



BSAC Business Briefing

Games Consumption Trends

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Gaming connects with consumers from across the demographic spectrum

The games sector continues to grow as more people play; this has been helped by an ever expanding range of games-capable devices. Gaming touches all major consumer groups, from: young children, playing games on their parents' smartphones and tablets; across teens, consuming games content on a variety of devices; through the traditional 18-35 year old predominantly male console gamer; and to older and female gamers, that play across PC, Facebook and smartphone platforms. Key enablers of wider gaming availability have been the explosive growth of the 'app' distribution model, the increasing availability of free games and the broader adoption of smartphones and tablet devices.

Gaming is also a truly global market, with 26% of spending in 2013 coming from North America, 25% from Europe and 43% from the Asia Pacific region. While the globalisation of the market offers companies in the UK and Europe more overseas opportunities, the enabler of this globalisation – primarily free or very cheap global distribution platforms – means that competition has also increased exponentially across certain segments of the market.

Lower barriers to global games market entry have resulted in the appearance of thousands of new content creators. A recent survey, commissioned by NESTA in conjunction with UKIE, shows that, of the 1,902 games companies in the UK, over 600 were started since 2011 and, during the 2010's as a whole, 75% of new UK-based games companies were specifically targeting Apple's iOS platform. A majority of these games companies are described as 'micro-studios', or small teams of games creators building apps for mobile devices. As such, the make-up of the industry has changed dramatically from the early 2000's, when it was far more focused on the console and PC platforms.

The industry continues to be very active in terms of mergers and acquisitions. During 2014 alone, the sector has seen Facebook's \$2 billion acquisition of virtual reality specialist, Oculus Rift, Microsoft's \$2.5 billion acquisition of Minecraft developer and

owner, Mojang, and Amazon's \$1 billion acquisition of games-related video streaming platform, Twitch. While the reasons behind each of these acquisitions is unique to each deal, the industry diversity represented here underscores the innovative and fast moving nature of the sector as a whole.

Games sector performance

Across Europe, consumers spent €13.6 billion on games content in 2013, up from €12.6 billion in 2012. This total comfortably eclipsed spending on cinema box office (€7.5 billion), on music (€4.9 billion) and on video content (€9 billion). While overall growth in games spend in 2013 was relatively sedate at 7%, the complex nature of the games sector and its many distribution channels and devices means that this top line growth rate hides a number of different segments that are performing in different ways.

Physical media spend represented 45% of all European games spend in 2013, down from 53% in 2012. Even with the introduction of a new generation of consoles, such as Nintendo's Wii U, Microsoft's Xbox One and Sony's PlayStation 4 (PS4), we do not expect there to be a reversal in fortune for the sale of physical games discs and cartridges. This is because an increasing amount of content for these dedicated games devices is distributed digitally, with 'day-and-date' simultaneous digital and physical releases of leading games titles commonplace on the new platforms. There are a number of digital market hindrances that remain unaddressed and are not easily overcome, so, while sales of physical discs are in decline, they will continue to play an important role in the console segment for the foreseeable future. We will touch upon the major hurdles to digital distribution in the console space later in this paper.

The digital games opportunity is made up of a number of different segments, some of which are expanding and others of which are contracting. Mobile and tablet gaming are growing at the fastest rate, with the share of market spend on these devices growing 7 points to 19%. Across Europe, consumers spent €2.6 billion on mobile and tablet games last year, a substantial 76% increase on the 2012 performance. Growth of consumption across the mobile and tablet games space is expected to continue at a rapid pace in both 2014 and 2015, and, by 2018, IHS forecasts that mobile and tablet will account for one third of all games spending.

Market transformation: sticking points

Like other entertainment industries, the games sector has been undergoing an accelerating transition to digital business models. However, the nature of games content means that the industry has been able to execute digital models more effectively and aggressively than other entertainment sectors. A case in point is the success of content that is free-to-download, but subsequently supported by micro transactions for the sale of in-game items or currency. However, the malleability of games content, and the ability of developers and publishers to alter and change content on a regular basis to improve monetisation, also throws up a number of challenges in what is a progressively on-demand and multi-screen future vision of consumption.

The key sticking points centre on the challenges of porting games across multiple screens and the large variance in game experience and use-cases that different devices offer to the consumer. While it is relatively easy to use streaming infrastructure to serve video or music content to all types of screen, be they monitors, TVs, mobiles and tablets, the same cannot be said of games content, because there is a requirement for constant two-way interactivity to control the on-screen content. The challenges and commercial failures encountered by the pioneering companies in the so-called 'cloud gaming' sector highlight the difficulties of developing a robust commercial proposition for on-demand provision of games. Additionally, use-cases for games differ from device to device and screen to screen. Having to build varied experiences for different platforms is expensive and, under these circumstances, maintaining coherence across the content offer is a major challenge. Generally, experiences are specific to the device used, and it is rare to find examples of genuine cross-platform deployment of content that is exactly the same.

We believe that these factors will limit the development of multi-screen services for games content in the medium term, and will maintain support for distinct device-based categories for games.

The new consoles

At the end of 2013, Microsoft's Xbox One and Sony's PS4 were introduced, and sales of both devices, particularly the PS4, have been very strong. One key factor behind this successful launch was the initial pricing of the PS4, which, at £349/€399, was 18% less than the 2007 PS3 launch price in the UK, and a substantial 33% less than its launch price in mainland Europe. This price point, alongside Sony's strong marketing and efficient supply chain to ensure plentiful availability, resulted in it being the quickest selling console in the company's history.

While Microsoft's Xbox One sales have been respectable, they have been unable to keep pace with the PS4 for a number of reasons. The challenges started at Microsoft's unveiling event for the Xbox One at the beginning of 2013, around six months before launch, where the company outlined – and received criticism for – its policies around the support of used games, digital rights management and the need for persistent Internet connectivity. The positioning of the product as a multi-purpose media device also tended to alienate some of the core console gaming market, causing it to lose early adopters to the rival PS4. At an earlier event, Sony had already laid out a simple message of building a platform that was centred on the gamer, and this had resonated strongly with the target market.

Even though Microsoft back-tracked on a number of the initially announced policies, the company was unable to regain the surrendered initiative and the situation was compounded by the need to price Xbox One above the PS4 – due largely to the cost implications of the bundled Kinect, a motion-sensing interface peripheral. Following the Xbox One's comparatively slow start, Microsoft has since made a concerted and successful effort to reposition Xbox One back to the core gamer. The company has also released a Kinect-less version of the product, allowing it to cut the entry price of the Xbox One platform and making it more directly competitive with the PS4. These positive changes mean that the forthcoming Christmas sales season is likely to see greater competition between Microsoft and Sony.

The sales of both PS4 and Xbox One show that consumers are still interested in the proposition that consoles offer. While other types of device and online activities are certainly impacting the market, the quality and performance of the console gaming proposition remains a uniquely differentiated one.

Nintendo's Wii U weakness

Strong sales of both Xbox One and PS4 have not been matched by Nintendo's latest console, the Wii U. Nintendo has struggled to communicate its advantages to the consumer, and games released for the platform have generally been disappointing. IHS expects European sales of Wii U to reach only 5 million by 2018, a stark comparison to the previous Wii console, which sold 32 million units over a seven year period. The change in fortune for Nintendo has been dramatic from one cycle to the next.

There have been some signs of improvement during 2014. Following the successful and well-received release of *Mario Kart 8*, their flagship racing game, Nintendo had a very successful E3 conference, after which IHS research showed that purchase intent for the Wii U platform across surveyed console gamers had grown by 50%. Sales have improved, and there are increasing amounts of high quality content coming to the Wii U, but we do not expect this to catapult the platform towards the levels of widespread adoption that the original Wii achieved.

Nintendo enjoyed huge success in bringing new audiences to the console sector through its Wii platform, but it is now likely that many original Wii consumers are being engaged on other devices, including smartphones and tablets. It will be hard for any of the console manufacturers to win back these consumers at this stage of the lifecycle, and Wii U's relative failures must result in a weakening of the console sector as a whole.

Digital games

The segments driving growth within the European digital games opportunity are centred on PC multiplayer online games (up 4% in 2013), console subscriptions and console game content sales (up 27% in 2013) and the PC download segment (up 26% in 2013). While the PC-based digital segments continue to grow in more established markets, much of the growth is coming from Eastern European territories and Russia, which are emerging as important markets for consumption of PC-based games.

In contrast, growth in the digital console segment is being driven by structural changes in the market and is applicable to all territories where consoles are sold. The changes include Sony's decision to place multiplayer gaming behind the paywall for the PS4, thus driving the company's PS Plus subscription revenues, and the day-and-date release of all boxed game titles in digital download format: on both of the new consoles, Xbox One and PS4, this has resulted in a sharp uptick in digital sales volume.

As mentioned earlier, there are a number of factors that will continue to hold back digital distribution on consoles. These include digital pricing, which is often less competitive than their equivalent boxed games in retail channels; and the absence of ‘instant play’ high-end on-demand games. The requirement to download huge game files in order to access to these digital purchases is a major hurdle to market development. We have already witnessed a number of commercial dead-ends and failures within the context of cloud gaming, which highlights the difficulties of delivering on-demand services. However, Sony is experimenting with its own on-demand games service, PlayStation Now, following its acquisition of cloud gaming company, Gaikai, but the success of this service is far from confirmed.

Mobile Games

Games for smartphones, tablet and mobile web generated €457m spending in the UK in 2013, up from €253m in 2012, with growth driven by freemium games (monetised via in-app purchases) for Apple iOS and Google Android devices. Globally, Google Play is closing the revenue gap on Apple’s App Store: IHS forecasts that, by 2018, Google Play will generate €9.7 billion in mobile games revenues globally, compared with €10.3 billion from Apple. Apple, however, retains a strong lead in revenues per device. The scale of the Android installed base will help Google’s revenues to grow, but its devices range from low cost entry level smartphones to more premium devices, whereas Apple’s iPhones remain focused at the high-end. In 2013, average mobile games revenue per Apple iOS device was €13.90 in the UK, which was more than double the €4.73 Google Play revenue per Android device.

The UK is the leading European market, but lags behind the USA and leading markets South Korea and Japan in terms of average mobile games revenue per mobile subscription. In 2013, average mobile games revenue per subscription in the UK was €5.92, compared with €8.92 in the USA, €13.26 in South Korea and a staggering €26.78 in mobile leader Japan. Japan and South Korea were among the fastest growing markets in 2013, and China is one of the best performing in 2014. Indeed, China joined the USA, Japan and South Korea as one of the countries with more than \$1 billion mobile games spend in 2013.

One of the major drivers of Asian mobile games growth has been integration with leading messaging apps, especially KakaoTalk (in South Korea), WeChat (in China) and LINE (in Japan). Mobile games’ integration with messaging apps has been less successful so far in Western markets. The dominance of Facebook-owned WhatsApp, which remains resolutely focused on providing a core communications experience rather than pursuing a broader content platform strategy, is one of the main reasons for this.

The top grossing app chart positions on the Google Play and Apple App stores are increasingly dominated by a select few longstanding successful titles, making it difficult for new players to grab a share of the market. IHS analysis of the top performing UK iOS apps at the end of Q2 2014 shows that, of the top 20 grossing positions, only five were released in 2014 – with the majority coming from 2012 and before. Leading mobile games publishers King (with its hit title *Candy Crush Saga*), Supercell (with *Hay Day* and *Clash of Clans*), and EA (with *The Simpsons Tapped Out*), continue to find chart success with titles first released in 2012. As these titles

wane in popularity, their publishers are increasing advertising spend to acquire new users and to keep these titles at the top of the market. This will have an impact on the wider games market, and potentially drive up user acquisition costs for all developers.

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