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THE ENTERTAINMENT SOFTWARE INDUSTRY IN CANADA

Report of the Standing Committee on Industry, Science and Technology

David Sweet
Chair

MAY 2014

41st PARLIAMENT, SECOND SESSION

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has the honour to present its

FOURTH REPORT

Pursuant to its mandate under Standing Order 108(2) the Committee has studied the Entertainment Software Industry in Canada and has agreed to report the following:

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THE ENTERTAINMENT SOFTWARE INDUSTRY IN CANADA

INTRODUCTION

On 10 February 2014, pursuant to Standing Order 108(2), the Standing Committee on Industry, Science and Technology (hereafter "the Committee") adopted the following motion:

> That the Committee undertake a study on the entertainment software industry in Canada and its integral role in the Canadian economy, and how the industry continues to be a model for growth and technological innovation, commercial success, and the creation of highly-skilled jobs, and that it report its findings to the House.

The Committee heard from 26 witnesses over the course of the hearings, which began on 24 February 2014 and concluded on 7 April 2014.

This report aims to identify the key elements of the Committee's study of the entertainment software industry and proposes related recommendations to the Government of Canada. Chapter 1 provides background information about the entertainment software industry in Canada. Chapter 2 examines the challenges and opportunities this industry is facing, including the role of the private sector, educational institutions and the federal government in addressing these challenges. Finally, Chapter 3 provides the Committee's recommendations to the Government of Canada to address these challenges.

CHAPTER 1: OVERVIEW OF THE CANADIAN VIDEO GAME INDUSTRY

A. From Humble Beginnings to a Growth Industry

Canada's entertainment software industry is currently the 3rd largest in the world behind that of the United States and Japan in terms of employees, and ranks number one on a per-capita basis. The entertainment software industry generates about $2.3 billion in gross domestic product (GDP) annually in Canada. Much of the growth in this industry started in the 1990s due to a combination of factors.

Jonathan Lutz, Vice-President and Chief Financial Officer, Electronic Arts Inc. (EA), reminded the Committee of the small size of the Canadian video game industry in 1991. At that time, the company began its operations in Canada with the acquisition of Distinctive Software, a Canadian video game developer established in Burnaby, British Columbia. According to Mr. Lutz, EA's decision to establish operations in Canada in the early 1990s was based mostly on the availability of strong talent within the greater Vancouver area and, to a lesser extent, the proximity of this location to EA's headquarters in Redwood Shores, California. The favourable exchange rate between Canada and the United States that existed at that time also played a role.

Similar to EA's experience in British Columbia, Nathalie Verge, Senior Advisor, Corporate Affairs, Ubisoft Entertainment Inc., told the Committee that the availability of a large pool of artistic talent, bilingual workers, the cluster of telecommunications and software development companies, and the creation of a Quebec payroll tax credit for the video game industry in 1996 motivated their company to open a studio in Montréal in 1997. According to Geneviève Poulin, Advisor, Corporate Affairs, Ubisoft Entertainment Inc., that studio employs 2,650 people and is currently the firm's largest in the world. The Committee also learned that Ubisoft was planning to create 500 additional jobs over the next 7 years. Also on the subject of future growth plans, Martin Carrier, Vice-President and Studio Head, Warner Brothers Games Montréal, noted that Warner Brothers intended to grow its labour force in Montréal by 100 workers by 2018.

Jayson Hilchie, President and Chief Executive Officer, Entertainment Software Association of Canada, summarized the success of the Canadian video game industry as follows:

> Canada has had tremendous success in the past with big budget video game blockbusters and we're known the world over for franchises like NHL and FIFA, *Mass Effect*, *Assassin's Creed*, *Splinter Cell*, and *Batman: Arkham Origins*, to name just a few. We're also well known for successful indie titles and critically acclaimed games that are enjoyed the world over. We've seen tremendous growth in this sector over the past few years.

While also acknowledging Canada's past successes, Jason Della Rocca, Chief Executive Officer, Execution Labs, cautioned that the Canadian video game industry was still vulnerable to downturns in the economic cycle, as exemplified when Vancouver lost about half of its workforce during the economic crisis of 2008. Mr. Hilchie articulated that the global entertainment software market is estimated at $77 billion for 2014 and is

predicted to reach $100 billion by 2018, which is bigger than box office revenues for movies worldwide.

B. Facts and Figures on the Industry

As illustrated in Figure 1, there were a total of 329 video game companies in Canada in 2013 and most of these companies were located in Quebec, Ontario and British Colombia.

Figure 1 – Number of Video Game Companies Operating in Canada by Province, 2013
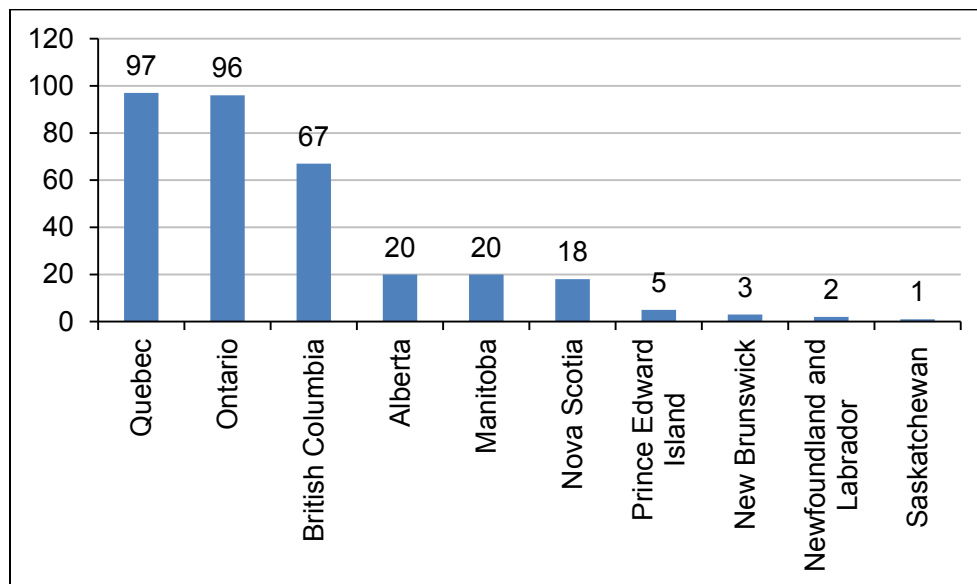
Source: Entertainment Software Association of Canada, *2013 Essential Facts about the Canadian Video Game Industry*, document submitted to the Committee on 5 March 2014.

According to a document entitled *2013 Essential Facts about the Canadian Video Game Industry* that was submitted to the Committee by the Entertainment Software Association of Canada, in 2013, 88% of companies were either micro companies with 0 to 4 employees or small companies with 5 to 99 employees; the remaining 12% of companies were large companies, with 100 employees or more. Donald Henderson, President and Chief Executive Officer, Interactive Ontario, also indicated that the large companies that make video games for personal computers (PCs) and consoles such as Xbox and PlayStation are usually located in Montréal and Vancouver, while many of the micro and small companies that make games for smart phones and tablets are located in Ontario. Only 4% of Ontario's digital media companies are currently considered large companies. He also expressed the view that Ontario's video game companies tend to be very entrepreneur-driven given their smaller size.

As presented in Figure 2, with 8,750 employees, Quebec accounted for 53.0% of the employment in the Canadian video game industry in 2013, followed by British Columbia with 5,150 employees (31.2%) and Ontario with 1,850 employees (11.2%). Mr. Hilchie noted that the average age of employees working in the Canadian video game

industry was 31 in 2012 and that their average salary for that year was $72,000.

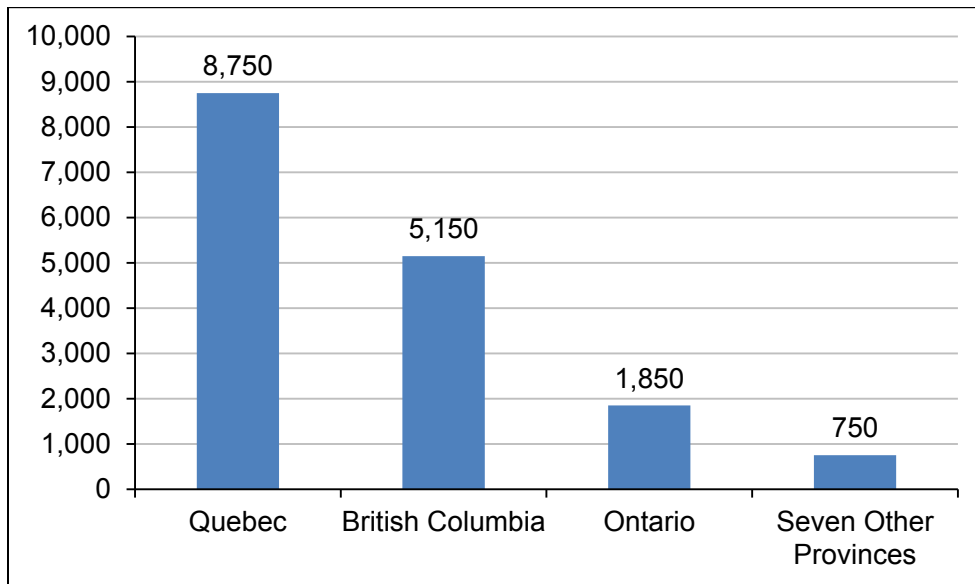**Figure 2 – Number of Employees Working in the Canadian Video Game Industry by Province, 2013**

Source: Entertainment Software Association of Canada, *2013 Essential Facts about the Canadian Video Game Industry*, document submitted to the Committee on 5 March 2014.

Noting the significant decline in the demand for Canadian actors in films and television over the past years, Simon Peacock, member, Alliance of Canadian Cinema, Television and Radio Artists – National, emphasized the great employment opportunities that are generated by the Canadian video game industry:

> Video games to a large extent have picked up that slack for a lot of performers. It's almost like a safety net for Canadian culture in many ways. If you value the arts, such as the theatre, video games now are largely subsidizing that. I can tell you that most of the actors who I work with also do theatre, but it doesn't pay the rent very well anymore, unfortunately.

For his part, Mr. Hilchie stressed that the Canadian video game industry comprises and fosters a unique mix of artistic, technological and commercial skill sets such as visual effects, game and sound design, motion or performance capture, computer programming, narrative development and marketing, which produce truly innovative products. He also suggested that such skills are highly transferable and can be used by other sectors of the Canadian knowledge economy to generate additional innovation.

CHAPTER 2: CHALLENGES AND OPPORTUNITIES AND THE ROLE OF THE PRIVATE SECTOR, EDUCATIONAL INSTITUTIONS AND THE FEDERAL GOVERNMENT

A. Shortage of Skilled and Experienced Workers

Deirdre Ayre (member, Other Ocean Group Canada, Canadian Interactive Alliance), Pierre Moisan (Vice-President, Strategic and Business Affairs, Frima Studio), Mr. Lutz, Ms. Poulin, Ms. Verge, Mr. Henderson, Mr. Hilchie and Mr. Carrier raised the issue of the shortage of skilled and experienced workers in the Canadian video game industry. As per their assessment, this shortage can be attributed to three main factors:

- The relative youth of this industry in Canada compared to the United States and Japan, which reduces the pool of experienced Canadian employees who can fill the vacant senior positions.

- The difficulties associated with training intermediate and senior employees from other industries to come into the video game industry as senior employees because of the uniqueness of this industry that combines math, science and art.

- The fact that video game developers are competing with other industries for increasingly rare skilled and experienced professionals such as computer programmers and software engineers.

i) The Role of Government Programs

While indicating they would always prefer to hire a Canadian worker as opposed to a foreign worker with the same skill set and experience, Mr. Lutz, Mr. Moisan, Mr. Hilchie, Ms. Poulin and Ms. Ayre reported that in Canada, it is sometimes impossible to find suitable personnel without stealing them from competitors. In order to alleviate this shortage, the witnesses advocated for better and easier access to foreign workers through the Temporary Foreign Worker Program (TFWP), and in particular, through its Canadian Intra Company Transfer component. Ms. Ayre noted that mid- and senior-level staff hired from abroad often act as mentors to less experienced Canadian workers. She also estimated that for every senior-level worker hired abroad there are about three or four junior Canadian persons employed in the Canadian video game industry.

Mr. Hilchie stated that delays in processing Labour Market Opinions (LMO) and issuing work permits had increased considerably due to changes made to the TFWP to prevent the abuses of this program that had occurred in other industries. For her part, Ms. Poulin expressed some concerns about the delays and the red tape associated with the Canadian Intra-Company Transfer Program:

> We face some obstacles in the international recruitment process, including long delays in obtaining labour market opinions — especially since the expedited process was suspended — proposed constraints to the Intra-Company Transfer Program, a four-year

limit for work permits, delays and unequal treatment in embassies, and so on. All that greatly complicates the process used to find those resources, which are really essential for us.

When questioned about potential changes to the intra-company transfer component, Mr. Lutz warned that increasing the minimum years of work experience from one to three years, requiring companies to pay higher salaries of 30% or more for foreign workers, and eliminating access to the program for companies that use too many foreign workers could seriously impact EA's productivity.

Alexis Conrad, Director General, Temporary Foreign Worker Directorate, Department of Employment and Social Development, explained that the department had the opportunity to meet with many representatives of the entertainment software industry and that the government is aware of the industry's needs to have access to foreign workers without undue delay. David Manicom (Director General, Immigration Branch, Department of Citizenship and Immigration) remarked that the TFWP serves to attract highly skilled foreign nationals who may eventually settle in Canada permanently and become citizens. Mr. Conrad stressed that what the government is trying to accomplish through recent and pending reforms to the TFWP is to ensure that employers with a good track record that have demonstrated the non-availability of Canadians to do highly paid work have timely access to temporary foreign workers. According to Mr. Conrad, the purpose of the reforms is to ensure that temporary foreign workers are not used as a substitute for Canadian workers or in lieu of a proper human resource strategy to hire and train Canadians. This last element explains why the government is putting in place a requirement that companies applying for temporary foreign workers provide a plan outlining the steps they will take to transition to Canadian workers.

Mr. Manicom noted that employers must first apply to Employment and Social Development Canada for a LMO to hire a temporary foreign worker. Once this authority is granted, the future employee can apply to Citizenship and Immigration Canada (CIC) for work authorization. The intra-company transfer stream of the TFWP is exempted from the LMO process. Mr. Manicom indicated that the intra-company transfer stream is subject to an ongoing review by the federal government and that consultation with employers and stakeholders is taking place.

Mr. Manicom also observed that other programs, such as the Canadian Experience Class and the Federal Skilled Worker Program, aim at attracting highly skilled professionals to Canada. CIC is rolling out a new electronic system for these programs in January 2015 to manage economic immigration applications. This new system would allow the federal, provincial and territorial governments as well as employers to actively target highly skilled immigrants and to match them with jobs available in Canada.

ii) The Role of Academic Programs

Further on the issue of labour shortages, Jocelyn Benoit, professor, École des arts numériques, de l'animation et du design, who appeared as an Individual, made the following four suggestions to increase the availability of skilled and experienced Canadian workers for this specific industry:

- Companies should be encouraged to free some of their employees to teach in Canadian colleges and universities.

- Colleges and universities should create training programs that allow the transfer of highly qualified workers from other industries in which demand for their skills is declining.

- The development of employees' skills should be supported as an ongoing process.

- The Canadian video game industry should offer more internships for students.

On this last point, Mr. Benoit mentioned the example of Ubisoft, which has started an inter-university competition for video game prototypes. Once the winning project is chosen, a team of 40 to 50 people is formed on the chosen university campus to produce the game. Mentorship comes first from university professors and then from Ubisoft employees.

Some witnesses suggested that improving academic programs that lead to a career in the video game industry could also help alleviate the shortage of skilled and experienced workers over the long term. In this regard, Mr. Della Rocca stressed the importance for colleges and universities to train students for entrepreneurship and nimbleness instead of training them only for employment in specific jobs. Additionally, Richard Smith, Director and Professor, Master of Digital Media Program, Centre for Digital Media, said that the Master of Digital Media Program teaches entrepreneurial skills and supports entrepreneurial ventures. He also noted that many of his students created their own companies either during their studies or after graduation. The Committee learned that annual fees for this program are about $30,000 for a Canadian student and $52,000 for a foreign student because the school operates on a break-even basis with no government subsidies to lower tuition fees.

In term of artistic training, Mr. Peacock argued that colleges and universities should start offering theatre programs and mid-career training that would provide students with the artistic skills that video game developers are looking for (voice-overs, motion-capture acting, etc.).

B. Fiscal Competitiveness

As shown in Table 1, in 2013, there were six provinces that had a tax credit for their provincial video game industry. While the rates and amounts of these credits varied from one province to another, all these tax credits are tax expenditures that subsidize the cost of labour.

Table 1 – Provincial Tax Credits for the Video Game Industry, 2013

Provinces	Fiscal Incentive
Quebec	**Tax Credit for Multimedia Titles** General component: Category A Titles: 30% of qualified labour.+ Premium for French: 7.5% of qualified labour if in French language version. Category B titles: 26.25% of qualified labour. Specialized corporations (credit is based on corporation's qualified labour, not production's qualified labour): If certificate states that a minimum of 75% of eligible media titles produced are Category A titles or that a minimum of 75% of gross revenues came from Category A titles: 30% of corporation's qualified labour. + Premium for French 7.5% of corporation's qualified labour. Other: 26.25% of corporation's qualified labour.
Ontario	**Interactive Digital Media Tax Credit** 40% of eligible Ontario labour directly attributable to interactive digital media products (no maximum) and eligible marketing and distribution expenditures (maximum of $100,000 per eligible product). Or: "Specified products" (fee-for-service products): 35% of eligible Ontario labour directly attributable to interactive digital media products (no maximum). Or: Large game companies: 35% of eligible Ontario labour directly attributable to the development of eligible digital games (no maximum).
British Columbia	**Interactive Digital Media Tax Credit** 17.5% of qualified British Columbia labour directly attributable to interactive digital media activities.
Manitoba	**Interactive Digital Media Tax Credit** 40% of eligible labour for prototyping and product development and up to $100,000 of eligible marketing and distribution expenses (maximum credit of $500,000 per project).
New Brunswick	**Digital Media Development Program** 30% of eligible New Brunswick labour (maximum of $15,000 per employee). Maximum rebate of $500,000 per year.
Nova Scotia	**Digital Media Tax Credit** Lesser of: 50% of eligible Nova Scotia labour + regional credit: 10% of qualifying expenditures for productions outside the metro Halifax zone or 25% of total Nova Scotia expenditures + regional credit: 5% of qualifying expenditures for productions outside the metro Halifax zone.

Source: PricewaterhouseCoopers LLP, *Digital media and animation incentives in Canada 2013*.

There is currently no federal tax credit specifically designed for the Canadian video game industry. That said, video game developers may be eligible to apply for the federal Scientific Research and Experimental Development (SR&ED) tax incentive program, as well as various other federal initiatives created to encourage research and development (R&D) and innovation.

Mr. Della Rocca explained how Quebec's Production of Multimedia Titles tax credit works:

> The tax break that we talk about in the gaming industry is on labour. In Quebec it's 37.5% on labour. If I spend $1 million on programmers, artists, designers, etc., at the end of the year, when I file all my paperwork, I will receive $375,000 back from the provincial government.

Mr. Henderson told the Committee that governments around the world are trying to attract investments from video game companies since these investments create highly paid jobs and generate significant tax revenues. On that point, Mr. Hilchie stressed how common tax credits have become by indicating that in the United States, there are about 25 states that offer digital media or video game production tax credits.

Ms. Verge explained that it is important for Canada to maintain its fiscal competitiveness in terms of provincial tax credits as well as the SR&ED program because these incentives favour Canadian studios when Ubisoft, which has operations in 28 countries, decides where it should produce its next video game. Indeed, competition for investment occurs among video game developers as well as among the various studios within a company. Ms. Verge also indicated that provincial tax credits enabled video game developers to take more risks and to be more creative and innovative. Mr. Henderson reported that provincial tax credits and the federal SR&ED program were used by Ontario-based companies to grow their businesses, create original intellectual property and develop their own brands. Further to this point, Michael Schmalz, President, Digital Extremes, stated that over the past ten years, his company had developed its own proprietary game development technology with the help of the SR&ED program.

Mr. Lutz informed the Committee that EA applies for the SR&ED program in all the Canadian provinces in which it operates. This program is a key incentive for EA to conduct R&D in Canada. Mr. Lutz and Ms. Poulin argued that multinational companies should be treated equally under the SR&ED program because multinational companies such as EA and Ubisoft conduct important and innovative R&D in Canada. Sara Morton, Director, Interactive Ontario, Marit Stiles, Director, Public Policy and Communications, ACTRA – National, and Mr. Henderson advocated for the creation of a federal interactive digital media tax credit that would work in concert with existing provincial tax credits.

C. Access to Early Funding

Difficulty in accessing early funding was mentioned by many witnesses as a hindrance in establishing Canadian entertainment software companies. Mr. Della Rocca explained the various stages of venture funding:

> There are different stages where you have investments. At the very earliest stage it's what you would often call "love money" because someone has to love you to be crazy enough to give you money. So it's angels and it's rich uncles and that kind of stuff. Then you have seed stage, or early-stage investment. In Montréal an example there would be Real Ventures, which was quite active in developing the start-up ecosystem. It's not until you are sort of profitable and you're generating revenue and now you need growth capital, that's where you see Fondaction and FTQ coming in at that stage. It's far too risky for them to be playing in the love money and early stage because the level of

failures is quite high and the bets are much smaller. So generally they're doing bigger checks at a later stage.

According to Mr. Carrier, access to funding is very important for smaller companies in the video game industry. Funding can be accessed through the Canada Media Fund, for example, or through venture capital. Hibernum, which was supported by the Quebec Department of Culture and Communications' investment fund and co-financed by the Fonds de solidarité FTQ, was cited as an example. Mr. Della Rocca meanwhile stressed the importance of start-up funds for small firms, citing Real Ventures (also funded by the Solidarity Fund) as an example of success..

Khaled Shariff, Chief Executive Officer, Project Whitecard Inc., noted that if venture capital funding were easily accessible in Canada, there would not be a need for tax credits in the entertainment software industry. Mr. Shariff also argued in favour of tying government assistance to the market, meaning that government assistance would be contingent on obtaining venture capital from the private sector. Mr. Della Rocca offered a different perspective by explaining that tax incentives are close to irrelevant from a start-up point of view since, in order to eventually benefit from a tax credit, a start-up first needs to have money and spend it. Mr. Della Rocca also indicated that governments should not necessarily optimize tax incentives but should instead attempt to diversify the type of government assistance programs that are provided by offering early-stage investment funding, for example. He praised the Canada Media Fund, which provides financial support at an early stage, as a way of actually producing content and noted that positive effects, namely on-the-job training for young workers, would ensue from supporting start-ups.

Mr. Della Rocca also stated that there is a whole movement towards favoring start-ups and entrepreneurship and also highlighted the federal government's role in providing venture capital funds. He nonetheless noted that the entertainment software industry does not necessarily benefit from these trends. Further to this point, he indicated that the shift toward mobile and online gaming is changing the investment dynamic in the entertainment software industry by increasing the strategic importance of venture capital. Mr. Della Rocca also explained that facilitating access to early-stage capital would have a dramatic effect on the volume or velocity of start-ups as well as on the creation of new intellectual property in Canada. Mr. Della Rocca also stressed that this approach could protect the industry from the so-called "innovator's dilemma":

> The summary of the "innovator's dilemma" is that the very things you do to succeed today are the things that prevent you from succeeding tomorrow. It's your own success that blinds you to those shifts and disruptions that are occurring. The best way to counteract the innovator's dilemma is to have and support start-ups that are not encumbered by the rules of success of yesterday; that can explore and experiment and fail; that can become the new big thing. To the extent that all of the resources and all of the attention goes [sic] into supporting the current paradigm, we will be completely lost when the paradigm shifts.

Ms. Morton highlighted that the best way for governments to help increase the supply of venture capital is to provide matching funds to private financiers rather than try to pick winners. She further noted that tax measures in support of early-stage funding may be worth considering. On this aspect, Serge Landry, President and Chief Executive

Officer, Canadian Interactive Alliance, commented that not all types of venture capital are currently lacking in Canada; the problem of accessibility is most acute with early-stage funding, that is, seed funding in the range of $100,000 to $2 million. Mr. Landry also suggested that the Government of Canada should contemplate implementing a crowd-funding policy similar to that of the United Kingdom.

D. Creating Domestic Brands and Original Intellectual Property

Several witnesses, including Mr. Moisan, Mr. Della Rocca, Mr. Landry and Mr. Benoit, spoke of the importance of creating domestic brands and original intellectual property if Canada is to reap the full range of benefits from having a domestic video game industry. Mr. Della Rocca further argued in favour of establishing new metrics to define success such as: 1) What is the volume of new intellectual property being created?; 2) How many new start-ups are being created?; and 3) How much investment and venture capital dollars are being generated?

Mr. Moisan, Mr. Shariff and Ms. Ayre stressed the importance of the Canadian Media Fund in supporting the creation of original intellectual property in Canada. Mr. Moisan called the role of this program "essential," while Mr. Shariff and Ms. Ayre argued in favour of increasing its funding envelope, or at least not decreasing it. That said, Mr. Shariff recommended streamlining the application process for this program. He stated that over the course of several years, he had to fill out "maybe over 1,000 pages of applications". He further noted that even responses of 100 pages are too large and he gave as an example a project sponsored by the National Aeronautics and Space Administration (NASA) in the United States where the response was 15 pages long plus a presentation.

Mr. Moisan also noted that the need for subsidies will be diminished the day Canada has its own brands by illustrating that "Garfield doesn't need subsidies. Mickey Mouse doesn't need subsidies." Mr. Henderson cautioned, with respect to government subsidies, that the objective should be to develop an industry rather than to try to subsidize cultural products. He further expressed that support for interactive digital media must allow the government to recoup its investments through employment and taxes, for example.

For his part, Mr. Benoit noted that significant funding is available for applied research in engineering and programming but that financial resources are scarce in the artistic areas, such as video game and level design. Mr. Benoit thus argued in favour of making research funding in the visual and narrative aspects of video game production more accessible.

With regard to intellectual property, according to Mr. Lutz, the countries with the strongest intellectual property protection laws are the ones who will thrive in the digital economy, and he praised *The Copyright Modernization Act* of 2012 as a strong first step in this direction in Canada.

E. New Growth Opportunities: Example from Abroad

Sales of games through the internet have made it increasingly easy for video game companies to reach a global audience; thanks to online distribution, selling video games on the Asian market is now as straightforward as selling them on the local market.

The advent of online sales has meant a drastic reduction in distribution costs and a corresponding increase in growth opportunities for Canadian start-ups. Indeed, the success of a single game title could put a start-up on a fast track to becoming a multi-billion dollar company. Mr. Della Rocca and Mr. Landry gave the example of the Supercell success story in Finland to illustrate this point. Box 1 provides an extract of Mr. Della Rocca's testimony on Supercell's success story.

Box 1 — The Supercell Success Story

Jason Della Rocca, Chief Executive Officer, Execution Labs:

There is a company named Supercell based in Helsinki, founded in 2010, so less than four years ago. It was created or founded by some game industry veterans with a few other studios in Finland as well as folks from Nokia. (…). It was seed funded with around $2 million, give or take, in 2010. About two years after that, its next round of funding was $780 million.

It had two games within its short lifespan, two games that were generating more than $1 million a day of revenue. These are a special kind of games in the sense that that you play the games on your mobile phone and they are free, meaning you can download them and play them for free. But then once you're in the game playing there are opportunities to pay for a fancy sword, or accelerate with some bonuses, etc. But essentially, they are free games. They are making $1 million a day with a free game.

They had about 125 staff working on those two games, and by comparison, Electronic Arts, one of the big behemoths of the game industry in that timeframe, with their over 800-game library and 5,000 or 6,000 global staff, was not generating anywhere near that level of revenue. In less than four years, and this is roughly, I think it was around October-November timeframe, Supercell sold 51% of its shares to some investors from Japan for $1.5 billion.

A couple of guys starting up in Helsinki in 2010, with two games and original intellectual property, were able to flip themselves after a round of $780 million for another $1.5 billion. They were so proud of themselves and the revenue they generated. It should be noted that Finland does have various government supports, R and D funding mechanisms, etc. They put an advertisement in the newspaper with their tax bill of $345 million. They were proud to give back their share of taxes from their proceeds to their country.

F. The Mobile Revolution and the Marketing of Canadian Video Games

Mr. Moisan, Mr. Henderson and Mr. Hilchie all expressed the view that the ever-increasing interest of consumers and developers in applications for mobile devices such as smart phones and tablets is one of the most important trends affecting the video game industry. The mobile revolution is drastically changing the way video games are produced and consumed as well as the way they are monetized. Reflecting on the impact of this trend, Mr. Moisan observed that today's video games have to be able to communicate among different platforms such as PCs, consoles and mobile devices in order to allow a consumer to start playing a video game on one platform and then continue this same game on another.

According to Mr. Henderson, in conjunction with the emergence of mobile devices, a new way of monetizing video games called the "free-to-play" model has emerged:

> As was mentioned, there's this new model of game development, whereby you give away the core product and then you try to monetize later on. You get them excited about your game and then get them to the point where they want to buy more. It's a fairly new phenomenon. We've seen it in the games industry over the last several years, but it has dramatically changed the way the industry works, especially for digital products like tablets and mobile.

Mr. Moisan indicated that the free-to-play model represents an added difficulty as customers are getting used to playing for free: "People no longer pay for the games at the outset; they will pay if they like them". Thanks to mobile applications stores such as the App Store and Google Play, it has become increasingly easy for companies to distribute and sell games to a vast audience and for consumers to access them. According to Mr. Della Rocca, the benefit of "app" stores has been the elimination of the middlemen between the game and the consumer. These developments have resulted in a reduction in the barriers to entry in the industry and have meant an increase in the level of competition. In this context, as described by Mr. Moisan, marketing is taking on a growing importance:

> (…) there was a period where there were garage companies that could make games. Then there was that trend for triple-A titles and only big companies could make blockbusters, which were quite risky, but now it's back to garage companies for many mobile applications. That's what our marketing efforts have to fight, because we are stuck with the fact that there are hundreds of thousands of apps.

Mr. Schmalz, from Digital Extremes, shared with the Committee the example of his company's choice to distribute its latest video game title, *Warframe*, on the Internet for free. This game has been monetizing well because myriad players across 125 countries have paid to get the additional features.

Further on the point of international market access, Mr. Moisan and Mr. Landry both underscored the importance of government assistance in exporting video games. In particular, they mentioned that consular offices and embassies could help Canadian companies establish contacts in large emerging economies. Mr. Landry noted that there has been a culture of game development in Canada, but not a culture of game publishing; this has to change so that Canadian games are published by Canadian publishers. According to Mr. Landry, a Canadian publishing agency should be created with the

assistance of the federal government. Mr. Landry also proposed that the Business Development Bank and Export Development Canada become more involved in the entertainment software industry and be willing to take on more risk. He also suggested that the federal government provide support to local events such as the Montreal International Game Summit and the GameON: Finance conference in Toronto.

Finally, Ms. Verge voiced support for the establishment of a comprehensive long-term policy toward the industry by the federal government. According to Ms. Verge, such a policy would complement similar provincial measures and ensure sustainability for the industry.

CHAPTER 3: RECOMMENDATIONS

RECOMMENDATION 1

The Committee recommends that the Government of Canada continue to support the strength and success of the Canadian entertainment software industry, both at home and abroad.

RECOMMENDATION 2

The Committee recommends that the Government of Canada examine ways to assist the entertainment software industry in meeting its challenges related to labour and labour training.

RECOMMENDATION 3

The Committee recommends that the Government of Canada continue to support the growth of domestic talent to meet labour needs.

RECOMMENDATION 4

The Committee recommends that the Government of Canada continue to support collaboration between the entertainment software industry and Canadian universities, colleges and educational institutions.

RECOMMENDATION 5

The Committee recommends that the Government of Canada continue to maintain its fiscal competitiveness in order that companies in the Canadian entertainment software sector continue to thrive.

RECOMMENDATION 6

The Committee recommends that the Government of Canada continue to support entrepreneurship and the growth and sustainability of small and medium sized enterprises in the entertainment software industry.

RECOMMENDATION 7

The Committee recommends that the Government of Canada continue support for domestic brands and protection of intellectual property.

RECOMMENDATION 8

The Committee recommends that the Government of Canada examine how the industry can be further incorporated within Canada's digital strategy, Digital Canada 150.

APPENDIX A
LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Electronic Arts Inc.	2014/02/24	11
Jonathan Lutz, Vice-President and Chief Financial Officer, Electronic Arts (Canada) Inc		
Frima Studio		
Pierre Moisan, Vice-President, Strategic and Business Affairs		
Interactive Ontario		
Donald Henderson, President and Chief Executive Officer		
Sara Morton, Director		
Project Whitecard Inc.		
Khaled Shariff, Chief Executive Officer		
Execution Labs	2014/02/26	12
Jason Della Rocca, Chief Executive Officer		
Ubisoft Entertainment Inc.		
Geneviève Poulin, Advisor, Corporate Affairs		
Nathalie Verge, Senior Advisor, Corporate Affairs		
As an individual	2014/03/03	13
Jocelyn Benoit, Professor, École des arts numériques, de l'animation et du design		
ACTRA - National		
Simon Peacock, Member		
Marit Stiles, Director, Public Policy and Communications		
Canadian Interactive Alliance		
Deirdre Ayre, Member, Other Ocean Group Canada		
Serge Landry, President and Chief Executive Officer		
Entertainment Software Association of Canada	2014/03/05	14
Jayson Hilchie, President and Chief Executive Officer		
Julien Lavoie, Vice-President, Public Affairs		
Centre for Digital Media	2014/03/24	15
Richard Smith, Director and Professor, Master of Digital Media Program		

Organizations and Individuals	Date	Meeting
Digital Extremes		
Michael Schmalz, President		
Warner Brothers Games Montréal		
Martin Carrier, Vice-President and Studio Head		
Department of Citizenship and Immigration	2014/04/07	17
David Manicom, Director General, Immigration Branch		
Martin Mündel, Director, Temporary Resident Program Delivery Division		
Department of Employment and Social Development		
Monika Bertrand, Executive Director, Transfers and Renewal, Employment Programs and Partnerships Directorate		
Alexis Conrad, Director General, Temporary Foreign Worker Directorate		
Amy Mifflin-Sills, Director, Program policy, Skills and Employment Branch		

Organizations and Individuals

Canadian Interactive Alliance

Entertainment Software Association of Canada

Writers Guild of Canada

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* ([Meetings Nos. 11, 12, 13, 14, 15, 17, 18 and 19)](#) is tabled.

Respectfully submitted,

David Sweet

Chair

NDP Supplementary Report – Entertainment Software Industry in Canada   May 2014

The entertainment software industry in Canada is an important job creator in its own right, while also producing major economic spinoffs in the services and communications sectors. In this climate of fierce international competition, the federal government should support this innovative Canadian industry to help it flourish and create middle-class jobs.

NDP members of the committee would like to make recommendations in the following areas, to contrast those in the main body of the report.

1. Offsetting SR & ED tax credit cuts and supporting innovation:

The entertainment software industry is an important driver of innovation in Canada. In a context of international competition, we must support small start-ups in the video game industry and help them grow into larger, more competitive businesses to keep innovation and high-skilled, middle-class jobs in Canada. Instead of supporting our industry, the Conservative government has cut 500 million dollars from research and development tax credits. This is a big setback for the Canadian economy.

Jonathan Lutz (Vice-President, Chief Financial Officer, Electronic Arts Inc.), Geneviève Poulin (Advisor, Corporate Affairs, Ubisoft Entertainment Inc.), Nathalie Verge (Senior Advisor, Corporate Affairs, Ubisoft Entertainment Inc.), and Mr. Carrier (Vice-President and Studio Head, Warner Bros. Games, Montreal) highlighted the importance of the SR & ED program for their product development. Pierre Moisan (Vice-President, Strategic and Business Affairs, Frima Studio) noted that the cuts to this program contributed to the abandonment of some projects that may otherwise have gone forward, while Ms. Verge warned that if the program lost its competitiveness, Ubisoft may reconsider developing projects in Canada. Mr. Carrier also pointed out that this program helps make Canada more attractive to Warner Bros, thereby encouraging product development in Canada. Furthermore, according to the Entertainment Software Association of Canada, the new design of the tax credit program creates disincentives for smaller firms to pursue R&D activities, and incentives for international corporations to outsource their R&D activities outside of Canada.

Cuts to the SR & ED program have clearly harmed the vitality of the entertainment software industry in Canada. The NDP recommends **that the government should immediately consult with businesses, to find solutions to offset the negative impacts of the cuts to the SR & ED tax credit in Budget 2012.**

Jocelyn Benoît (École des arts numériques, de l'animation et du design, who appeared as an Individual), explained that basic research also plays an important role in supporting the entertainment software industry. Therefore, the NDP **recommends that the government appropriately fund basic research alongside applied research to support the entertainment software industry.**

2. Examine boosting the Canadian Media Fund to support innovative start-ups:

Multiple witnesses indicated that that the Canadian Media Fund (CMF) was well-placed to support the video game industry, especially to help the entry of new studios and developers into the market place. These include Mr. Moisan, Khaled Shariff (Chief Executive Officer, Project Whitecard Inc.), Jason Della Rocca (Chief Executive Officer, Executions Labs), Deirdre Ayre (Member, Other Ocean Group Canada, Canadian Interactive Alliance), Julien Lavoie (President, Chief Executive Office, Canadian Interactive Alliance), and Mr. Carrier.

As Mr. Della Rocca eloquently states:

Particularly for a start-up like that one, working on games for the mobile devices, tax breaks aren't terribly relevant… In those cases, whether or not it's through the federal government, they need more early-stage opportunities, such as venture-oriented funding or programs like the Canada Media Fund that are providing dollars to actually produce stuff at the start.

Throughout the study, witness testimony underscored the interdisciplinary nature of the industry. For instance, when speaking on behalf of the industry as a whole, Jayson Hilchie, president and chief executive officer of Entertainment Software Association of Canada, stated that "[the] industry comprises a unique mix of artistic and technological professions, and the collaboration of these two areas is what produces truly innovative products."

The NDP recommends that the government should examine whether the CMF could be expanded to increase the eligible number of projects in the entertainment software industry to help smaller companies with marketing and development costs. The collaborative nature of the industry makes it critical that support through the CMF not come at the expense of other media sectors currently supported by it.

3. Access to financing and Venture Capital to support job creation and growth:

Labor sponsored venture capital funds like the Fondaction, and the Fonds de solidarité FTQ play a critical role in supporting innovative small businesses in the province of Québec. Industry innovators like Mr. Della Rocca and Mr. Carrier, expressed the importance of the support Labor Sponsored Venture Capital funds provide for both entertainment software newcomers and industry leaders. The sector will likely see a drop in the amount of capital available because of the Conservative government's ill-advised decision to withdraw the tax credit that supports these investments. This means innovators will have fewer funds to grow their businesses into larger ventures and create quality, middle-class jobs.

The NDP recommends **that the government reverse its decision to phase out the Labor Sponsored Venture Fund tax credit.**

4. Training a high quality Canadian workforce to ease reliance on the Temporary Foreign Worker Program (TFWP):

NDP members of the committee recognize that the entertainment software industry, like other highly technical and skilled sectors, faces unique labor market challenges. Industry representatives have underscored the importance of having the option to bring in temporary foreign workers to train workers in Canada in their specialized fields. However, Citizenship and Immigration Canada, and Employment and Social Development Canada should only permit recourse to the TFW program when there are no Canadian citizens or permanent residents available to fill these senior positions.

Conservative mismanagement has left the Temporary Foreign Worker program open to abuse resulting in the firing of qualified Canadian workers, lower wages and the exploitation of temporary foreign workers. By permitting widespread abuse of the program, the Conservatives have undermined its reputation and eroded public trust, even for employers who are using the program properly for short-term skills shortages that Canadians are not able to fill.

Therefore, the NDP recommends that the government request an urgent audit of the TFW program by the Auditor General.

Given the highly technical nature of the work performed in the entertainment software industry and the added-value of these middle-class jobs for the Canadian economy, we must ensure that we are training young Canadian creators to foster the next generation of Canadian talent. We must ensure we are taking steps for Canada to have the highly-skilled and experienced workforce for the industry to remain competitive in the long-run. As one expert witness notes, how the industry will adapt to overcome its reliance on foreign workers is one of the sector's long-term challenges:

> "In the coming years, the industry will have to face a number of challenges. One of them is access to labour, from less experienced employees to experts. Demand will be strong in the coming years. To allow for the hiring of highly qualified people, it would be desirable to encourage companies to free up employees so that they can teach in a university setting. It can often be difficult for companies that focus on profits and income in the short term to free up their best employees so that they can teach. But we have to think in the long term." (Mr. Benoit)

In order to alleviate long-term reliance on the TFW program, **the NDP recommends the government work with the provinces and territories, post-secondary institutions and the entertainment software industry to train a highly-skilled Canadian workforce capable of filling present and future quality, middle class jobs in this industry.**

The NDP also recommends that the government work with the video game industry to promote mentoring and internships to help young Canadians gain valuable job experience in the industry.