companies all involved in its creation. We recommend that Government should set out its action plan for such a body (para 88)

49. We do not believe that Government should intervene to create new trade associations for the video games industry. It is entirely for businesses in the sector to determine how best their interests should be represented through membership-based organisations.



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