



## **BSAC Business Briefing**

### **Games Consumption Trends**

**November 2012**

#### **Games are now a major pillar of entertainment media spend**

Across Europe, consumers spent €11.3 billion on games content in 2011, comfortably eclipsing spending on cinema box office (€7.5 billion) and video content (€8.8 billion) and second only to the pay TV market, responsible for €36 billion in entertainment spending. The scale of the games market underlines the established nature of an industry that is now a major part of the entertainment media opportunity. This is a key reason why the largest diversified companies across the media sector have been actively investing in games as part of their overall strategies to drive value from their content properties.

Beyond the scale of the overall games opportunity, it is also clear that the games sector, while late in many ways to an aggressive shift to digital and mobile distribution, now leads all other sectors when it comes to digital monetisation of these fast moving and developing opportunities. European spending on digital and mobile distributed games content reached a significant €4.1 billion in 2011, a 'digital percentage' that is well in advance of other entertainment sectors. This scale reflects the ability of games content to be served using innovative and highly effective monetisation strategies that can't easily be used with other forms of content. So while the games market is now an accepted part of the entertainment media sector as a whole, it has its own unique characteristics that set it apart and, in the context of commercial development, takes specific skills to make a business success.

#### **The great digital/mobile transition in games**

Like other entertainment industries, and particularly the music sector, the games sector has been operating over the last decade against a background of transition towards digital distribution, mobile distribution and connected games services. In the last four years we have seen an acceleration in the shift of consumer spending share away from physical media product towards digital and mobile games content. While the shift has been driven by consumer acceptance of

new forms of distribution, it has also coincided with the lifecycle shifts of dedicated games platforms, with the handheld segment entering a generational transition in 2010 and the TV console segment entering its own transition in 2012.

Between 2014-2016, we expect this digital transition will be interrupted somewhat by the introduction of new TV consoles from each of the three manufacturers prompting a resurgence in physical media spending. Even so, by 2014, IHS Screen Digest expects a majority of consumer spending to be derived from digital and mobile channels. We believe that physical media games sales are now on an underlying generational decline, which will not be reversed.

### **The success of free content & microtransactions**

The more rapid shift to digital and mobile distribution spend has coincided with the widespread industry adoption of 'freemium' games experiences. Freemium is a combination of free access to games content, which is then monetised through add-on premium content, in-game purchase of items (e.g. new weapons or clothing for a character) or additional functionality that can be bought to enhance the games experience. This freemium model, with monetisation via 'microtransactions', was pioneered by Asian online games makers. Operators that implemented this approach found that they could compete very effectively and attract very large user bases because their core content was free. Although a majority of users never spent money on these games, these early industry adopters found that, those that did, often spent significant amounts on the in-game enhancements that were charged for.

The free content and microtransaction model arrived in the West in the mid-2000s through so-called multiplayer online games. With the advent of Facebook gaming and launch of Apple's App Store for its iPhone and later iPad devices, there has been an acceleration in adoption of these business models by the industry in the West. By 2016, IHS Screen Digest expects that 29 percent of spending on games across Europe will come from microtransactions, a vast majority of which will be driven by freemium models. Back in 2009, microtransactions were only responsible for 5 percent of spending across the European market but this year will already constitute around 20 per cent, illustrating the significant transformation in business models that has already occurred in the market.

### **Dedicated and generalist games devices are converging**

In 2012, the number of devices serving games content is numerous and only expected to increase. Both dedicated games devices and general purpose Internet-connected devices that serve games are being marketed to attract as wide an audience as possible. The dedicated handheld and TV consoles are doing this through offering more casual content and non-game entertainment services to promote daily engagement. The generalist devices - primarily smartphones and tablets, but in the future connected set-top boxes and TVs - are increasingly offering games content. The games experience on these devices is improving all the time.

As such, both dedicated and generalist platforms are converging on the middle ground, serving the mass market in terms of the entertainment content and services they offer. Under these conditions, and especially with regards to attracting the mainstream gamer, we believe that generalist devices are being particularly strongly positioned. Smartphones, in particular, are everyday devices that offer a wide number of use cases and, as they increasingly serve games content, are a substantial disruptor to the handheld console market. Consumers now have a choice to invest in a standalone dedicated games device or a smartphone, which they will use every day and that also plays games. Offered this choice, many consumers will choose to have only one device, especially under the current constrained macroeconomic conditions. Sony and Nintendo rely on the unique experiences and content they can offer to sell their dedicated handheld console devices, but it is clear that the 'uniqueness' gap between handhelds and smartphones is being narrowed with every new iteration in high-end smartphone and tablet.

### **Manufacturer device ecosystems are emerging**

Consumer electronics and platform companies, such as Sony, Microsoft, Apple, Google, Samsung, Amazon and LG, are building what can be described as device ecosystems to serve content across the main use cases found in the market. Keeping consumers within these ecosystems creates synergies across content sales, drives adoption of new products and, ultimately, is very important in driving revenue growth and company expansion. In the past, games content consumption was siloed in nature when it came to devices - games were played on standalone consoles using physical media that was built for that device. With the advent of online games and application platforms, games content is becoming a key content type to serve across these device ecosystems.

While consumer electronics companies own a collection of devices within an ecosystem, loosely divided between mobile devices, tablets, PCs and home entertainment products, they are limited unless connected together by horizontal distribution platforms that give users access to their profiles and content across different screens. This fits with an emerging consumption trend, which calls for a more distributed and fluid, 'on-demand' use of content when and where people require it. Hence across the games sector those companies which operate these horizontal distribution platforms for games content and that are already established in the market will become increasingly strongly positioned with the shift away from the old dominant physical media supply chains of old. Apple, Google, Sony, Microsoft, Samsung and Amazon are all well positioned to grow their distribution influence in the coming years, if they can successfully deliver a well connected ecosystem experience. As a result, these companies are investing heavily in infrastructure and software solutions that enable these horizontal platforms to be fully integrated across devices.

### **Dedicated console sales will be negatively impacted**

The competitive nature of the connected device landscape means that IHS Screen Digest expects sales of next generation consoles to be negatively impacted. We believe it is inevitable that some users will be drawn away from dedicated games devices to other more generalist devices that

serve some great games content. IHS Screen Digest expects the handheld segment to be the most disrupted by smartphones and tablets. TV consoles hold a stronger position with no compelling alternative offer directly competing in the market as yet (although connected TV devices are finding good traction), but the increasing use of tablets in the home and the quality of games experiences offered on these devices, means TV consoles will also be negatively impacted. If a major player, such as Apple, was to develop a more comprehensive connected TV device and platform offering adding games apps from its existing ecosystem of devices, then it is likely the TV console market will be more significantly disrupted.

### **What does the transition mean for physical media spend over the next five years?**

The traditional TV and handheld games console markets still predominately rely on physical media sales for the majority of their content sales. While these devices are increasingly Internet-connected and offer their own digital content and services, sales through online console platforms do not match those of physical media products - less than 10 percent of content sales across consoles currently come through digital distribution channels although we expect this to increase gradually over time.

The latest handheld consoles - Nintendo's 3DS and Sony's PS Vita - both use physical media cartridges and we expect the next generation of TV consoles - Nintendo's Wii U, and new platforms from Sony and Microsoft - to also continue to use their own versions of physical optical discs for content delivery. This market for next generation physical media games is expected to decline when compared to the sales across the previous cycle of consoles, not only because gamers are engaged in other digital and online-led markets and freemium games experiences, but because much of that content is available on more generalist connected devices - PCs, smartphones and tablets - and not consoles. IHS Screen Digest forecasts that the handheld console sector will be more aggressively disrupted by these more general devices, although there will also be competitive repercussions for the TV console platforms as well.

### **Console platform manufacturers are fighting their corner**

As stated above, console platform manufacturers are continuing to build compelling offerings which straddle a number of use cases and also include non-game entertainment to promote ongoing and sometimes daily engagement. The challenge for these companies is remaining relevant to the consumer in an environment of very capable generalist connected devices such as tablets, smartphones and, increasingly, connected TV devices. Nintendo is reinforcing its reputation for innovation with the introduction of the Wii U, which was launched in the US market on 18th November and will follow shortly in the other key sales territories in the next few weeks. With its unique controller with incorporated touch screen, the company is positioning the device as the first fully-integrated 'second screen' experience for a games console, which aligns strongly with trends in content consumption on the primary screen.

Sony has a wider opportunity to build on its device ecosystem using its established Sony Entertainment Network (incorporating PlayStation Network) as the glue between its multiple

device offerings. It is also slowly moving away from reliance solely on its own devices by using Sony Entertainment Network to extend its content proposition to the most popular third-party generalist platforms and devices. As a first step, the company has signed partnerships with device manufacturers HTC, Asus, Fujitsu and Sharp to extend its PlayStation Network experience on to their devices.

Microsoft has fewer devices to incorporate into a first-party device ecosystem even with its recent announcement of the Surface tablet and its close partnership with Nokia to build phones using the Windows Phone operating system. As a result the company has been more willing to extend some of its Xbox Live gaming experiences to competitive devices such as those devices running Google's Android and Apple's iOS. At present the 'extended' experience is relatively limited through Microsoft's Xbox SmartGlass initiative, but the company has an acute understanding that to keep its Xbox experience relevant to the consumer it must engage consumers across the most popular connected devices, so we expect it to evolve quickly over the coming months. The ambition is that this engagement will lead users back to Microsoft's entertainment hub, the Xbox, which sits at the centre of the company's home entertainment strategy.

*Ben Keen & Piers Harding-Rolls, IHS Screen Digest*