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A Review of the Video Games Industry in the United States

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Abstract

With increasing revenues for video game manufacturers, higher software sales and a more diverse audience, the video games industry has been experiencing strong and rapid growth in recent times, rivalling other forms of entertainment. As a result, games have begun to attract the attention of marketing practitioners who are finding it increasingly difficult to attract consumer attention, and are seeking alternative media for marketing communications. This paper provides a review of the video games industry in the United States and raises the question as to whether games are a viable new medium for marketing messages. Areas for research are identified.

The Growth of Video Games

PricewaterhouseCoopers (2004) predicts the entertainment and media industry will grow 6.3% annually to reach $1.7 trillion in 2008, with the video games market predicted to grow 15% to 25% annually during 2003 to 2006 (Kane, 2004). This will make it the fastest growing overall consumer category worldwide over the next five years (Carton, 2003). Global video game software spending (for console, computer, online and wireless games) is forecast to grow from $21 billion in 2002 to $30-$35 billion in 2007, with a sales growth rate in excess of 20% expected in 2007 in each global region (Kane, 2004; RocSearch, 2004). The price of video game console platforms introduced in 2000 and 2001 (Sony PlayStation 2, Microsoft Xbox, and Nintendo GameCube) has dropped, increasing the sale of software and accessories (Kane, 2004). Digital technology advances are driving growth in the industry, facilitating product innovation and the development of new games and consoles (Kane, 2004; RocSearch, 2004). It is being predicted that revenue for the video game industry could surpass that for music in the next five years, and that it will rival the film industry in creativity, scale, audience responsiveness and revenues (see, for example, DFC Intelligence, 2004a; Kane, 2004; Williams, 2002). The growth of entertainment software has been outpacing the annual growth of the music and movie industries, with interactive entertainment being the only entertainment industry continuing to grow in 2003 (ESA, 2004a). From 1998 to 2001 the video game industry was the fastest growing entertainment segment with a growth rate of 15% to 25% (Williams, 2002).

A strong convergence is actually becoming apparent between video games and other entertainment categories. Game producers are becoming involved early in new film production so as to create related games that can be released to coincide with the movie launch - a synergy which creates a boost in sales for the video game three to four times higher than if the game is launched post movie release (Paterson, 2003). An opportunity is also being presented for publishers to extend a game's lifespan and gain cross-promotional partnerships by releasing special music singles and remixes for game use (GIGnews, 2002). Beastie Boys for example released a new single in the *Grand Theft Auto 6* video game (Dolan, 2004), and for the first time ever, an award was presented for the best video game soundtrack at the 2004 MTV music awards (with the winner being the soundtrack for *Tony Hawke's Underground*).

Video games are becoming a mass medium with similar properties to other media in terms of their structure and practices. One of the key differences between video games and other forms of entertainment such as film, television and music is the numbers. Lewis (2004) provides an example. The video game *Madden NFL 2004* sold two million copies to gross $100 million within three weeks of release, and it is estimated that by the time the next version is launched in 2005, it will have sold four million copies for $200 million. At the same time as the game's release, the hit movie Seabiscuit returned $78 million at the box office, while the 2003 Oscar winning film Chicago made $171 million in nine months. Furthermore, the average *Madden NFL 2004* player will spend at least 100 hours playing the game over twelve months, for a total of 400 million hours across the entire market (with four million game copies sold). According to Lewis (2004), the television smash hit The Sopranos (the most popular show on cable television in the U.S) drew an average of 11 million viewers for each of its thirteen one-hour episodes, totalling 143 million viewing hours. This example illustrates the growing power of the video games industry.

The Manufacturers

At the hardware and software level the video games industry is oligopolistic, with three major console manufacturers controlling the market - Sony which launched its PlayStation in 1994, Microsoft which launched Xbox in 2001 and Nintendo which launched its first home video game system in 1985. These three major players account for 80% of all game revenue (Taub, 2004). Unlike other media, each of the manufacturers operates a proprietary system whereby only software designed specifically for each box can be used, which creates competitive pressures (Williams, 2002). In this industry, the first-mover advantage, mass acceptance of the product and technical innovation are critical success factors (Gallagher and Park, 2002). The manufacturers derive the bulk of their money from software sales, selling the console units themselves below cost in order to create a large installed user base which will provide the critical mass to generate the profits required (Grossman, 2005). By pushing consoles through the marketing channels, the manufacturers create an installed base of players who are forced to purchase software titles developed specifically for their selected console.

A large user base is also necessary to attract game developers, who derive a royalty from each software unit sold (Williams, 2002). Profits are made from software through licensing agreements, with developers and publishers required to pay a per-copy licensing fee, as well as an additional fee to manufacture the software at the console manufacturers' plants (Williams, 2002). A strong network of licensees is critical in order to enable the console manufacturers to generate a large quantity of titles, which is particularly important when launching a new console system (Williams, 2002). A trend in the market has been for publishers such as Electronic Arts (the largest and most successful publisher), to purchase developers (such as Maxis and Westwood Studios), to facilitate the creation of many titles. This strong network of developers and publishers represents the console segment's key strength and a major barrier to entry in the industry. Development costs for games have risen sharply (DFC Intelligence, 2004b), with a top-shelf video game now typically costing $5 million to $25 million to create (Shields, 2005a; Taub, 2004). In this competitive industry marketing costs have also increased, equalling or even exceeding development costs (DFC Intelligence, 2004b). At present however, revenues for developers are increasing with the number two video game maker Activision reporting a growth in revenue from $9 million in 1990 to $865 million in 2002 (Van Tassel, 2003).

Sony is the largest and most successful video games manufacturer. In 2000 Sony dominated with a market share of 55%, followed by Nintendo with 26% and Sega (which has since withdrawn from the market) holding 18% (Williams, 2002). Sony was the leading force in the video games industry from 1998 to 2003 (DFC Intelligence, 2003) and continues as the global market leader today, with a market share of 69%, followed by Microsoft with 16% and Nintendo with 15% (Edwards and Greene, 2005). From 1995 to 2002, Sony reported $36 billion in revenue from video games, compared to Nintendo with $32 billion (RocSearch, 2004). After launching its PlayStation system in December of 1994, the total number of PlayStation units sold worldwide as at May 2005 totalled more than 102 million (Sony, 2006). Sony has the largest and most loyal installed customer base with 27 million users, or one out of every four U.S households (Altizer, 2004). Of the U.S top ten best selling games in 2005, eight belonged to Sony and its PlayStation 2, with two for Microsoft's Xbox (ESA, 2006).

The Games

In the U.S, almost 230 million games (both computer and video games) were sold during 2005, with the average video game costing around $50 (ESA, 2006). The video games industry is providing products that both entertain and educate, from spin-off games based on films, to a variety of sports games, history-based games, action-adventure fantasy and educational games (Kane, 2004). Compelling content is one factor that drives the market (Altizer, 2004). In 2005 the majority of console game players purchased action games (30.1%), followed by sports (17.3%) and then racing (11.1%) (ESA, 2006). Of games released in 2002, 55.7% were rated for 'Everyone', 27.6% for 'Teens' and 13.2% were rated for a 'Mature' audience (RocSearch, 2004). Games released for a mature audience increased over the previous year.

Product lifecycles for video games are highly variable, with changing consumer tastes posing a risk to new software success (Williams, 2002). The keys for publishers, who are responsible for the launch of new games, are strong marketing and distribution networks as well as hit titles (Williams, 2002). Publishers are increasingly relying on merchandise, special effects and big releases, often attending trade shows to promote the latest games and releasing demonstration versions prior to game launch (Kane, 2004; PBS, 2004). The video games industry is also relying on sequels (RocSearch, 2004), reflecting the rise in development costs (Taub, 2004). In the six-month period ending in June 2004, only two of the top ten selling video games were based on original ideas with the rest being licensed from pro sports, based on blockbuster movies and books, or spin-offs from other best selling games (Taub, 2004). Licensed brands are growing in importance (DFC Intelligence, 2004a), as they have mass market appeal and their easily recognisable titles, modelled after successful franchises, gives them greater sales potential (NPD Group, 2004).

The Game Players

Broadly, game players can be segmented into two groups - the hard core/ avid gamers and the more casual users (Williams, 2002). In 2001, the most frequent video gamers cited a number of reasons for playing - 81% played games because they are fun, they are challenging (72%), they are an interactive social experience that can be shared with family and friends (42%), and because games provide a lot of entertainment value for the money (36%) (ESA, 2004b).
A key driver for video games is the expanding demographic of players (GIGnews, 2002; Van Tassel, 2003), allowing the industry to achieve strong performance by delivering content that

appeals to a broader audience (Paterson, 2003; Simon 2003). Video games are transforming into a form of mass market entertainment, with game use increasing among users of all ages. While video games now represent one-third of the whole toy industry in the U.S (Paterson, 2003), they are no longer a form of in-home entertainment just for children.

Approximately 50% to 60% of all Americans over the age of six now play video games, with the average age of players being 33 years (ESA, 2006). In the U.S, 40% of the most frequent players are between 18 and 35 years of age (ESA, 2004c) and 38% of Americans who play are women (ESA, 2006). It is estimated 112 million people aged 13 years or older participate in some form of electronic gaming (Shields, 2005a). Video gamers also come from a wide variety of socio-economic backgrounds, with 41% of U.S game playing households earning more than $50 000 a year (ESA, 2003). The audience for games is more mature and diverse than it once was, as demonstrated by the variety and scope of available game titles and genres.

Some fundamental shifts are occurring not just in terms of who is playing games, but also in the manner in which they are being played. Time spent playing has risen steadily and is expected to increase further. According to media investment bank Veronis Suhler Stevenson, Americans spent 64 hours on average playing video games in 2002, almost double that of five years earlier (Delaney, 2004). In the U.S, 44% of parents in households that own a video game console say they play with their children daily or weekly, with 60% playing at least once a month (ESA, 2004b). Households now feature several video game users, own multiple systems and purchase more software per system (DFC Intelligence, 2004b).

The increased usage of video games within households is taking up more consumer leisure time, stealing time and dollars away from other entertainment options like television, movies and music (Lewis, 2004). Although the penetration of game consoles (estimated at 43%) is not as large as that for televisions, around 45 million U.S households now have a video game system, up from 34 million in 1994 (Anonymous, 2005; DFC Intelligence, 2004b). Around 23% of households own more than three systems (Anonymous, 2005). Further, 52% of American gamers who are spending more time playing video games report watching less television, 47% go to movies less often and 41% watch movies at home less often (ESA, 2004d). It was estimated that in 2004, each American would spend 75 hours playing video games - longer than the time spent watching DVD or video tape rentals (Lewis, 2004). The majority of game play is also occurring during prime time television hours, particularly for males aged 18 to 34 years (Altizer, 2004) who watched 7% less prime-time television in 2003 than in 2002 (Delaney, 2004), and 12% less in 2004 (Anonymous, 2005). Video game usage time is expected to continue to increase in coming years, with growth in consumption expected to outpace other forms of media (GIGnews, 2002).

A New Marketing Medium

Given their strong growth and appeal to an expanding demographic of consumers, it is not surprising that games are attracting marketing attention. At the same time they have grown to become a key segment in the entertainment category, competition for consumer attention has increased, and the ability of consumers to process advertising messages more deeply is being constrained (Ha and Litman, 1997; Sandler and Secunda, 1993). This - along with increased clutter in a crowded media environment and the desensitisation of viewers to commercial messages (Sandler and Secunda, 1993) - has raised the profile of games as a medium for marketing communications.

According to PQ Media (2006), traditional advertising and marketing spending grew 4.9% to $413.45 billion in 2005, while total spending on alternative media strategies grew 18.8% to almost $98 billion. From 2000 to 2005, the compound annual growth rate for spending on alternative media strategies was 13%, while in traditional media it was only 2.5%. Within this grouping, entertainment advertising and branded entertainment (which includes product placement, advergaming and video game advertising) represented the largest segment. PQ Media estimates $44.7 billion was spent on entertainment advertising and branded entertainment in 2005, while estimates of spending on in-game advertising specifically range from $27 million to $34 million (Anonymous, 2005; Keighley, 2004). By 2010 however, spending on in-game advertising could rise to anywhere between $800 million to $2.5 billion (Anderson, 2006; Keighley, 2004; Shields, 2005b). A number of industry developments are expected to fuel this growth.

With increased development and marketing costs, game makers are more receptive to in-game product placement, and are taking a proactive approach to consider possible marketing opportunities (Nelson, 2002; Reid, 2004). The market has also seen the emergence of third-party brokers to negotiate deals, which is expected to increase the number of games developed around brands (Delaney, 2004). Some agencies are even creating specialty units and divisions for video game advertising (Mandese, 2004). A partnership between game publisher Activision and Nielsen Entertainment to develop a ratings system for video games, also promises to enable marketers to place highly targeted brands more easily and efficiently (Delaney, 2004). These developments are facilitating and encouraging the use of games for promotional purposes.

Conclusion and Ideas for Future Research

It has been claimed video games are posing a serious threat to other, more traditional media (see, for example, Van Tassel, 2003), and that in fact they are becoming the most powerful marketing medium ever created (see, for example, Nelson, 2002). Their role however, as a marketing communications tool, is yet to be validated. Empirical research into the dynamics of video games is necessary before conclusions can be drawn about their effectiveness as a medium. It is hoped this paper draws academic attention to the area. As a starting point, the following research questions are worthy of attention:

1. What is the structure of the industry in Australia?
2. How can the market be segmented?
3. What are the characteristics of different types of games?
4. How are marketing messages being incorporated into games?
5. How can the practice of placing marketing messages in games be defined within the existing conceptual framework?
6. What is the impact of these messages on consumer behaviour?

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