

Excerpt from

The economic significance of the gaming machine industry

Study for Die Deutsche Automatenwirtschaft e.V.

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Study

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1 Executive Summary

This study presents an up-to-date picture of the gaming machine industry, which is impacted both by the coronavirus pandemic and by increasingly restrictive regulatory measures. We work through the reasons for the developments of recent years and provide the basis for a forecast of the trends to be expected in the near future.

To comprehend the scope of the gaming machine industry, we can, on the one hand, look at the number of amusement machines with prizes (AWP) in amusement arcades and bars, as these are the dominant category. At the beginning of 2022, the figure was about 180,000 machines. On the other, we can identify the economic indicators for the industry. In 2021, which was still affected by the coronavirus pandemic, gaming machines with and without prizes generated net sales of approximately EUR 4.2 billion. The approximately 62,000 people employed in the industry generated added value of over EUR 1.7 billion. The sector's businesses therefore generated a total of 9.4 per cent of the turnover of the overarching "Art, Entertainment and Recreation" sector.

The gaming machines industry is subject to a heavy tax burden. In 2021, entertainment and profit tax charged came to about EUR 435 million. Compared to previous years, this figure is still low as profit tax was assessed on earnings which in 2021 remained low due to the impacts of the coronavirus pandemic. The amount of entertainment tax charged also fell, although we are unaware of any reductions in the rates of entertainment tax. The reason for this appears to be the delays – caused by the coronavirus - in collecting, paying and recording entertainment tax. This is because the above data reflects the tax revenues actually received. The largest item related to tax charged is for VAT, which in 2021 came to about EUR 779 million. This means gross sales in the entertainment machine industry came to a total of almost EUR 5 billion.

Alongside the economic activity within the industry itself, additional production in other sectors is triggered by the procurement of associated services. These "indirect effects" amounted in 2021 to approximately EUR 1.8 billion. Of this, about EUR 577 million went to manufacturers of machines, but the property sector also profits significantly from the demand for premises.

If we look at how the sector has developed over time, it becomes evident that the gaming machine industry was having to tackle declining performance even before the coronavirus pandemic.

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Until 2017, sales figures were still increasing annually, but the trend was then reversed. Between 2017 and 2019, both the number of AWP's in operation and turnover fell by an average of about 12 per cent. One major reason for this development was the Interstate Treaty on Gambling which took effect as early as 2012. Implementing laws with differing content were adopted at the level of the individual states which were all aimed at reducing commercial gaming via quantitative, location-based restrictions. The transition periods under the Interstate Treaty on Gambling for existing arcades expired on 1 July 2017. Only then did the closure of operations unable to comply with the minimum distance requirements and the ban on multiplex arcades become a reality.

In the period between 2019 and 2021, the decline in turnover reached almost 20 per cent. The number of AWP's installed also fell by 20 per cent between 2019 and 2022. Official data suggests that, at 33 per cent, the temporary decline in sales in 2020 due to the coronavirus pandemic was considerably greater again, though it was possible to cancel this out in 2021. Alongside the restrictive effects of the lockdown and hygiene measures during the coronavirus pandemic, the impact of the amendment of the Gaming Ordinance (Spielverordnung = SpielV) in 2014 and of the Interstate Treaty that took effect on 1 July 2021 amending the regulation of the gambling industry in Germany (the "2021 Treaty") also contributed to the downward trend. Given that the federal states are in some cases using their rights under the 2021 Treaty to approve temporary exemptions, factors reducing the scale of the gaming machine industry apply throughout the period from 2017 to 2022. For that reason, and because, given the unclear legal arrangements in some cases, provisions governing hardship cases and pending litigation mean there are considerable delays in reducing the market, the full dismantlement of AWP's has presumably not yet been achieved.

5 Classification of the results and outlook

This study examines the current position of the gaming machine industry in Germany. Generally, it is clear that the sector has suffered a decline in recent years. The number of AWP's in the market fell almost 12 per cent between 2017 and 2019 (see IFH, 2021a). Since 2017, sales have also declined, thereby bucking the trend in the overarching Art, Entertainment and Recreation sector. While sales in the entertainment machine industry still reached EUR 5.9 billion in 2017, in 2019 they only reached EUR 5.2 billion. This means there was a marked deterioration in the economic situation of gaming industry enterprises even before the coronavirus crisis began. In 2020, the first year affected by the coronavirus pandemic, data from preliminary VAT returns suggest sales of EUR 3.5 billion, which equates to a fall of almost 33 per cent compared to the previous year. The response in terms of the number of installed machines was not as extreme, but even here a decline of about seven per cent is evident (see IFH, 2021a). According to our calculations, turnover managed to recover somewhat in 2021, though at EUR 4.2 billion it did not reach the pre-pandemic level of 2019. At the beginning of 2022, the number of installed gaming machines was just 180,000 or 29 per cent below the 2017 figure of 255,000 AWP's.

One reason for the lower sales in 2020 and 2021 is the coronavirus crisis. The pandemic affected the entire leisure industry, with businesses in the area of entertainment, culture and sport – and hence also amusement arcades – having to close down. The hospitality industry, which hosts about a third of gaming machines (see IFH, 2021a), suffered a huge downturn as a result of the lockdowns and hygiene measures. Measures to stop the spread of the virus remained in place into 2021. So, for example, the amusement arcades were unable to start operating again until 15 June.

Alongside the impacts of the coronavirus crisis, however, it is primarily the stricter regulatory measures that have decimated the size of the gaming machine industry's offer on the market, and turnover with it.

The Gambling Treaty between the federal states, which took effect on 1 January 2012, meant that, for the first time, the gaming machine industry was included in gambling regulations. Implementing laws with varying content were adopted at the level of the individual states.

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In addition to the ban on advertising or mandatory closure times, the ban on multiple concessions (multiple arcades in a single building or building complex) and the introduction of minimum distance requirements between arcades are the main changes restricting the gaming machines sector's offer. Transition arrangements were put in place for existing arcades so that multiple concessions could continue to operate until 1 July 2017. The distance requirements also only affected existing arcades from that date.

The Interstate Treaty creating new regulations for the gambling industry in Germany came into force on 1 July 2021. This largely adopted unamended the provisions that had previously applied to commercial gaming machines under the 2012 Interstate Treaty on Gambling. However, based on a new transition arrangement for existing arcades, the federal states are able to legislate for temporary exemptions to the ban on multiple concessions provided the arcades meet certain qualitative requirements, such as demonstrating the operator's level of knowledge through a test, special training for staff and certification by an accredited testing organisation, to be repeated every two years. In addition, federal states are able to implement the minimum distance requirement in stages, again provided certain qualitative requirements are met, for example. The individual states ("Länder") either failed to exercise these options at all or have done so in quite different ways. What is more, to date there have been numerous delays with passing the necessary state laws. Hence the factors reducing the scope of the gaming machine industry's offer have applied over an extended period from 2017 to 2022.

A national system that applies irrespective of the type of gambling and which locks players out, for which the gaming machine industry has been calling for years, and which required significant investment on the part of operators, has also been introduced.

Alongside the restrictions relating to location, a 2014 amendment to the Gaming Ordinance (SpielV) also significantly reduced the channelling effect of legal gaming at national level in terms of demand by making gaming machines less attractive. However, thanks to the transition periods, the rules relating to devices generally did not change and were not tightened up until the end of 2018. The key changes in terms of market performance are:

- The maximum loss per hour was limited to EUR 60 (down from EUR 80) and the maximum win to EUR 400 (down from EUR 500).
- The average loss per hour was reduced to EUR 20 (down from EUR 33).
- A mandatory suspension of play after three hours was added to the five-minute break after an hour's play, meaning that after three hours all readings on a AWP machine have to be reset to zero.
- Automatic stakes have been abolished. Players now have to start each game manually by pushing a button.
- Some form of activation medium or code needs to be handed out before a machine can be activated. Activation of another AWP is only permitted if the game on the first machine has ended, and a new activation has occurred.
- In bars, the maximum number of AWP's permitted is reduced from three to two.

At the same time as the sales figures for the gaming machines sector declined, we see an increase in the illegal market (see Trümper 2020, 2021).

With the sixth ordinance amending the Gaming Ordinance (SpielV), which came into force at the end of 2014, the federal government created the legal parameters for a ban on gaming outlets passing themselves off as restaurants or bars. Those institutions which operate, for example, as café casinos, sports bars, clubs etc., whose real source of income is the illegal operation of gambling machines are illegal gambling venues. Often, they also operate “fun games” which are entertainment devices banned under the Gaming Ordinance since 2006 that are not licensed by the National Metrology Institute, the PTB, and should be treated as part of the illegal gambling market. Fun games do not recognise any limits on winnings or losses and do not have any of the legally prescribed breaks with enforced termination of play. The commercial attraction for operating fun games lies in their high degree of attraction to players and simpler handling compared to legal gaming machines. They can be operated largely unhindered in illegal venues and illicit restaurants and bars, without entertainment tax being charged.

Consistent and comprehensive enforcement by the local government agencies generally responsible, against this form of illegal gambling - which poses a particular threat to young people and gamblers - fails in many cases due to a staff shortages and information deficits. In the study presented by Jürgen Trümper, former director of the working group against gambling addiction, “Insights into the Illegal Gambling Market” (Trümper), in the course of which about 1,000 venues suspected of operating illegally were visited, in about 62 per cent of local authorities, for example, the presence of illegal fun games could be documented. In his report, the author concludes, “Pragmatically, it needs to be accepted: the legal gaming offer must be attractive enough for all customers to use it. Illegal gambling offers essentially exceed the limits of legislation and player safeguarding in order to make them more attractive than legal gambling. In the way it regulates gambling, the legislator is therefore required to think of ways of circumventing illegal venues and illegal gambling media and to take steps to obstruct them. Otherwise, there is a risk that the channelling purpose of legal gambling is pursued ad absurdum as what it offers is no longer taken up by gamers as they have already turned their attention to what is available illegally.”

The development of illegal gambling in Germany is also investigated in a study by DICE Consult published in March 2023 (see DICE Consult, 2023). Based on the field studies by Jürgen Trümper already cited, the study estimates the size of the black market over time based on the number of illegal gambling machines and the impact of the different regulatory regime on the development of the legal and illegal gaming machine market in Germany. The authors of the study conclude that stricter regulatory measures (for example, regarding the minimum length of games, the quantity of gaming machines available or the attractiveness of the game) lead to demand for legal gaming machines being diverted to illegal gambling machines. Specifically, they identify massive growth in the black-market share of the market in recent years, from about 4 per cent in 2021 to between 30 and 46 per cent in 2022. The study concludes that safeguarding measures are only effectively applied in the legal area and therefore a successful channelling of user demand should be seen as the overarching purpose of regulatory measures.

The performance of the gaming machine industry in future years will be dictated by multiple factors. From 2022, the expiry of the remaining coronavirus measures will, on the one hand, probably lead to a normalisation of operations in arcades and bars. On the other hand, the regulatory situation, which has contributed to the decline in the gaming machine industry, will either remain in place or will tend to be further reinforced in future. The reason for this is a transition provision in the 2021 Gambling Treaty which is intended to mitigate the shock of adjustment by banning multiple concessions.

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The states that opt to use the transition clause in their implementing legislation are allowed to allocate temporary licenses for up to three arcades per building or complex of buildings upon a joint application by operators. Nine of the 16 federal states have adopted the transition provisions under article 29(4) of the 2021 Interstate Treaty on Gambling in their own state legislation. Depending on the particular state, the term of the transition provisions varies from three to fifteen years. For this reason and because of the unclear legal arrangements in some cases, provisions governing hardship cases and pending litigation leading to considerable delays in reducing the market, we have not yet hit bottom in terms of reducing the numbers of AWP machines. Instead, the decline will continue in 2022 and subsequent years.

This assessment is also reflected in the facts and figures on the gaming machine industry already available for 2022. The experts, who were surveyed on the figures for 2021 reflecting the state of their industry, have mixed expectations for 2022. No-one is expecting the sales figures to significantly recover, however. Even the figures for entertainment tax revenues from gaming machines indicate a downward trend in the sector. Admittedly, revenues in the first three quarters of 2022 rose almost 200 per cent compared to the previous year. But this still did not yet match the level of the year before the crisis; tax revenues from the first three quarters are more than 13 per cent below those of the corresponding period in 2019. Performance in terms of the number of machines installed similarly indicates a persistent downward trend in the sector. Since 2018, the number of AWP machines in operation has declined by an average of 7.4 per cent a year.

The declining performance by the gaming machine industry in recent years is therefore only to a limited extent attributable to the coronavirus pandemic. Instead, it is primarily the result of a combination of tightened regulations that significantly reduce the gaming machine industry's offer in terms of quantity, and the simultaneous increase in illegal, land-based gambling. This documents the fact that, compared to illegal gambling, the gaming machine industry is no longer sufficiently attractive to fulfil its channelling responsibility under the Interstate Treaty on Gambling to the extent necessary to safeguard young people and gamblers. Based on the available indices and data, we can assume this trend will persist in the near future.

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