



Financing video games



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Introduction to the **Guide**

Financing a new project is one of the main challenges faced by companies in the video game sector.

In the following sections, we will provide a practical overview of how to do this, focusing on the main elements that developers and publishers who wish to obtain external financing for their projects must consider.

In this guide, you will find different possible investment structures so that you can choose the most suitable one for your project. We also explain the essential criteria that video game developers seeking alternative sources of funding besides their own or traditional resources should take into account.

Specifically, this guide will be useful to:

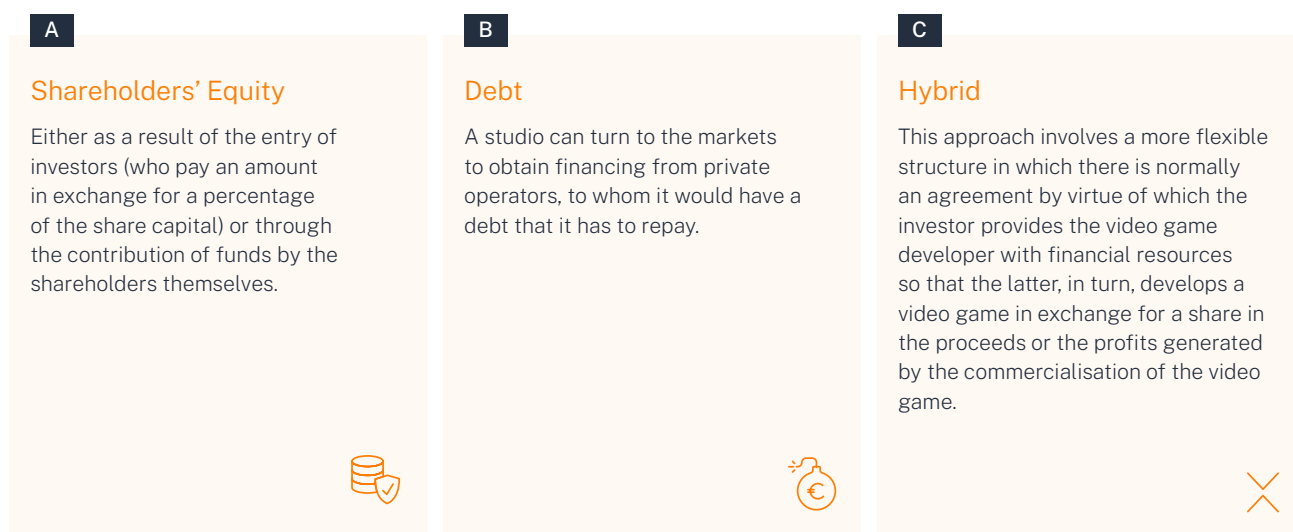
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- Learn about the different ways of financing your project: *What financing options are available in addition to bank credit?*
 - Choose the best financing option for your video game: *How are investment deals structured in the video game sector?*
 - Draft appropriate clauses in your project's financing agreement: *What options are available to maintain control over my project?*
-



1. Investment agreements

In addition to traditional sources of financing, such as bank loans, through which a bank lends the necessary funds in exchange for repayment of the principal plus interest, there is a third option for publishers and developers: investment agreements with third parties. In this regard, in recent times, the use of shareholders' equity, namely, the financial resources available to companies, and debt, has been supplemented by other hybrid and more imaginative solutions that allow for greater flexibility and, in many cases, a clear competitive advantage.

The range of options available to developers can be summarised, depending on their nature, as follows:



2. How to structure the investment

Although these types of instruments could be implemented in different ways and through different mechanisms, it is common for investment agreements ("**IA**s") to be used for this type of project. These agreements must address the following issues, both in terms of the investment and its execution:

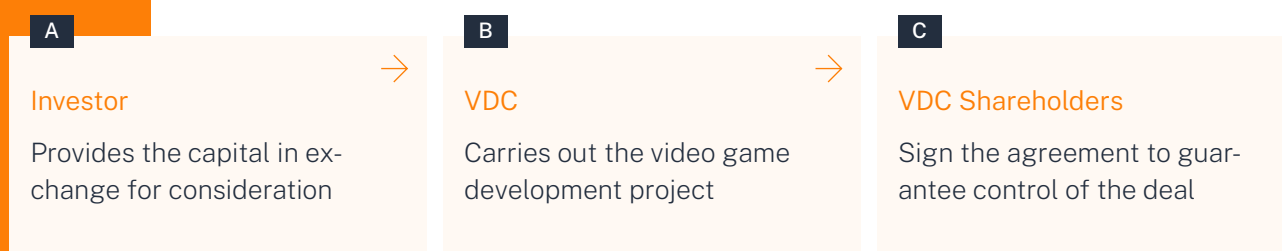
-  Amount of the investment
-  Investor's percentage share of profit
-  Investor's management and control of the company
-  Duration of the agreement
-  Conditions for exiting the investment



The relationship between investors and developers, also known legally as a “synallagmatic contract”, is the economic basis on which IAs are founded and generally follows the outline below. Although there may be variations on a case-by-case basis, a common scenario would be as follows:

- 1_ An investor makes funds available to a video game development company (the “**VDC**”) to finance the development of said video game, either through a single payment or (as is often the case) through partial payments of the total investment that will be linked to the achievement of different milestones in the video game development project;
- 2_ In return for the funds made available to the VDC, the investor will receive a fraction of the financial proceeds of the commercialisation of the video game; and
- 3_ In addition, and at the same time, the investor will reserve a series of political and economic rights (including voting rights at meetings, decision-making rights, and rights to participate in the distribution of dividends) within the VDC (to secure their investment and potential participation in the future project).

The parties involved in the IA are as follows:



In turn, through this type of contract, investors seek to be able to invest flexibly in a project without having to be part of the share capital of the VDC from the beginning. Investors seek to avoid the consequences of being directly involved in the capital of the VDC or its management bodies, including the application of competition law in the control of the VDC or possible restrictions on foreign investment which may present in the regulations of the place where the project is developed. IAs also facilitate the exit of investors from the project and the dissolution and liquidation of the project if it is not solvent and sustainable.

3. Analysis of IAs in relation to other investment models

As we can see, IAs are just another option available to publishers and developers. To assess the advisability of opting for an IA, it may be useful to compare this financing option with other avenues, such as debt or traditional investment. Each of the elements involved in the transaction can be crucial:

	Concept	"Standard" investment	Debt	Hybrid, IA
Consideration	Financial or non-financial remuneration that the VDC undertakes to provide in exchange for the financing.	Economic rights inherent to the status of shareholder (i.e. the distribution of dividends).	Repayment of the principal amount borrowed plus interest.	The investor is entitled to receive a fraction of the revenues resulting from the commercialisation of the video game.
Timeframe for profitability ¹	The time at which the investment generates the agreed revenues.	No timeframe is specified in the transaction documents.	N/A.	A maximum time limit is usually provided for in the transaction documents.
Capitalisation	The investor decides to convert their right to receive repayment of the loan into an equity shareholding in the company.	N/A.	This may include the creditor's right to capitalise the interest on the debt.	Capitalisation is possible.
Risk	Risk exists when the return on investment is not assured and depends on what the project generates.	The investor assumes some of the risk of the project.	The investor does not assume any of the risk of the project.	The investor assumes some of the risk of the project.

4. Clauses that are usually included in IAs

As shown in the previous table, IAs have certain characteristics, which is why it is common to include certain clauses that are adapted to these characteristics. These are only guidelines, but are frequently found in most IAs in the sector.

An important clause for...	Content
Ensuring profitability in a given timeframe	Include a maximum period (e.g. from the start of the commercialisation of the video game) for your share of the revenues arising from the development of the video game to reach the corresponding amount and obtain the expected return on your investment .
Protection against insufficient revenue (capitalisation of the credit right)	Include a right of capitalisation for a scenario in which the peak commercialisation is insufficient to generate the revenues needed to earn the agreed return. In such a case, the investor is entitled to contribute their credit right to the capital of the VDC , thereby becoming a shareholder in the VDC.
The risk arising from the investment, for the relevant investor protection	Ensure that the content of the VDC is, in fact, as intended . To this end, include a set of representations and warranties . Through these, the investor confirms and ensures certain key aspects of the VDC, such as its financial status , the soundness of its assets and the absence of legal problems .

1. For example, if you have invested €100 and agreed on a timeframe to achieve a return of 20%, you will reach this target when the project has generated €120.

An important clause for...	Content
The risk arising from the investment, for the relevant investor protection	Ensure compliance with the objective. • Limitation of the freedom of the shareholders to make certain decisions. • The imposition of confidentiality obligations. • "Bad leaver"/"very bad leaver" regime for the founders, namely, if the founders of the VDC cease to provide services to the VDC without justification, their shareholding can be acquired by the investor at a steep discount.
	Prevent the unauthorised modification of the object or contents of the VDC. Therefore, prevent the founders of the VDC from illegitimately extracting value from this,² similar to what a minority shareholder would wish to avoid. This usually requires express systems for accessing important/sensitive company information. It should be noted that these systems for accessing information are subject to specific conditions.
	Have a preference for/limit the entry of new investors into the capital of the VDC. • Obtain a right to acquire the new equity interests (<i>participaciones</i>) or shares created when the VDC decides to increase its capital. • Acquire the equity interests/shares that form part of the capital of the VDC with preference over any third party. In other words, in the event that a shareholder decides to sell his shares, the investor will have preference over any other potential buyer. • Limit the entry of new investors by enforcing confidentiality agreements, so that new potential investors cannot review detailed information about the company before investing, thus preventing them from carrying out the corresponding due diligence process.

5. Conclusion

- 1_ IAs are a mechanism that allows video game developers to access resources and financing provided by specialist investors that understand their sector and are therefore more willing than other investors to tolerate greater project risk in exchange for a higher potential return on their investment.
- 2_ However, it is precisely this greater exposure to project risk that means that, even though these investors are not shareholders in a VDC, they effectively have political and economic rights that are equivalent to those of a shareholder in a VDC.
- 3_ Therefore, in a market where acquisitions and investments in VDCs are becoming more and more common, VDC shareholders will have to take into account the existence of these investors under the IAs and their ability to, in practice, block or greatly influence these potential projects even though they do not, strictly speaking, have a shareholding in the VDC.

2. In this case, clauses could be included in the IA which allow the investor regular access to financial and operational reports of the project. This ensures that the founders do not divert funds or change the purpose of the company without the knowledge and authorisation of the investor.

Summary

Essential checklist

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- What are my financing options? Identify whether it is feasible for you to finance the development with your own funds or whether you will need to seek external funding.
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- Should I resort to debt financing? Analyse whether bank financing is a real alternative and, if so, what the cost might be.
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- How to design an investment agreement? Analyse expected profitability, the revenue schedule and potential associated risks.



Glossary of definitions

Capital Increases

Capital increases are processes by which a company increases its share capital by issuing new shares or equity interests.

Such increases may be undertaken to raise additional funds to finance projects, reduce debt, or improve the financial structure of the company.

Existing shareholders usually have a pre-emptive right to subscribe for new shares before they are offered to new investors.

Share capital

The total amount of money or assets that the shareholders contribute to the company at the time of incorporation.

The share capital is divided into shares or equity interests, which determine the percentage of ownership of each shareholder.

Credit

In the context of video game project financing, credit refers to funds loaned by an investor or financial institution to the developer.

This credit must be repaid within a certain period of time, with or without interest, and can be converted into shares in the company if agreed in advance.

Pre-emptive rights

A pre-emptive right is the right of existing shareholders or investors in a company to buy new shares or equity interests before other potential investors. This right allows them to maintain their ownership percentage in the company and avoid the dilution of their shareholding.

Political and economic rights of shareholders

The political and economic rights of the shareholders are the benefits and powers that the shareholders have by virtue of their shareholding in the company.

These rights include the ability to vote at shareholders' meetings, participate in decision-making and elect members of the board. Economic rights include the receipt of dividends, participation in the distribution of profits and the right to receive a proportionate share of the company's assets in the event of its liquidation.

Due diligence

Due diligence is the process of thoroughly investigating and evaluating a company before making an investment. This process includes the review of financial, legal and operational documents, as well as the assessment of risks and opportunities.

Shareholders' equity	Shareholders' equity comprises the financial resources belonging to the shareholders of the company, including share capital and accumulated reserves. These funds represent the part of the company's assets that is not financed by debt and reflect the financial strength of the company. Shareholders' equity is used to finance the company's operations and growth without incurring repayment obligations.
Representations and warranties	Representations and warranties are statements and promises made by the developers about the status and conditions of the video game project. These statements assure investors that the information provided is accurate and that the project meets certain standards and requirements. If any representation turns out to be false, investors may be entitled to claim compensation.
Bad Leaver/Very Bad Leaver Regime	Contractual clauses that penalise founders or shareholders if they leave the project without a justified reason or under conditions detrimental to the company. These clauses may include the loss of economic rights, the obligation to sell their shares at a reduced price, or the imposition of financial penalties.
Profitability	Profitability is the ability of a project or enterprise to generate profits or earnings in relation to the investment made. In the context of video games, profitability is measured by revenues from the sales of games, microtransactions, advertising, and other business models, less development, marketing and operating costs.
Project risk	Project risk refers to the possibility that the video game development project may not generate the expected revenues or achieve the objectives which have been set. This risk may be due to various factors, such as technical problems, changes in the market, competition, or lack of user acceptance.
Minority shareholder	A minority shareholder is a shareholder or partner who holds a minor stake in the company, usually less than 50% of the share capital. The rights of minority shareholders are protected by law to prevent abuse by majority shareholders.
Subscription of new shares	The subscription of new shares is the act of acquiring new shares or equity interests issued by the company during a capital increase. Existing shareholders and new investors can subscribe to these shares, contributing additional capital to the company and increasing their stake in the share capital.

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