

Current Trends

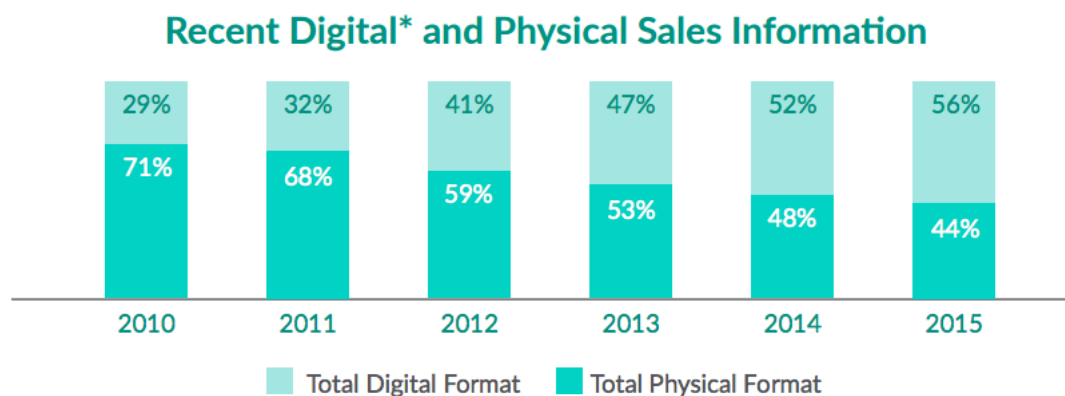
Overview

The video game landscape has changed dramatically over the last five years. The dominance of consoles, which have been the mainstay of the video game industry since its infancy, is being increasingly challenged by rising popularity of PC, and particularly, mobile gaming. At the same time, video games have become increasingly social, with more games featuring online gameplay. Finally, the emergence of virtual reality is set to push the industry in completely new directions. Below, I will discuss shifts in the business models of video game companies, evaluate their forward-facing corporate strategies, and finally, speculate and advise on future developments within the industry.

Major shifts in business models

Digital distribution

Table 1: Industry Sales Format Breakdown (2010-2015)



Source: The NPD Group/Games Market Dynamics: U.S.

*Digital format sales include subscriptions, digital full games, digital add-on content, mobile apps and social network gaming.

Note. From ESA, 2016.

Traditionally, console makers and video game publishers made most of their revenue through physical game sales. However, in the last five years or so, the industry has shifted more towards digital sales. In 2010, physical game sales comprised more than two-thirds of total industry sales. By 2014, physical game sales dropped to less than half of industry sales and continue to decline (ESA, 2016). This trend is in part due to the growing number of PC and mobile players, who buy their games almost exclusively online. However, console makers and game publishers are also contributing to this shift.

Console makers like Sony and Microsoft have made more and more games available for download through their respective online marketplaces. Online sales are more profitable for console makers and game developers because of the low cost of digital distribution compared to the cost of selling games at retail stores like GameStop (Alvarez, 2016). Additionally, video game publishers have increasingly adopted the downloadable content (DLC) sales model in recent years. Whereas publishers would get a one-time payment for the purchase of their games in the past, game developers can add new game content periodically and sell these updates to players as packages. As its name suggests, DLC is downloaded by players online and it represents an effective and popular strategy for after sales game monetization.

Microtransactions

In addition to digital distribution, internet connectivity has also popularized online multiplayer and its associated microtransactions model in the console space. For instance, *GTA Online*, *Grand Theft Auto V*'s free online multiplayer mode, is reported to have generated more than \$500 million dollars in revenue for its developer, Take-Two Interactive. To put this number into perspective, *GTA V* game sales are estimated to have

generated around \$3 billion dollars in revenue alone (Makuch, 2016). Although microtransaction revenue may be less than 20% of game sales revenue for Take-Two Interactive, the profit margins for microtransactions are extremely high. This is because microtransaction game content is optional and mainly consists of exclusive items that can be purchased with in-game currency. As a result, microtransactions have a disproportionally high yield relative to its development costs.

The highly successful *Grand Theft Auto* franchise has traditionally relied on compelling single-player story modes to drive sales. However, as online multiplayer and microtransactions become more profitable, game developers such as Take-Two Interactive may allocate more development time and resources to more profitable online multiplayer modes in favor of story-driven single-player game modes.

Evaluation of corporate strategies

Nintendo's mobile strategy

Once a giant in the console market, Nintendo is a distant third behind Sony and Microsoft today. After disappointing sales of its most recent console, the Wii U, Nintendo was prompted to reassess its strategy to address current market trends. In the past, Nintendo resisted the advance of the smartphone and refused to license popular games like the Mario franchise for mobile use (Alvarez, 2016). However, in March 2015, Nintendo announced a partnership with Japanese mobile developer DeNA to produce applications for smart devices (DeNA, 2015).

Nintendo released its first app, Miitomo, on March 17th, 2016. Miitomo is a free to use social messaging app that allows users to discover surprising facts about their friends. While Miitomo is not a game per se, it is deeply integrated into the Nintendo

ecosystem. Miitomo was launched alongside My Nintendo, which is Nintendo's new loyalty program. Users can use points earned in Miitomo to redeem rewards including digital game downloads for Nintendo consoles such as the Wii U or the 3DS and discounts on software purchased from the Nintendo eShop (Nintendo, 2016).

Miitomo became the most downloaded app in both the Japanese and U.S. App Store within a week of launch. By April, Miitomo had over 10 million users worldwide (Nintendo, 2016). Although Nintendo had no precedent in the mobile app marketplace, it opted to enter through the crowded social messaging app market. However, Nintendo has managed to create a product compelling enough to differentiate itself from its competitors.

Overall, I think Miitomo is a good effort to attract new users into investing in the Nintendo ecosystem and keeping existing users invested. While the app itself has been wildly popular, Miitomo is merely a means to expose and incentivize users to invest in Nintendo's core products, namely its consoles and games. By releasing a social messaging app, Nintendo is effectively leveraging the social circles of its users in recruiting more people to use Miitomo and potentially other Nintendo products and services. With Miitomo, Nintendo seems to be off to a promising start in the mobile app market. Though the company still has much to do to make up for lost time.

Microsoft's Universal Windows Platform strategy

Microsoft is the biggest major player in the video game industry, with a market share of 11% (Alvarez, 2016). Recently, Microsoft's head of Xbox, Phil Spencer, announced Microsoft's plans to unify its PC and Xbox platforms into a single Universal Windows Platform (UWP) running Universal Windows Applications (UWA).

The idea behind UWP is to allow developers to create a single UWA that can run across different devices on a shared software platform rather than making multiple versions of the same app for different platforms. For instance, using the UWP, a game developer would be able to create a single game that runs on both Xbox and PC instead of creating the same game from scratch for each platform (Stuart, 2016). However, the implications of Microsoft's UWP plan is not just limited to their consoles' software, it could fundamentally change the fixed hardware cycles that dictate the console market today.

Up until now, video game consoles have had fixed life cycles ranging from four to six years before the next generation of consoles is introduced. Each new hardware platform is tied to its software platform throughout the console generation. This means that newer consoles will be incompatible with previous generation games and that the console hardware will remain stagnant throughout the generation. Currently, the console market revolves around the console cycle, with sales peaking at the beginning and dipping towards the end of a cycle (Alvarez, 2016).

Microsoft's UWP plan would essentially decouple their console's software platform from its hardware platform, allowing for incremental hardware upgrades rather than generational hardware cycles. While Microsoft's UWP plan would greatly increase the catalog of games available for the Xbox, I think Microsoft risks alienating a core group of console gamers who appreciate their console for what it is, rather than for having the qualities of a PC.

Right now, the console gaming experience is still distinct enough from PC gaming for players to justify purchasing a console. However, Microsoft's decision to merge the two platforms and introduce incremental hardware upgrades to its consoles

comes dangerously close to erasing the distinction between console and PC gaming. Ultimately, I think the UWP plan will make it more difficult for players to justify purchasing a dedicated gaming console if their PC can do everything their console can and much more.

Future developments

Virtual Reality

No discussion of the future of the video game industry, and indeed, the entire media industry would be complete without mentioning virtual reality. According to the Entertainment Software Association's most recent survey, more than half of the most frequent gamers are familiar with virtual reality and among those, 40 percent said they would be likely to purchase their own VR headsets within the next year (ESA, 2016). Anticipation for virtual reality is particularly strong within the gaming community because of its potential to introduce fully immersive gameplay. The first commercially available VR headset for PCs, the Oculus Rift, was released on March 28 this year with a catalog of 30 games at launch (Oculus, 2016).

In the mobile sphere, Samsung and HTC have already entered the market with their own VR headsets. Within the console market, Sony plans to introduce its PlayStation VR in October 2016 (Sony, 2016). Of the big three console makers, Sony has been the only company to announce its plans for their VR headset. Nintendo has so far only expressed interest in virtual reality and Microsoft seems to be moving towards augmented reality (AR) with its HoloLens technology.

While the virtual reality market is nascent, we can already see competitors vying for consumers at this early stage. The market will only get more crowded and competitive

as time goes on, as more companies attempt to tap into the potentially lucrative market. Currently, the PC, mobile, and console markets already have early entrants ready to capitalize on this emerging technology. I would urge Nintendo to not be resistant to the advancement of virtual reality as it was towards the advancement of smartphones because VR is here to stay and the sooner Nintendo develops a product, the sooner they can enter the crowded market.

Technological convergence

The video game industry is undergoing and being transformed by technological convergence. Technological convergence can simply be understood as many different technologies evolving to perform a similar set of functions. An ongoing example of technological convergence in the video game industry is Microsoft's Universal Windows Platform (UWP) plan mentioned earlier. The UWP plan would essentially merge Microsoft's PC and console platforms to form a single application ecosystem. Whereas Microsoft's consoles could only run Xbox games and dedicated apps and PCs could only run PC games and Windows apps, the UWP aims to make the same games and apps run across both platforms. This would effectively make Microsoft's consoles into hubs for content rather than dedicated gaming systems.

This kind of convergence where different technologies merge to perform similar functions has already been realized in devices such as smartphones. However Microsoft seems to be spearheading the movement in the console industry. Together with HoloLens, I suspect Microsoft's ambition is not merely limited to the console and PC market but rather includes occupying a space in homes where individuals use multiple connected hubs to access information and entertainment through Microsoft's ecosystem.

I think technological convergence in the video game industry is bound to occur. With high-end PCs exceeding the performance of consoles and smartphones catching up quickly with every hardware refresh, the fixed console cycle model seems to make less sense with each passing year. Rather than investing vast amounts of resources into developing console platforms that will become obsolete in a few years, Microsoft has opted to create a universal software platform for all of its devices across multiple hardware platforms. In my opinion, Microsoft's strategy is more sustainable in the long term and embraces the force of convergence that other console makers have so strongly resisted. However, I also think Microsoft can afford this strategy because of its unique position as a software company compared to more dedicated video game and consumer electronics companies such as Nintendo and Sony.

Conclusion

In conclusion, gaming today is more connected, social, and cross-platform than ever before. Online connectivity has not only created more cost-efficient digital channels of distribution but also alternative monetization opportunities for vendors through online gameplay. Faced with mounting pressure from the growing PC and mobile market, the major console players have each responded to this challenge in their own way. Nintendo finally decided to enter the mobile app market after its long resistance, Microsoft is exploring alternatives to the traditional console model, and Sony is at the forefront of console VR development. In the face of the emergence of virtual reality and the brink of technological convergence, these companies have set forth their vision for what many have described as the last console cycle. If these trends continue on their current trajectories, the video game landscape will be very different in five years time.

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