

Opening a Branch in Narnia

How could the UK financial services sector exploit virtual worlds?

Dave Birch
<mailto:mail@dgwbirch.com>
<http://www.dgwbirch.com>

FINANCIAL
WORLD

An edited version of this article appeared in *Financial World* magazine, July 2006.

What on Earth were sensible banking-type persons doing at a CSFI round table on virtual worlds? Why were they listening to people talking about avatars and real-money trades (RMTs), dwarven warriors and magic axes? They were there because virtual worlds (*Second Life*, *World of Warcraft*, *Project Entropia* and all the rest) are where the next generation of customers, and perhaps the next generation of products, can be found. Two of the leading experts in the field, Aleks Krotoski and Richard Bartle, came along to help me open a window into these virtual worlds.

I'M A BIT FUZZY ON THAT WHOLE REAL/VIRTUAL THING

The dynamics are clear. Look at what's been happening in Asia. South Korea hopes to have 20Mbps broadband to all homes by the end of this year (with 50-100Mbps targetted for 2010) and Japan has similarly ambitious targets. Hand-in-hand with the growth of the high-speed networks to the home, interactive and community-based Internet sites are becoming increasingly embedded in Korean and Japanese lives [1]. The same is becoming true here, where broadband penetration is already more than 50%. As broadband penetration increases, people begin to congregate online in "virtual worlds".

These virtual worlds have begun to attract real attention. When the *Harvard Business Review* runs an article on marketing in non-existent places such as the *World of Warcraft*, you begin to suspect that there is something going on [2]. And it's not just marketing, but money heading the same way. Venture capitalist Bill Gurley invested several million dollars in *Second Life*, the non-violent game discussed by Aleks Krotoski at the round table, in which players lease virtual land (512-square meters costs \$9.95 per month, while a small island will run you \$195 every 30 days) and build and decorate their own virtual properties [3].



The *Cyworld* “game” in South Korea makes a profit of about \$1 million per day. Well, so what. The top five UK banks make a profit of more than \$100 million per day. Let’s look at a more meaningful comparison. MTV generates revenues of nearly \$800,000 per hour. *World of Warcraft* alone generates revenues of nearly \$100,000 per hour in subscription income. And here’s the critical statistic: in 2005, for one of the established games in Asia, the profits from selling items and avatars were 12 times the profit from online subscriptions [1].

VIRTUAL MARKETS

Where people anticipate the courts providing a firm basis for the trading of virtual property, markets have already been established. There is already a worldwide market where, as Richard Bartle has said, “people buy things that don’t exist from people who don’t own them”.

To use *Second Life* as an example again, there are currently around 170,000 residents and around \$6.5 million USD in transactions took place in a recent 20 day period. This year, then, around \$100 million will flow through the virtual world of *Second Life*. Linden Labs, the creators of *Second Life*, recently rolled out their own trading exchange, Lindex [4]. There is already a land speculation company called Cyberland that has issued half-a-million shares to about 500 players: at the time of writing, about 800 shares a week a trade through the in-game virtual stock exchange [5].

Yet, on the world scale, this is a tiddler. Hong Kong-based IGE is one of the biggest virtual currency dealers and their monthly revenue exceeds \$1 million. Another market, Itembay, had trades totaling around \$100 million in 2005 and earned \$5 million in commission.

These markets are not universally popular with game players. But they are a fact of life. Avatars from Sony’s massively multiplayer online game *Everquest* trade for hundreds of dollars and while Sony Online Entertainment opposed the trade for years, there wasn’t much they could do about it [6]. They negotiated an agreement with eBay to prevent the trading of *Everquest* items (eg, castles, magic potions, swords, that sort of thing), but it didn’t stop the trading: in Internet fashion, it immediately moved elsewhere. When the publishers of one US online game, *Anarchy Online*, actually did sue some people for “grinding” (ie, creating new characters and then building them up for sale), they lost [7].

So Sony took the only sensible course of action open to them. Instead of going down the music industry route of filing lawsuits against customers, they set up their own trading centre. The Sony Station Exchange opened [8]. In the first



three months of operation, the Sony Station Exchange hosted \$540,000 in *Everquest II* trades (earning the company \$54,000 in commissions). Not only does this benefit Sony (40% of their customer service calls are related to fraudulent out-of-game trading) and the players who want to trade, it may spur the development of wholly new virtual worlds where a secure trading exchange is integral to the platform and actively encourages secondary markets between financial institutions.

Why shouldn't my online bank offer me Platinum Pieces as well as Euros? [9] And if they do, why shouldn't the FSA regulate it? The South Korean government has said that it is already looking at potential regulation of the 1 Trillion Won (approximately \$1 billion) annual market in virtual assets [10].

Trade Routes

What does all this trading add up to? In a famous study the economist Edward Castronova¹ calculated that the per capita GNP of *Norrath*, the imaginary world in *Everquest*, is somewhere between Bulgaria and Russia [11]! Professor Castronova further points out that, just as in the real world, most consumption is domestic. He calculates that only 5% of "GNP" is traded across the border to the real world and so is able to estimate that size of the virtual economy. For the worlds he studied, the virtual economy is the equivalent (in GDP per capita and population) of Namibia, which has about two million people and, according to World Bank figures, a gross national income of \$1,790 [12].

Building on these figures, I estimate that since about \$400 million was traded in Asian virtual worlds last year, their "GDP" is already around \$8 billion [13]! If that sounds high, remember that there are more than 4 million *World of Warcraft* subscribers in China and in peak hours 600,000 are online at any one time [14].

So there is a truly dynamic cyber-economy growing in these cyber-worlds and it's about to cross another line. You will soon be able use ATM cards issued by the game's developer to withdraw real US dollars from Versatel ATMs in North America against your virtual PED (*Project Entropia* Dollars) account.

ONLINE FUTURE

With these numbers, and markets that operate in a legal structure, come financial services. If Leadbelly Gutbucket, the mightiest of the Dwarven heroes of Raven's Peak, wants to buy a castle then why shouldn't he borrow the money from Ye Olde Barlcays Moneylender in the village square?

¹ Who has said that pounds, yen and dollars may become shadow currencies to the gold piece if human society continues to migrate to virtual worlds.



This could work, even though Leadbelly isn't real, because the virtual world is a world built on reputation. It's a little like the world of eBay. Yesterday, I bought a new watch from someone, or something, I had never met and will never meet: yet I was entirely comfortable trading with this virtual identity because it has 2,257 eBay stars. It wasn't their location, the price or what the government thought about them that mattered to me, it was what everyone thought about them. Those 2,257 stars earned money for someone yesterday and if the stars were taken away then their income would plummet.

In this "reputation economy", it is possible to imagine a judicial system that operates without recourse to the physical world. If I have invested great effort in obtaining a high reputation for Leadbelly, I will be reluctant to jeopardise that by not repaying Barclays. Why? Because Barclays could have Leadbelly's reputation cancelled, which means no-one will trade with me in the virtual world: in a market where the real identity of counterparties is not relevant, reputation is the key to transactions.

Customer Acquisition

Banks have begun playing in the virtual community, initially as a customer acquisition tool, but have been keeping to the "soft sell" (quite wisely) as they investigate the imaginary landscape. A typical example is the *Life Takes Visa* campaign which reach a very high awareness in target markets by riding the dynamics of another kind of virtual community, the photo-sharing (this does not even begin to describe it) *flickr*.

Wells Fargo provide an interesting case study. They bought one of the islands in *Second Life* (now renamed Stagecoach Island) to "teach young adults important lessons in financial literacy" [15]. The branding is almost non-existent, appearing primarily at the virtual ATMs. The ATMs are a focal point: players can take a financial quiz in order to get virtual cash which they can then use for a variety of activities. Tim Collins, the bank's senior vice president for "experience marketing" says that "An educated consumer is our best customer" [2]. If they want to try and get kids to understand trading, interest rates and the basic survival concepts for a capitalist world, it might well prove more effective for the FSA to set up a stall in *Runequest* than Reading.

Not that all of the kids need teaching. They appear to be evolving their own perspectives on gold, games and Gresham's Law². Phishing is already widespread, and incidents of hacking are widely reported: Sony has been a victim. Hackers created counterfeit (cloned, actually) platinum pieces for *Norrath*

² The title of my book on the topic!



and sold them on the Station Exchange. Supposedly the hackers made \$70,000 selling the illegal currency. Sony says that it tracked down the hackers and closed their accounts [16].

It's interesting to speculate on the banking businesses (eg, money transfer using delivery elves rather than Western Union) that might find themselves opening branches in non-existent places, but surely insurance companies must be the first to make big money. It can only be a matter of time before we see a TV advertisement (at half time in the live-from-World-of-Warcraft final between 10,000 UK Orcs and 10,000 French Elves) showing a cheerful middle-aged housewife instant messaging her insurance company to quote her happy on contents insurance for her virtual home in *Second Life*.

CONCLUSION

Some of these ideas might sound bizarre, but virtual worlds adumbrate change beyond the world of financial services. The attraction the virtual sphere of interaction, to communicating and earning a living in the virtual world, are obvious once the virtual personae become economic agents. One could imagine a flight to virtual communities, where mathematics (in the form of cryptography) provides a defence against crime and disorder that the metal barriers of a gated community cannot. If the community decides on a new law—no swearing in public places, let's say—then they can enforce it instantly and 100% effectively by downloading a software update. If there are members of the community who don't like it, they can go to another community instead. The designers of virtual worlds have a power that Mr. Blair can only aspire to. He might want to build a society founded on respect for the individual and their property, but he cannot patch the code and reboot the UK to make it happen!

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