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Entrepreneurship and Innovation in the UK Betting Industry: The Rise of Person-to-Person Betting

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The emergence of Web-based ventures in 2000 offering person-to-Person (P2P) betting represented a genuine revolution in the oligopolistic United Kingdom betting industry. The radical innovation of P2P betting was that it enabled punters (the term for betting customers) to lay (accept) bets, a role that had previously been the preserve of bookmakers. This created a free market in betting, offering dynamic markets to punters and also enabling trading style activities as seen in financial markets. P2P betting flourished and by 2004 it was estimated that it accounted for up to 25–30% of UK horseracing betting turnover. The oligopolistic bookmakers, however, were less than enthusiastic about this innovation, challenging the P2P concept. In response, the P2P firms claimed P2P betting brought innovation and transparency to betting markets. This article considers P2P betting in context, and looks at its impact on the United Kingdom betting industry.

Keywords: Person-to-Person betting, Betting, Betting exchanges, E-commerce, New venture creation

Introduction

In the 1990s dot com entrepreneurs backed by enormous amounts of venture capital funding tried to enter a wide range of markets. Many believed that the Internet, by lowering entry barriers and enabling greater efficiency, would lead to the dramatic industry shakeouts described as 'seismic shifts' by Day (1997), whereby incumbents in stable industries are unable to cope with the onset of new competition. In reality, however, the Internet did not redraw industry structures; in the main it was an enabling technology, which made existing firms more efficient, a situation confirmed by the dot com meltdown of 2000 (Porter, 2001).

One industry targeted as inefficient was the UK betting industry, historically dominated by a few big firms with healthy margins traditionally in the range of 15–20% (Bowen, 2002). In 2000 new ventures were launched which enabled people to bet directly against each other through websites, thus cutting out the bookmakers, in a concept known as person-to-person (P2P) betting.

Whilst many new ideas did not survive the bursting of the dot com bubble in 2000, P2P betting was to be a highly successful innovation. By 2004 the UK horseracing establishment estimated that it accounted for up to 25–30% of horseracing betting activity in the UK (UK Parliament, 2004).

Objectives

This paper considers the development of the P2P betting market in the UK: Section 2 will outline the key features of the UK betting industry. Section 3 will go on to consider what P2P betting is and the emergence of the early players in the market, Flutter and Betfair. Section 4 will explain the different models of P2P betting and the emergence of an industry standard model – the exchange – as pioneered by the dominant firm Betfair. Section 5 will then consider the challenges faced by P2P betting including those running a real time Internet operation, and the legal and ethical challenges which question the whole basis of this innovation. Finally, section 6 will discuss some possible future trends in the sector.

The UK Betting Industry Prior to P2P Betting

What is Betting?

The betting industry forms part of the wider gambling industry, which includes casinos, bingo and lotteries. The general distinction that may be drawn between gambling and betting is the possible element of judgement in betting – for example, that a certain horse will win – which contrasts with the pure chance of gambling activities.

Market Size and Structure

All governments which allow betting make choices which balance the economic benefits of this activity with the ethical and legal concerns it raises. Whilst some jurisdictions ban betting or severely restrict provision, the UK market is a relatively liberal environment (Paton *et al*., 2002).

In 1999–2000 turnover (the amount staked) of the UK betting industry was approximately £7.3 Billion, out of total gambling turnover of £27.2 Billion (National Audit Office, 2005). The dominance of horseracing within betting caused the historic categorisation of the industry into on-course betting, meaning at the racecourse where the event is taking place, and off-course betting. Off-course betting has been legal in the UK since the early 1960s at licensed betting offices (LBOs), and has seen the growth of telephone betting and more recently electronic channels such as the Internet. Of these off-course channels the LBOs accounted for over 80% of total UK betting stakes and were oligopolistic in nature, being dominated by the 'Big Three' bookmakers – Ladbrokes, William Hill and Coral – who had a combined market share of 60% (Paton *et al*., 2002). There was regional competition from independent bookmakers but the large capital investment required to develop a network of betting outlets and a restrictive licensing system meant that challenging the established order was difficult (Paton *et al*., 2002). The remainder of turnover was split between the more fragmented and competitive on-course sector and the telephone betting sector where the Big Three had 78% of the market. Bets placed at off-course channels were historically subject to general betting duty (GBD), which stood at 9% in the 1990s. The GBD generated revenue for the government and was used to pay The Levy, funding for UK horse and dog racing in return for data rights for their events.

Betting Products on Offer
The traditional range of betting products available in the UK were described in the Budd Report (DCMS, 2001) as follows:

Fixed Odds: This still makes up the vast majority of betting in the UK and involves betting at predetermined odds, for example £100 at 3-1.

Pool Betting: This is a traditional form of betting which is used all over the world, also known as pari-mutuel, whereby the winners share the amount staked – the investment pool – minus the deductions of the operator. This type of betting is only significant on-course in the UK where it is controlled by the monopoly operator, the Tote.

Spread Betting: An innovation in betting was the emergence of spread betting companies, who offered markets in 'uncertain outcomes'[1]. The relative complexity of spread betting and greater risk, as potential loss is not predetermined, meant that it remained a niche product in the sector. A relatively small proportion of its activity centred on horseracing, thus limiting its threat to the fixed odds bookmakers (Ashforth, 2002).

The Imperfect Market
Levitt (2004, p223) considers why traditional fixed odds betting markets are organised differently to financial markets when they have much in common; investors using information who seek to gain through uncertainty, exclusive outcomes with a winner and a loser, and large amounts of money at stake[2]. However, while the neutral financial market maker seeks to equate supply and demand between players who can buy or sell (for example shares), the market maker in fixed odds betting markets, i.e., the bookmaker, is an active player who takes positions against the punters. Thus the fixed odds betting market is a seller-controlled market where punters can only 'buy' – bet that something will happen – whilst 'selling' (taking bets) is the preserve of the bookmaker.

Odds for a horserace are set considering the estimated probability of an outcome occurring, which add up to 1. However, bookmakers make money by setting less generous odds, illustrated by a concept known as the over-round; how much greater than 1 the probabilities add up to, which represents their theoretical margin. The actual margins – the difference between the amount staked and the amount paid out, called the *gross win* – were traditionally in the range of 15–20% in the UK (Bowen, 2002).