

BETFAIR: TRANSFORMING THE WORLD'S WAGERING

Leyland Pitt, Simon Fraser University
Daniel Shapiro, Simon Fraser University
Richard Watson, University of Georgia

The age old story. Two men in a bar arguing about the outcome of the US Presidential Election. One believes the Republicans will win, and the other thinks the Democrats will do it this time. If they simply bet against each other one will be at a disadvantage and the other will enjoy an edge, because the reality of the situation is that the outcomes of events such as elections are very rarely akin to flipping a coin. Being in the United Kingdom, they go to a high street bookmaking firm such as Ladbroke's, William Hill or Corals. On October 26th 2004 the best odds that they would have obtained from any of these would have been 8/11 on the Republican Party and 23/18 on the Democrats (and these odds would not both have been offered by one bookmaking firm, they would have had to "shop around")¹. If they had logged on to the Internet at a site called Betfair (www.betfair.com) however on the same day, they would have been quoted the equivalent of 78/100 Republicans and 128/100 the Democrats, which a little arithmetic will show are slight, but significantly more favorable odds to both players². They might also both notice that by the 26th of October, players on the Betfair website had traded more than 2.9 million pounds sterling on the outcome of the US presidential election – or around US\$5 322 950 at current exchange rates.

Rumor has it that Andrew Black, co-founder of Betfair got the idea for the online betting exchange firm on a hot July Sunday afternoon in 1999 while enjoying a few beers with friends, about to watch the Men's Open Tennis final at Wimbledon on television. One of Black's friends wanted to back Pete Sampras to win, but was appalled at the very short odds quoted by a bookmaker he called. Another friend scoffed at the thought of Sampras beating compatriot Andre Agassi, and said that he would lay better odds himself. Black saw the opportunity to provide a marketplace for people to trade in their opinions. Betfair was born.

By 2004 Betfair was the world's largest betting exchange, with around 48 000 people placing bets each week on the many events the website features. Elections, major horse races, golf tournaments and soccer matches inevitably trade more than 3 million pounds sterling at a time. Yet Black, co-founder Ed Wray, and the senior management of the firm face a number of dilemmas. Topics that dominate management meetings include:

- Who is our competition, how should we react, and where might new competition come from?
- How should we grow Betfair into a truly global firm, what challenges can we expect, and how do we deal with vested interests and governments in countries where betting exchanges are seen as a significant challenge to the status quo? Will experiences in some countries better prepare us for entering others?

¹ See www.sportinglife.com/oddschecker

² Odds of 8/11 equate to 73/100, and odds of 23/18 equate to odds of 127/100

- Who should we align ourselves with? Is there a standard procedure we can follow in entering a market, or do we have to start again each time?
- How can we grow the Betfair business model? Are we a gambling and wagering company, or do our competences and processes allow us to grow into other markets and businesses as well?
- Should we list the company on a major stock exchange, such as London, or should we hold on completely to what has become a very good business indeed?

Bookmakers and Totalisator Systems

Traditionally, those wanting to wager on the outcome of an event, such as the Kentucky or Epsom Derby, the Superbowl, or Wimbledon, have had to resort to a pari-mutuel totalisator system, or a bookmaker. Pari-mutuel systems deduct a percentage of all bets (normally around 15%), and winners are then paid as a ratio of the remaining pool to their stake. The disadvantage to the bettor is that as the weight of money for their selection increases after they have placed their bet, so their odds, or payoffs, decrease. This means that it is difficult for players to use any kind of betting system to maximize profits or minimize losses. A player at a race track might for example be \$100 dollars down by the last race, and places a bet of a \$100 on the favorite in an attempt to recoup their losses. At the time of placing the bet, the horse is showing a \$2 payout for a \$1 bet on the totalisator board. At these odds, our player will indeed recoup losses if the horse wins. However, subsequent sheer weight of money then reduces the payout on the horse to \$1.50 by the off. If the horse wins, our player will still be \$50 down for the day, and there are no rewards for skillfully placing the bet early. The totalisator cannot ever lose – much like a lottery, it simply takes as its income a fixed percentage of all funds wagered.

Bookmakers, like those in Las Vegas, and in countries such as Australia and Great Britain offer fixed odds on the outcome – odds of 6/1 (\$6 to \$1) for example, means that the bettor will be paid \$6 plus their \$1 stake should their selection win the event. The advantage to the bettor here is that the odds are fixed, and will not be reduced by subsequent weight of money for their choice, as in the example above. On the other hand however, if the odds are later increased by the bookmaker, the early bettor does not benefit from this. The disadvantages to the player in this case are that bookmakers, like casinos, have a significant edge because the odds offered are shorter than true probabilities in order for them to profit in the long run – typically around 14% of turnover. In many countries bookmaking is banned, and in those which it is not it is strictly controlled and licensed, because there have been instances of unethical bookmaker behavior in racing and other sporting events. For example, bookmakers have been accused of fixing races, bribing jockeys and other corrupt action, and this is not in the ordinary player's interest. It is difficult enough to find a winner in an event without having the odds unfairly stacked against one by cheating. Where bookmaking is legal, jurisdictions have often taxed winning bets as a form of state or provincial revenue, thereby increasing the odds against players, and in some cases tax the stake, which means a further disadvantage.

Unlike totalisator systems, bookmakers can and do lose on some events – for example, where they have misjudged the probabilities in the odds that they have offered and been

too generous, and where other outcomes do not attract the wagers anticipated. These “one-way” models are illustrated in Exhibit 1. While these models differ in many ways, their basic premise is the same: Use the money taken from losing bets to pay winning ones, and allow for a percentage “rake-off” before doing so.

Andrew Black and Betfair

Just as the on-line auction company E-bay has changed the nature of auctions and C2C trade, betting exchanges are altering the nature of wagering, and creating more level playing fields for gamblers and anyone with an opinion. Rather than bet against a bookmaker, or pool their money with that of others, online betting exchanges allow gamblers to bet against each other. So, they can be either bettor, or bookmaker, or both, by choosing to “take” a bet (e.g. bet that Horse A will win a race), or “lay” a bet (e.g. offer odds that Horse A will lose a race).

In 1999, Briton Andrew Black was making a decent enough living writing software, and as a professional gambler, concentrating mainly on playing bridge and betting on horses. But he was dissatisfied with traditional bookmakers, and started to think of an alternative business model. “By the time they [the bookmakers] build in their margins”, says Black, 41, (in Time Magazine, July 2004, noted as one of the Innovators of 2004) "you've got to be 20% smarter to make money. And if [you] make a mistake, [you] can't trade out of it. I thought, there's got to be a better way." When the site launched in 2000 with \$1.8 million raised from Black's and co-founder Ed Wray's (a former vice-president of JPMorgan) network of contacts, it was taking less than \$90,000 a week in bets. This number began to climb gradually. Significant investors began to acquire stakes in the business, including Benchmark Capital, UBS Capital, and JPMorgan Chase

Betfair.com (www.betfair.com) is located in the United Kingdom. The company turned over £1.5³Bn in 2002, and won a Queen’s Award for Innovation in 2003. To give better indications of the volumes of cash being turned over on the website by mid-June 2004, the site did a bigger turnover on the Kentucky Derby than the totalisator on the track at Churchill Downs, the race venue. More than £4 million was wagered on the US Open golf tournament in June 2004, simply on the final outcome (and not taking novelty bets into consideration, such as would Tiger Woods make the cut, and who would be the top European player). A week before the Men’s Final at Wimbledon in 2004 more than £3million had been wagered on the overall outcome, and wagering on individual matches inevitably exceeded £200 000 each (more than £1 000 000 was wagered on the third round men’s’ singles match featuring Briton Tim Henman). The company provides the opportunity for speculators to bet on events that range from the more conventional sports such as horse- and greyhound racing at tracks around the world, football, soccer, baseball, golf and tennis to more exotic activities, such as hurling, darts and snooker. There is also the opportunity for wagers to be laid or taken on non-sporting events such as the outcome of presidential and political elections, Big Brother competitions and the Oscars, and the company offers a range of financial bets on most of the world’s major

³ Because it is a British firm most financial figures on Betfair are quoted in £s (Pounds sterling). However, players in different countries can choose to see and play in the currency of their choice – e.g. Americans can see markets in US\$, Australians can see markets in AUD\$.

markets (turning over more than £100 000 daily simply on whether the FTSE will rise or fall). A particularly popular event in 2003 turned out to be the California Governor Election, featuring movie star Arnold Schwarzenegger, and more than \$1m was wagered on the nomination of the Democratic Party nomination for US President in 2004.

The Betfair System

Unlike conventional bookmakers, and like totalisator systems, Betfair is not really interested in the outcome of an event – it simply provides a market for opinions and for trades to take place. Unlike totalisator systems, and like bookmakers, the odds offered on Betfair are fixed, and Betfair also doesn't take a percentage of the money wagered. Rather, its income is derived from a small percentage commission (ranging between 2 and 5%, depending on a player's turnover) on a player's net winnings on an event. So for example, if a player backed 2 horses in a race, lost \$5 on one and won \$20 on another, then a commission would be taken on the net winnings of \$15. Similarly if a layer had accepted a bet of \$5 against Tiger Woods winning the 2003 US Open, and laid him at odds of around 3/1, the player would have won \$5 (because Tiger Woods lost) and paid a small percentage commission to Betfair accordingly.

Any event on the Betfair website will show the possible outcomes (for example, horses or dogs in a race, the players in a golf tournament, or the two teams in a game, which may also include a draw or tie), and columns entitled "Bet" and "Lay". The "Bet" column shows the odds available to a player who wants to back an outcome, and how much money a player can place on those odds. So for example, if the "Bet" column showed a price of 4.00 and \$100 available then a player will get odds of 3/1 (the price represents the payout plus the stake), and so by wagering \$100, would get \$300 plus their stake of \$100 back if the selection won.⁴ Likewise, the "Lay" column shows what players want as odds, and how much they wish to bet. So a "Lay" price of 3.00 and amount of \$200 means that someone who thought the outcome might lose could take up to \$200 on the outcome at that price. So for example, if one took \$10 of the \$200 (leaving \$190) at these odds, one would keep the \$10 if the outcome lost, and lose \$20 as well as forfeiting the stake of \$10 if the outcome won (for a net loss of \$20).

Even for those not inclined to gambling, but nevertheless interested in the mechanics of markets, it is worth visiting the website just to see how narrow the differences between the "Bet" and "Lay" columns on the larger markets (such as horse races and golf competitions) on the Betfair website are. Prices are inevitably made and taken, and the margins are minuscule, much smaller than those of even the most generous bookmaker. It is worthwhile to observe the "book percentage" on the "back" and "lay" sides of each event that is displayed on the site, an example of which is shown below in an actual screen dump from the Betfair site of betting on the 2005 Superbowl in Exhibit 2. The book percentage is an indication of how much net profit or loss a player would be able to achieve if s/he either backed every outcome or laid all. A percentage higher than 100% means that an odds maker would make a profit by laying every outcome up to a given

⁴ The \$100 available indicates how much can be wagered in the outcome of odds of 3/1. If a player wagered only \$20 then there would still be \$80 remaining. Once this has been taken, then the next (shorter) odds in the "Back" column would move forward, and so forth.

amount, and that a taker would lose by backing all the possibilities. A percentage under 100% would mean the opposite. When one considers that the traditional bookmakers referred to above bet to a percentage of around 114%, that means that the player is facing a book of around only 86% (in simple terms by backing all the possibilities s/he would be returned 86c on the dollar). The percentages on major Betfair events rarely exceed 105% for odds makers (and they are not guaranteed of laying bets at these prices), and are almost always under 100% for the backers (although again, they are not guaranteed of getting these odds). The betting on the Superbowl in Exhibit 2 is at September 2004, and one might speculate that by the time of the final game, the "Back" percentage would have reduced to just more than 100%, and the "Lay" percentage to just under 100%, as more money is wagered on the event (note that not all teams are shown in the illustration, only the top 14 in the betting). In simple terms this means that players can generally get better prices on Betfair than they can from either bookmakers or a totalisator.

Rather than profit by taking a percentage of losing bets, Betfair profits by taking a small percentage of net winnings. Therefore, the greater the turnover on events, the more Betfair will generate revenue. The firm is successful if it can assemble large numbers of customers – and provide a market for them to interact with each other. Customers place funds with Betfair by making an online deposit through a credit card (or by check or bank draft through special arrangement), and a debit and credit account system is then maintained by a database. The balance is reduced every time a customer takes a bet (e.g. backs a horse), and is also reduced on reserve every time a customer lays a bet (i.e. incurs a potential liability by laying an outcome at odds). When a player wins, the net winnings are credited to their account. Customers with a positive balance can withdraw at any time and request to have all or part of their positive balance re-credited to their credit cards or bank accounts. The company also allows customers to make payments in advance by check, or to have checks mailed to them or deposited into their bank accounts by prior arrangement. A simple example of the Betfair model, as opposed to the bookmaker and totalisator models portrayed in Exhibit 1, is shown in Exhibit 3.

A feature of the Betfair website is that it permits players to bet "in the running" – that is, after a race has started until a winner eventually crosses the finishing line. In the event of a very close photo-finish, or an objection, Betfair will also reopen in-play betting so that bets can be taken on the outcome of the photo-finish or the objection. Players can also bet on games and matches while these are "in play", a particularly popular feature in sports such as football, soccer, golf, cricket and baseball.

Growth in Revenues and Business

Betfair continued to grow rapidly, and its turnover in 2003 was substantially higher than 2002. The figures stand in excess of \$90 million a week in matched bets, about 13% of the estimated \$35 billion global annual online sports-betting industry⁵. From April 2002 to April 2003, Betfair's pretax profits rose from \$1.9 million to \$15.5 million. The site has registered users in 85 countries. On an ordinary mid-week horse race in the UK, the website was regularly matching bets exceeding £400 000. On Australian and American races the site averaged around £25000 a race, and even on smaller centers such as South

⁵ From Time Magazine, July, 2004 (<http://www.time.com/time/europe/html/040719/gdi/black.html>)

Africa (on which the site provided betting on races on a daily basis) the site averaged around £9000 on a race. For horse racing enthusiasts this meant round the clock racing coverage – because of the differences in time zones, when racing in Europe and South Africa finished for the day, racing in the USA (from coast to coast and usually at about 8 or 9 venues) was in full swing. About an hour after the last race in California ended, racing began again on Australia's east coast, progressed west, and by the time the last race finished in Western Australia, there was only an hour to wait before racing began in South Africa again.

The website provides daily opportunities to wager on a variety of horse races in Australia, New Zealand, the UK, France, Germany, Ireland, South Africa, Hong Kong and the USA. There is also regular betting on sports such as greyhound racing, Australian Rules football, basketball, cricket, soccer, baseball, ice hockey, rugby (union and league), golf, tennis, and motor racing, while less common sports such as darts, hurling, and chess also feature when there are large tournaments. Wagering is also facilitated on non-sporting events such as political elections, television reality show competitions, competitions such as the Oscars and the Booker Prize, and financial outcomes, and the company also sets up special betting on less frequent events such as the Olympic Games. The website also offers players the ability to trade in a number of languages, including German, Italian, Danish, Swedish and Mandarin.

The Incumbents Retaliate and Competitors Enter the Market

According to historical records and archeological evidence, gambling has existed throughout the ages and cultures of most civilizations. Anthropologists agree that data collected in the 20th century lends support to a contention that gambling took place within a large portion of history's major civilizations. For example, gambling artifacts have been recovered from ancient China (2300 B.C.), India, Egypt and Rome. A set of ivory dice dating from before 1500 BC were salvaged from Thebes, while specific writings mentioning gambling were found on a tablet in the Pyramid of Cheops⁶. In the New Testament, in the Book of John⁷, there is a description of how the Roman soldiers gambled for Christ's garments at the time of the crucifixion. Not surprisingly, gambling is a huge industry worldwide, and the incumbents don't take lightly to insurgents attempting to take a share of the pie. Gambling is also a highly regulated industry, and even within countries, the legislation differs markedly from state to state or province to province. A summary of the legislation as it pertains to online horse racing and sport betting in selected countries is provided in Exhibit 4.

In the United Kingdom, the company has been the focus of lawsuits by the major British bookmaking firms such as Corals, William Hill and Ladbrokes. The bookmakers have charged that by allowing individuals to lay bets, they are acting as bookmakers, and are not licensed to do so. Graham Sharpe, spokesman for William Hill argues, "If you have a bet on an exchange, you don't know who it's with; if [the person] is offering extravagant odds, you don't know why."⁸ The British courts have thrown out all the cases and

⁶ See <http://www.gamblingphd.com/historical-information.htm>

⁷ Chapter 19, verses 16-18

⁸ From Time Magazine, July, 2004 (<http://www.time.com/time/europe/html/040719/gdi/black.html>)

rejected the bookmakers' arguments, and Betfair has been allowed to proceed with its business. While bookmakers might not like the idea of the site, it is evident that many of them are using it, either to buy back bets at advantageous prices, or to lay bets that they might otherwise not have been able to find takers for. The substantiation for this is the substantial volumes of money that are available to be traded on many events.

In Australia, not only have bookmakers objected to the site and attempted to close it down through legal action, it has also been the focus of an aggressive advertising campaign by the Totalisator Agency Board (TAB), a listed company that provides totalisator services. The advertising has attempted to cast Betfair in a negative light by claiming that betting on exchanges encourages dishonesty in sporting events and racing, a similar argument used in the United Kingdom by bookmakers. So far the Australian federal government has not acted against the firm in any way, although Betfair has disabled certain features on its website in Australia to comply with Australian gambling legislation (for example, Australian players are not able to bet "in the running" – that is, after an event has started or a race is running). As can be seen from Exhibit 4, gambling is more a matter of state than federal legislation in Australia. While the legislation is not quite clear whether it is legal or not for Australians to bet on betting exchanges or online casinos outside of Australia, there is no legislation prohibiting players in one state betting on operations in another. Recent news reports have indicated the various state operated totalisator agencies have considered establishing betting exchanges as well.

As would be expected, a number of competing online betting exchanges have been established in countries such as the United Kingdom, the USA and South Africa, with variations on the Betfair business model. Some of the major operators are listed in Exhibit 6. So far none of these offers the selection and range of wagering possibilities that Betfair does. Tradesports (www.tradesports.com) tends to concentrate on sport and racing in the USA, and also runs markets in political events, and prominent issues such as the Michael Jackson trial, and whether Osama Bin Laden will be captured.

The Way Forward

Black and Wray realized early on that the business was growing at a rate where mere enthusiasm and hard work were no substitutes for professional management. Among the many appointments the firm made, the two regarded as strategically most important by Black and Wray and industry observers alike were those of Ian Winton and Stephen Hill. Winton, an ex-advertising agency executive, was appointed as director of marketing communications in 2004. Hill joined the firm during 2003 as Chief Executive, after resigning as CEO of the Financial Times Group to take up the position. One of the reasons Hill got the job was because he had some experience of international growth from his days at the helm of the FT, when it expanded successfully into Germany and the USA.

There are many issues that confront the group, including potential corruption, aggressive conflict with incumbents, technology, international growth, and the possible expansion of the business into other areas. These all demand the attention of top management.

In July 2004, Betfair was dragged into the spotlight when it reported suspicious betting patterns on its exchange to the Jockey Club in the United Kingdom just before the Lingfield race in which leading jockey Kieren Fallon - riding favorite Ballinger Ridge - lost to Rye after seemingly easing down before the finishing line. The newspaper News of the World alleged Fallon had told an undercover journalist that Rye would win. No proof was found that the race was fixed, but Ian Winton was quoted as saying: "We are putting a searchlight on the sport and helping it clean up its act. There is a clear paper trail on our website which doesn't exist in high-street [betting] shops. We are entirely transparent. We have no vested interest in the outcome of a horse race." In resisting the advance of betting changes into China however, Asian Horseracing Federation chairman and Hong Kong Jockey Club CEO, Lawrence Wong, had this to say of exchanges: "We fundamentally object to betting exchanges because they threaten the integrity of racing. It provides opportunities for insiders with privileged information - such as owners, trainers and stable staff, to bet against their own horses." Stephen Hill counters: "We know who all our customers are. During the latter half of 2004 we have required every customer to supply us with a copy of their passport, banking details on the credit card or account they are using, home address proven by a utility bill, and other details. It is impossible for a bookmaker or a totalisator to have that kind of detail about customers, honest or dishonest, for the great majority of their customers bet in cash."

On the technology front, Betfair continues to make news. Gary Nugent, iForce Partner and Mid Market sales director at Sun, regards Betfair as one of the most technology-critical firms he has encountered: "Technology is critical to the success of Betfair.com. It required a highly scalable infrastructure that could provide optimum customer security."⁹ At peak times the exchange matches up to 12,000 bets a minute and over 1,000,000 bets per day -three times as many trades a day as the London Stock Exchange.

On the positive side, in April 2004 the firm announced a mobile version of its product, Betfair Lite, which will allow customers to catch up on betting odds and prices over their mobile phones or PDAs. While initially users will not be able to place bets wirelessly, such a capability is in development. The service, provided via the lite.betfair.com website, works on PDAs and mobiles with HTML or XHTML browsers, but not on WAP phones.

Technology also has its downside for Betfair. In July 2004 the firm's website was attacked by Web-based criminals. A malicious denial-of-service attack prevented a server from functioning properly by flooding it with traffic. The attack prevented some users from accessing Betfair. Several customers complained on Betfair's forums that they were unable to view or place bets and some claimed that they had lost money. This type of situation does have the potential to be financially disastrous to large players - for example, if a player exposes himself to a bet with a large potential downside, and the system goes down and the player is then unable to trade to mitigate the risk, losses can be substantial, and the player has little control over the situation.

⁹ <http://sun.systemnews.com/articles/77/1/feature/13321>

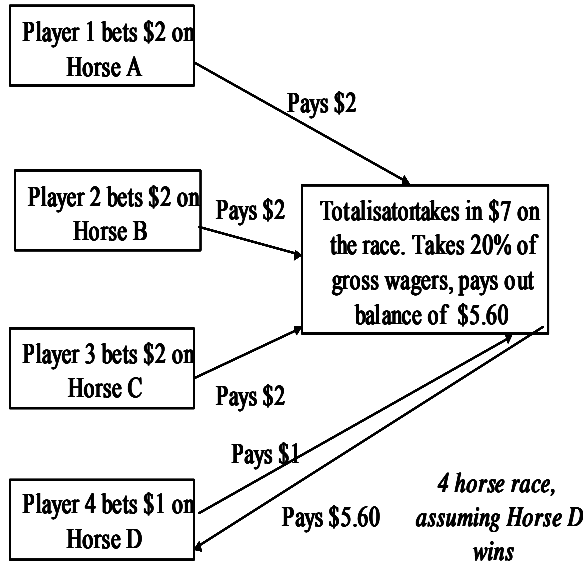
Some observers compare Betfair to online auction company EBay – “EBay for gamblers”. Both websites provide venues for those who want to trade, and the firm’s are essentially market makers, charging small commissions on successful transactions, with no favor to buyer or seller. Others disagree, and argue that in the case of EBay both parties to a trade benefit, for the seller receives cash and the buyer receives an item of value at a good price. In the case of Betfair on the other hand, for there to be a winner, there has to, by definition, be a loser. Both parties do not benefit, they contend.

Stephen Hill was elected to silicon.com’s Top 50 Agenda Setter’s List in 2003, a directory of the most influential figures in online business. Interviewed in the publication New Media Age, he said, “I want to take Betfair into whole new business areas. This is primarily a technology company, not a betting one. I don't think of Betfair as a gaming company, but more of an Internet technology company. I see no reason why the technology can't be used in other areas”¹⁰.

¹⁰ “New Betfair CEO keen to expand business areas”, (2003) New Media Age, July 17th, p.6

**EXHIBIT 1:
Wagering on Totalisators and Bookmakers**

Pari-mutuel Totalisator System



Bookmaker System

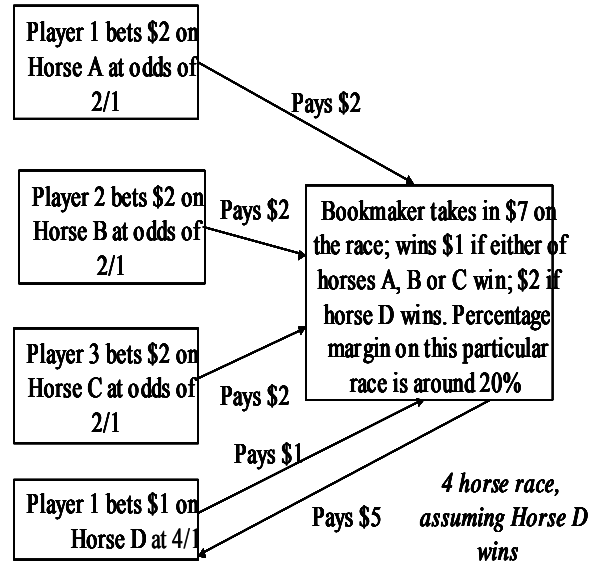


EXHIBIT2:
Illustration of “Back” and “Lay” percentages on Betfair

| NFL Season 04/05 - SuperBowl Winner | | | | | | | Refresh |
|--|--------------------------|---|---------------------|---------------------|--------------------|--------------------|---------|
| <input checked="" type="checkbox"/> View P&L | Settings | <input style="width: 20px;" type="text" value="?"/> | 105.4% | 97.2% | | | |
| Total selections: (32) | GBP | Back | | Lay | | | |
| New England Patriots | 7.8 £20 | 8 £271 | 8.2 £322 | 8.4 £350 | 8.6 £278 | 8.8 £556 | |
| Indianapolis Colts | 12.5 £12 | 13 £100 | 14 £326 | 14.5 £83 | 15 £38 | 15.5 £10 | |
| Philadelphia Eagles | 9.8 £2 | 10.5 £190 | 11 £181 | 11.5 £230 | 12 £10 | 12.5 £26 | |
| Seattle Seahawks | 10.5 £2 | 11 £286 | 11.5 £161 | 12.5 £82 | 13 £127 | 13.5 £10 | |
| Kansas City Chiefs | 22 £53 | 23 £70 | 24 £76 | 25 £60 | 27 £13 | 50 £10 | |
| Denver Broncos | 17 £58 | 17.5 £88 | 18 £85 | 18.5 £29 | 19 £23 | 19.5 £50 | |
| Baltimore Ravens | 29 £34 | 30 £28 | 32 £35 | 34 £18 | 36 £10 | 38 £5 | |
| Minnesota Vikings | 16 £58 | 16.5 £78 | 17 £110 | 18 £134 | 18.5 £10 | 19 £20 | |
| Carolina Panthers | 23 £43 | 24 £41 | 25 £9 | 26 £62 | 27 £10 | 28 £50 | |
| Tennessee Titans | 19 £5 | 19.5 £96 | 20 £151 | 21 £105 | 23 £10 | 90 £2 | |
| St. Louis Rams | 28 £42 | 29 £34 | 30 £46 | 32 £46 | 36 £10 | | |
| Tampa Bay Buccaneers | 42 £23 | 44 £54 | 46 £31 | 50 £10 | 55 £10 | 100 £3 | |
| Green Bay Packers | 22 £25 | 28 £7 | 30 £127 | 36 £543 | 48 £5 | 50 £3 | |
| Atlanta Falcons | 22 £20 | 25 £212 | 30 £157 | 36 £21 | 38 £90 | 40 £3 | |

**EXHIBIT 3:
The Betfair Model**

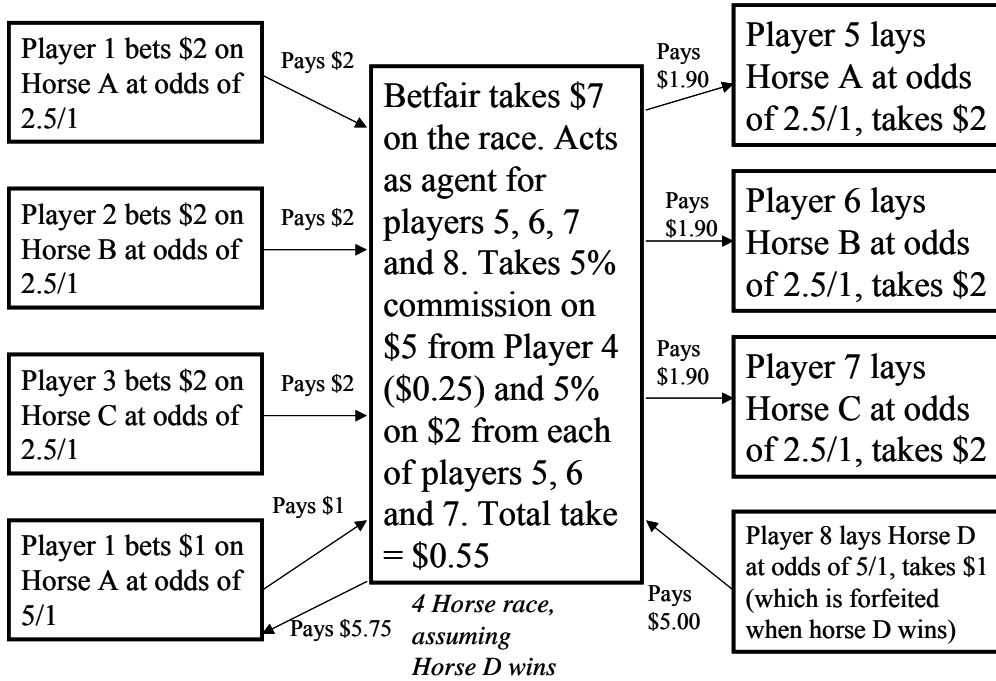


EXHIBIT 4:
A Summary of Legislation Pertaining to Casino Gambling, Lotteries, Online Betting on Horse Racing and Sporting Events¹¹

| Country | Summary of Legislation |
|---|---|
| Ireland | Ireland's bookmakers operate Internet-based services under the terms of their bookmaking licenses. |
| United Kingdom | The current position of the United Kingdom regarding Internet gaming is dependent on the type of gaming. Casino gaming is allowed only on licensed premises, and the customer must be on the premises when the gaming takes place. Therefore, no Internet casino gaming license is available in the United Kingdom and to set up a site in the country is illegal. However, residents are free to play on overseas sites, and those sites can accept bets from the United Kingdom without breaking any British laws. The United Kingdom does allow bookmakers and football pools to accept bets via e-mail and there are many sites that accommodate this type of betting. Anyone setting up an Internet betting service in Great Britain must hold a bookmaking permit from the local licensing magistrates. Lottery betting is allowed by telephone or mail, but is not allowed when conducted on a machine. Therefore, online lottery betting on the Internet is prohibited in the United Kingdom. The Gaming Board has, however, granted permission for two lottery-managing companies to run lotteries over the Internet in much the same way as using the telephone - as a means of communication connecting the buyers and sellers of lottery tickets. |
| Australia (Note: Note: Gambling Laws also vary considerably by state) Northern Territory | The Northern Territory licenses online casinos, sports books and race books. Licenses are issued for five-year periods. Licensing fees, application fees, and renewal fees are negotiated on an individual basis. Initial and ongoing audits are required. Racing bets are taxed at 1.55% when they are from Australia, and 0.5% otherwise. Sportsbook bets are taxed at 0.5% when they are from Australia or New Zealand, and 0.25% otherwise. Online gaming is taxed at 4%. |
| Australia (Note: Note: Gambling Laws also vary considerably by state) New South Wales | Licensed bookmakers are permitted to offer betting on Internet sites in New South Wales. |
| Australia (Note: Note: Gambling Laws also vary considerably by state) Australian Capital Territory | Casino and sportsbook licensing regulations exist. An application fee ranging from AUD \$11,000 (USD \$8,100) to AUD \$20,000 (USD \$14,700) is charged. For charitable organizations, the fee is AUD \$11,000 (USD \$8,100). For organizations that are already licensed under another ACT gambling act or corresponding law that have an approved control system in place, the fee is AUD \$15,000 (USD \$11,000). For all other organizations, the fee is AUD \$20,000 (USD \$14,700). The application fee includes AUD \$10,000 (USD \$8,100) to cover application evaluation expenses. The application evaluation expense portion of the fee is refundable upon payment of actual evaluation costs. The license term is one year. During the FYE June 2003 there were no interactive gaming service providers licensed in the Territory. |
| Australia (Note: Note: Gambling Laws also vary considerably by state) Tasmania | Tasmanian gaming licenses permit license holders to conduct gaming activities by means of a telecommunications device including Internet gaming. Activities that fall under a Tasmanian gaming license include sports betting, simulated gaming, fixed odds wagering and major lotteries. |
| Australia (Note: Note: Gambling Laws also vary considerably by state) Norfolk Island ¹² | The Norfolk Island Gaming Authority is a independent statutory Authority established under the Gaming Supervision Act 1998 (Norfolk Island) with extensive powers to regulate and enforce the Island's gaming and licensing legislation. The Authority's principal functions include the approval and regulation of gaming and bookmaking operations. The Authority enforces a strict regulatory regime that provides high standards of gaming administration and control for the world market. Casino gaming and bookmaking licenses are available. There is a license application fee of AUD \$3,750 for each type of license. |

¹¹ From <http://online.casinocity.com/jurisdictions/>. A full description of legislation in other countries is available from this website.

¹² Norfolk Island is a territory "under the authority" of Australia, but it is not owned by it. It finances its own education, its police, its airport - in fact receiving from Australia not a great deal more than it returns to it. (See "A Guide to Norfolk Island, <http://guide.nf/>)

| | |
|--|---|
| | <p>Investigation costs must be paid by the applicant, and an advance deposit of AUD \$25,000 is required from Australian applicants and AUD \$50,000 from all other applicants. A pre-operational levy of AUD \$25,000 applies for each license covering a twelve month period. Once operational, the minimum annual levy is AUD \$25,000 per license when all aspects of the licensed operations are based on Norfolk Island. If part of the operations are outside Norfolk Island, the minimum annual level is AUD \$75,000 for a single license holder and AUD \$100,000 for a dual license holder. Online casinos are taxed 4% of the gross win and sportsbooks are taxed at 0.5% of the turnover. Wagers cannot be accepted from residents of Norfolk Island or Australia.</p> |
| <p>Australia (Note: Note: Gambling Laws also vary considerably by state) Western Australia</p> | <p>The Gaming and Wagering Commission is responsible for regulating the conduct of on and off-course wagering in Western Australia under the Betting Control Act and Racing and Wagering Western Australia Act. This includes the conduct of race and sports betting by bookmakers, race club totalisators and the off course wagering activities of Racing and Wagering Western Australia (RWWA). The Commission's role in this regard is to licence all betting operators, authorize the conduct of telephone and internet betting and the systems use to conduct this betting, monitor on course and off course betting operations for compliance with the relevant legislative provisions, and licence Directors and Key employees of RWWA.</p> |
| <p>South Africa (Note: Gambling Laws may vary by province)</p> | <p>It generally appears that an operator of an online wagering site will need a local bookmaking license and have their software approved by the South African Bureau of Standards.</p> |
| <p>United States of America (Note: Gambling Laws also vary considerably by state)</p> | <p>Legal online gambling in the United States includes betting on horse and dog races and games of skill. Other types of Internet gambling have been targeted on many fronts including Congress, the courts, the Bush Administration, and credit card agencies. Despite this negative climate, it is estimated that gamblers lost over \$4 billion to online gaming sites in 2003. Legislative attempts to regulate Internet gambling have been unsuccessful. In 2003 the Internet Gambling Enforcement Bill was passed by the House of Representatives, but was never voted on by the Senate before the 107th Congress adjourned. The bill sought to prevent online gambling sites from using credit card instruments in their transactions. Many credit card companies have moved to prohibit the use of their cards in online gaming transactions in reaction to pressure from state governments. Along with major credit card services, online cash payment system PayPal also announced that it would prohibit money transfers to online gambling sites, citing an uncertain regulatory environment. The Bush Administration has made its position known regarding the legality of Internet gambling in a letter from the Department of Justice to the Nevada Gaming Control Board, stating that "federal law prohibits gambling over the Internet, including casino-style gambling..." Also, the Second Circuit's decision in United States v. Cohen indicates that the federal judiciary is willing to use the 1961 Wire Act to prosecute Internet gambling sites, even when they are operated offshore. Beginning in 2003 the United States Department of Justice started using subpoenas to threaten media outlets that advertise online gaming sites. It also issued warning letters to a number of associations including the National Association of Broadcasters and the Newspaper Association of America to forward to their members. These actions have had a chilling effect on advertising for online gambling. In August of 2004 Casino City challenged the actions of the Justice department by filing a lawsuit seeking a declaratory judgment that advertising online casinos and sportsbooks is protected commercial free speech under the First Amendment to the United States Constitution.</p> |

**Exhibit 5:
Other Online Betting Exchanges: URLs and Brief Descriptions¹³**

| | |
|--|---|
| <p>Sporting Options (http://www.sportingoptions.co.uk/bettingexchange)</p> | <p>Functionally similar to Betfair. Not as high volume of bets traded, but their commission rates are less, varying from 1</p> |
| <p>BETDAQ (http://www.betdaq.co.uk)</p> | <p>Revamped their site offer many new features including, when laying a selection you can now enter the Backers' stake you hope to win as opposed to your own liability. Maximum commission rate of 3%.</p> |
| <p>iBetX (http://www.ibetx.com)</p> | <p>International person to person betting exchange. Provides coverage for UK and US horse racing. In addition to normal betting exchange features they allow you to upload a text file to place multiple bets simultaneously. Commission charges range from 1% to 3%. Free £20 bonus for new customers.</p> |
| <p>GGBet (http://www.gg.com/bet/bettingexchange)</p> | <p>Horse racing betting exchange from GG.com. Their standard commission rate is 5%, but this figure reduces down to 1% based on bets placed.</p> |
| <p>Tradesports (https://www.tradesports.com)</p> | <p>Person to Person betting (mostly on American sports). Deposit and Trade \$50 and receive a \$50 free bet. Frequently quoted in respected magazines such as The Economist as a source of indication of probability (e.g. "According to Tradesports.com, the current probability of Bush winning the Presidential Election is 58%").</p> |
| <p>Trading Sports (http://www.tradingsports.net/)</p> | <p>Not a betting exchange, rather, provide the technology to enable web sites to offer their own branded person to person betting exchange. Used to power sites such as Tradbets, betfanatic and matchedbets.</p> |
| <p>SABookmaker (www.sabookmaker.co.za)</p> | <p>Allows licensed South African bookmakers to both take and lay bets, and players to ask for bets (but not to lay bets)</p> |

¹³ Based partially on information from <http://www.racing-index.com/betting-exchanges.html>

Case Notes for Teachers

Some Points that the Betfair Case Can Address

The Betfair case can be used to focus students on important issues in three business disciplines, namely information systems and technology; strategy and international business; and marketing.

Information Systems And Technology

At a micro-level, the Betfair case demonstrates the following five effects:

1. Low cost, powerful and ubiquitous computing puts the service into the hands of the masses (this is an effect of what is often referred to as Moore's Law). Whereas previously only large organizations (pari-mutuels, large bookmaking firms, casinos) had access to powerful computing, individuals now have PCs or laptops on their desks, and have similar computing power at low cost. In addition, Betfair is now making a "lite" version of the service available on mobile phones and PDAs.
2. Large networks create utility for all. Around 50 000 users access the Betfair system each day. This makes the huge network created by Betfair of immense benefit to the users (favorable odds to players, and a ready market for layers). (This is an example of an effect called Metcalfe's Law of network utility).
3. The power of a communication network such as that created by Betfair to reduce transaction costs. Most notably, Betfair reduces the odds against players by eliminating the "rake-off" taken by traditional pari-mutuels and bookmakers, by simply letting players play against each other. However, it also allows bookmakers to access larger, international markets at no extra cost.
4. An abdication of power from the center – it is difficult for government legislators and semi-government organizations (as totalisators are in many countries) to control the behavior of millions of individuals who are wagering on Betfair, online and in most cases unseen. While the organization itself has thus far attempted as much as possible to work with rather than against lawmakers in various countries, there are enormous revenue and tax implications for federal and state governments of systems such as these.
5. That technology-inspired and -enabled innovations are very frequently not initiated by incumbents but by individuals who now have access to markets. Just as the large record companies never innovated technologies such as MP3 and sharing services such as Napster, it was not the pari-mutuels or bookmakers who created the betting exchanges that now threaten their existence. Their approach to the Internet was, "Lets just do what we've always been doing, online". It was simply a smart individual who was frustrated by the limitations of current system offerings, who believed he could design something better. This is a phenomenon that has been observed in many other examples online – booksellers, travel, and auctions are just a few of the examples.

Technology, not gambling, is at the heart of Betfair's business. It is worth focusing on the end of the case where Stephen Hill says he'd like to take Betfair into whole new business areas. His view is that it's primarily a technology company, not a betting one. Getting students to consider what these possibilities might be often leads to a

really exciting generation of ideas. One of the most interesting recently was a student who noted that Betfair might enter the financial services business. Like a bank, Betfair has personal details of customers. The firm is also awash with cash, on which it has the potential to earn significant amounts of interest – players keep money in escrow with the firm while awaiting the outcome of an event, some of which have very long time horizons. For example, Betfair currently has a book on who will be the next Pope, and players are tying up money in bets that will potentially take a very long time to be decided.

Strategy and International Business

From a strategic perspective, the Betfair case illustrates firstly how technology has the capacity to cause tectonic shifts within an industry, immediately making all (even the largest) of the incumbent players vulnerable. While their first recourse may be to the law in search of protection (as was the case in the music industry with file sharing) eventually these players face the inevitable fact that the newcomer satisfies market needs more effectively. Obviously the simple strategy question here is also profound: What should we do? The reactions above and beyond legal recourse have been interesting – in Australia for example, the Totalisator Agency Board (TAB) after first trying (unsuccessfully) to have Betfair declared illegal in the country is now attempting to imitate with its own exchange. The latter tactic however highlights a further aspect of the Betfair case with regard to strategy: The notion of a sustainable competitive advantage. The size of Betfair's network (a result of a first mover advantage) provides players with the benefit of critical mass that they will not be able to gain elsewhere (especially in smaller networks.) In simple terms the TAB's network will probably be limited to Australia, Betfair's is international; the TAB's network will be small while Betfair's is huge.

The Betfair story also permits an analysis of the importance of interplay between the customers, competitors, collaborators and competences of a firm. Without doubt in many cases its competitors (traditional bookmakers) are also its customers, damned if they do and damned if they don't. The firm has also been quick to understand the importance of collaboration from the world's major sporting and racing bodies however, and has embarked on proactive initiatives with these to eliminate possibilities of game or race fixing. It has also entered into numerous sponsorship deals with these bodies too, no doubt in an attempt to foster collaborative relationships. The story also permits an analysis of the competences a firm such as Betfair needs to recruit, foster and nurture. While technology skills are obvious, a discussion will inevitably lead to an identification of expertise in other areas, including marketing, player psychology, diplomacy and legal issues.

From an international business perspective the story permits an analysis of the various entry strategies open to an online firm in different countries. Not surprisingly Betfair's first really aggressive initiative into another country was into Australia. While the Australian population is relatively small, the Australian annual per capita expenditure on gambling is the highest in the world, and horse racing is one of the country's major industries and employers. However, rather than take on the Australian

market head-on, Betfair employed a flanking strategy by entering the South African market first. The latter is a much smaller market than Australia, but in many ways similar, with a very large racing and gaming industry and the same enthusiasm for sport. The firm cooperated with government and industry bodies, and successfully set up operations within a short while. This was used as evidence of the firm's commitment to being a serious participant when entering Australia. Betfair also conducts large volumes of business in the USA, Canada, Germany, France, Scandinavia and other countries, and obviously has as its target the Chinese market, through its early forays into markets in Hong Kong.

Marketing

The Betfair story provides a platform for the discussion of a range of marketing issues, including channel strategy, new product development, target marketing, and the debate between standardization and customization. Betfair is a classic example of the Internet's power to disintermediate – it facilitates players to bypass bookmakers and pari-mutuels and to wager with each other. On the other hand it also provides an example of reintermediation by entering into the traditional channel between bookmakers and their customers. How to grow the business – can the model be extended into other areas, and how can the Betfair brand be exploited are classic new product development discussion issues. The story also facilitates a discussion of target markets, and this can be extended to a stakeholder analysis.

From an international marketing perspective Betfair provides the platform for a discussion of the standardization versus customization debate. Should the firm attempt to enjoy the economies of scale and simplicity that come with the implementation of a uniform approach to marketing in all the companies it serves, or should it attempt to adapt to local conditions, cultures and traditions as far as possible. So far it would appear that the firm is not unaware of national differences – the site offers users the facility of operating in a number of languages (Norwegian, Swedish, French, German, Mandarin) other than English. Users can also select their location and immediately be made aware of local events of interest where trading can occur (North American users would have events such as NFL football, baseball and ice hockey highlighted, while South Africans and Australians might have cricket and rugby matches drawn to their attention).