2013 GAME CHANGERS
How will the next generation of consoles affect your business?

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INTRODUCTION & MOTIVATION

The next generation of consoles presents a renewal of an important part of the interactive entertainment industry. Recent announcements of the PlayStation 4 and Xbox One as well as the smaller, new market entrants have fueled a vigorous discussion within the industry. In particular, the position of the incumbents, and their ability to maintain it, has been a hot topic of discussion. For example, Daniel Thomas at VentureBeat recently criticized Xbox One for throwing out “its only good idea with [the console’s] DRM policy reversal.” Elsewhere, Gamasutra’s editor-at-large Leigh Alexander called Sony’s showing at E3 a “spiritual victory” and reminded gamers not to forget about the GameStick. And lead Portal designer Kim Swift adamantly supported OUYA as the exclusive console for her new game Soul Fjord, while both the likes of Square-Enix and indie developer Supergiant Games will find a home on the PS4.

The industry is divided on the topic of what the landscape for the next hardware generation will look like. Traditionally, major console releases stimulate per capita spending on interactive entertainment. Central to the current investigation into the next-gen consoles, then, is the question to what extent the market for games has changed, and what this will mean for revenues. Will an increase in spending come from the “Big Three,” or has the market, in the ten years since the last release, shifted so much that other platforms are now dominant? Capturing a sustainable audience will prove to be the key challenge in the period to come. What, for instance, do we make of the “console for the people,” the Android-based OUYA, which, despite piercing reviews, sold out in pre-sales. Meanwhile, Wedbush analyst Michael Pachter speculates that Microsoft may need to lower the Xbox One’s price in order to compete with the PS4. Perhaps more so than any other time before, consumers spending will determine the shape of the overall landscape.

Digital River and SuperData Research decided to explore the future of the console ecosystem. After a discussion about how the industry landscape is changing, it became clear that gaming is increasingly becoming about gameplay across screens and devices. Monetization is less about platforms and more about user experience across screens, leaving Digital River and SuperData eager to uncover how services and devices are accommodating. Thus, the two companies set out to uncover through this report the following question: “How will the next generation of consoles affect your business?” To formulate an answer, we first offer an overview of the current games industry at large, and discuss its most relevant changes. Second, we take a look at consumer preferences, console ownership, awareness and purchase intent with regards to new devices. Finally, we synthesize our findings from talking to publishers and developers, who, by virtue of the creed that “content is king,” will play a key role.

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2 http://www.gamesindustry.biz/articles/2013-06-20-microsoft-prepared-to-lower-price-on-xbox-one-next-year-pachter
METHODOLOGY

All figures mentioned in this report are based on data collected by SuperData, unless otherwise noted.

The research in this report is based on SuperData’s syndicated digital games sales data, totaling 2.8 million monthly paying online gamers across genres, such as MMO, console, mobile and social games. In addition, a customized survey carried out by SuperData in March 2013 involving 1,105 respondents. Finally, findings from publicly available reports and news sources were used for illustrative purposes and additional insights.

If you have any questions or remarks regarding this study, please contact us.

We appreciate your feedback.
“We believe the digital world is the future, and we believe digital is better.”

- Yusuf Mehdi, Microsoft Chief Marketing and Strategy Officer
LANDSCAPE

Today, traditional console manufactures like Sony, Nintendo and Microsoft compete head-to-head with a host of new devices. Central to this market dynamic is the question: “Can the current games market sustain all those devices?”

Current console ownership

The market for consoles is already considerably crowded. For one, there’s a large installed base of last generation devices: the average American gamer now owns more than two dedicated gaming consoles. In fact, only 1 in 5 gamers does not own a console, leaving less wallet- or time-share for new machines.

Industry veterans will remember the crash of 1983, when the games market was saturated with hardware devices. Today, the industry runs a similar risk, as a higher-than-ever console installed base consumers may be resistant to adding more hardware to their living rooms. Since gamers are changing, there may be a market for devices that meet the growing diversity of players’ needs. However, consoles like the GameStick, which serve solely to attract one specific kind of gamer, may be pushed to the wayside by devices that offer a more varied experience.
New hardware releases have traditionally been instrumental in increasing consumer spending on interactive entertainment.

After the 1983 crash, the Nintendo Entertainment System successfully pumped life back into the industry after consumption nearly flatlined, increasing per capita spending from $1 to $10 by 1989. Now, console releases consistently create a peak in consumption, and show an increase in overall spending with each new generation. The last console cycle resulted in per capita spending of $50.

An important question for the coming generation is whether it will again manage to grow the overall market, both in terms of addressable audience and spending per gamer.

Since the last console generation, digital distribution and browser-based game play have become increasingly popular. The unboxed market, accounting for downloadable content and MMO revenue (free-to-play and for subscription-based), saw its per capita spending grow from just $1 in 2000 to $14 in late 2012.

Console makers are noticing the trend, too. Yusuf Mehdi, Microsoft’s Chief Marketing and Strategy Officer, said of the Xbox One, “We’re trying to do something pretty big in terms of moving the industry forward for console gaming into the digital world. We believe the digital world is the future, and we believe digital is better.” The industry’s emphasis on digital will only serve to further increase unboxed growth and spending interest will continue to shift toward that direction. Since interactive entertainment leans on disposable income, there is a finite number of dollars that consumers can spend. This makes it crucial for hardware producers to recognize digital as a point of opportunity.

Insight: Gamers own more consoles than ever and may not be looking to expand their collections. Meanwhile, with growing digital sales, hardware manufacturers will need to accommodate this spending trend.

Changing audience

The average gamer profile is changing. The demographic makeup of an average gamer is much more diverse than it was five years ago. For one, the gamer audience is much larger today. Hit titles on social and mobile like Candy Crush Saga can have upward of 130 million monthly active users across platforms. Similarly, action-based MMO League of Legends reached 32 million monthly active users in 2012. Today, free-to-play gamers are outnumbering subscribers almost 6 to 1. And digital consumption is skewing toward newer platforms, with the numbers of mobile, social and F2P MMO gamers surpassing those who play downloadable content on their PC or console by more than 800%.

Despite a steady growth of the gamer audience, not all will benefit from the console market, leaving the traditional, hardware-based industry prone to over-supply.

With the evolving platform landscape, it is no wonder the gamer profile is changing as well. According to Yves Guillemot, CEO of Ubisoft, “In the long term there’s no reason why the casual [games business] would not overcome the hard-core business because there are more people that are interested in buying casual.” Only 24% of U.S. gamers now describe themselves as hardcore while mid-core and casual players account for 40% and 36%, respectively. Additionally, a growing number of gamers admit to playing on more than one platform, bottlenecking gameplay with new releases.

Insight: There are more gamers, but there are also more platforms. Therefore, the increase in gamers does not necessarily reflect the same increase in console demand.

“...there are more people that are interested in buying casual.”
- Yves Guillemot, CEO of Ubisoft

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4 http://www.gamesindustry.biz/articles/2012-10-12-league-of-legends-32-million-monthly-active-users
“People don't want to carry more than one thing in their pocket... Android and iPhone [...] are the devices of choice. They offer multiple functions outside of gaming.”

- Lyle Hall, CEO & President of Heavy Iron Studios
CONSUMER

Consumers are the driving force behind the games market, and their adoption of smartphones has meant a major shift in the game industry landscape. With smartphone penetration at 61% and Facebook penetration at 48%, it is clear why there has been massive growth for games on the two platforms during the recent console release hiatus. Creative director of Ubisoft, Alex Hutchinson, points out how players are seeking more assorted gameplay experiences: “Most people who liked console games in the past still do today, but they’re also looking for a wider spread of experiences. I want some games I can play quickly after work or while the kids are asleep and have a short satisfying experience.” As gamers continue to diversify, they are seeking devices that satisfy their varied needs. Microsoft stated in 2011 that 40% of Xbox usage was “non-game” and app analytics firm Flurry estimates that app users spend 32% of their time on smartphones playing games. This means that people use their devices for a range of activities rather than for a single purpose. The market demands hardware that does more than just play games.

Consumer behavior and devices

The role of consoles as the primary gaming platform has steadily diminished. Just over 81% of gamers say they play on a PC, accounting for an increased penetration of social and browser games and DLC. With over half of gamers playing on consoles, the medium is far from obsolete. However, with the proliferation of mobile and social media penetration in the United States, consumers are making a shift away from dedicated gaming devices and toward non-dedicated devices like smartphones, tablets and PCs. Break-out social games like the Farmville franchise and popular MMOs like World of Warcraft attract gamers toward more versatile devices, allowing them to also be more versatile gamers.

The device landscape has undergone a complete reversal from just five years ago. In 2008, (just a few short years after the Xbox 360, PS3 and Wii were released) consoles reigned supreme with 42% of gamers using them as their primary gaming device. Moreover, handhelds like the Nintendo DS were the primary gaming platform for 6% of respondents, ahead of the 5% of players who preferred their smartphone.

Today, PCs have taken the lead and half of gamers use them as their primary device. By contrast, only about 1 in 3 gamers primarily use consoles. Similarly, handhelds and mobile devices have traded places. The introduction of competitive tablets and smartphones like the iPad and the Samsung Galaxy has helped to more than double the number of respondents who use mobile devices as their primary platform. “There definitely is a change going on with an increasing number of people playing games on tablets and smartphones,” Ujesh Desai, NVIDIA’s VP of Corporate Marketing, said of evolving device usage. Crytek founder Cevat Yerli noted that “the current generations are drying out and the longer we wait for the next generat-

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tion of consoles, the higher the likelihood that they could fall behind tablets in terms of being the first thing people reach for when the time comes to play games.”

The decrease in consoles and handhelds supports the theory that in the vacuum created by the absence of a new console cycle, tablets and other non-dedicated devices have become more prominent.

So what is guiding the trend toward non-dedicated gaming devices? In part, the successes of developers like Zynga and Riot have led to a proliferation of social games and free-to-play MMOs, helping to both grow the number of PC gamers and introduce a new wave of consumers to the industry. However, a large number of seasoned gamers are also switching their preference. While the PC and mobile industries continue to rapidly innovate and upgrade hardware and software capabilities, consoles have upgraded at a slower pace, burdened by the longest hardware cycle yet. Two-thirds of PC users would switch to a console if it offered the same capabilities as a PC, pointing to incentives like larger screens and the ability to use controllers instead of keyboards. On the other hand, gamers who would not switch said that the ability to constantly upgrade their PC gave them more freedom and offered them a better value. Additionally, many said they value the portability and versatility of laptops.

Smartphone gamers echo this sentiment: 69% of mobile gamers indicate that they have no interest in a handheld device. Players feel restricted by a unique device and believe a phone that offers both games and a plethora of other smartphone features is simply the better choice. Lyle Hall, CEO and President of Heavy Iron Studios, has noticed the trend as well: “People don’t want to carry more than one thing in their pocket, [and] that’s why Android and iPhone have done so well. They are the devices of choice. They offer multiple functions outside of gaming.”

Insight: Device usage is changing and players are looking for devices that satisfy their versatile gaming needs.


**New devices: familiarity and interest**

Aside from creating a market for multi-functional devices, the last generation’s exceptionally long console cycle has also caused an uptick in new dedicated gaming machines. Android-based console OUYA was released this summer and the GameStick and Valve’s Steam Box will hit the market by the end of this year. Both the OUYA and GameStick performed impressively on Kickstarter, raising $8.6MM and $648K, respectively, and the OUYA sold out on Amazon and at Target and Best Buy locations within two days after its release. However, despite their impressive crowd-sourcing performances, only one in three gamers has heard of either console.

The Steam Box has fared better, as 72% of gamers say they’ve heard of it. Even so, with the release of the Xbox One and PlayStation 4, all three consoles will need to ramp up their marketing in order to compete with established giants like Sony, Microsoft and Nintendo. According to a retail executive, “the road to retail is a long one,” referring to the need for hardware manufacturers to educate their customers on the use and benefits of their consoles.

Almost a third of gamers say they are not excited about any of the new consoles, and those who were excited seemed disinterested in new devices, with the exception of the Steam Box—it was number one on the list for the gamers’ next console purchase. However, with a base price of $499 (going up to $999 for its top model), the Steam Box will have to overcome gamers’ console budgets as the average amount U.S. gamers are willing to spend on their next console is $347.

**Insight:** The next generation of consoles still needs to woo consumers.
“The Xbox may not have survived without the killer app that was Master Chief’s first outing.”

- Ryan McCaffrey, Executive Editor, IGN
What role do publishers play in the battle for hardware success? Finding out what publishers look for in a console is key to understanding which devices will be most attractive to consumers since great games is what they want most. Around 49% of consumers say they consider which games are available for a console among the most important factors in choosing a new device, along with graphics quality and price. So finding success means device manufacturers need to attract publishers that make games consumers are excited to play.

Consoles don’t sell consoles. Titles sell consoles.

Backing the right platform is key to any publisher’s strategy, which is why most tend to remain tight-lipped about the allocation of research and development. Courting the right publishers, along with great designers and content developers, is important for consoles, as quality games are essential to a successful launch and loyal following. IGN Executive Editors Rich George (Nintendo) and Ryan McCaffrey (Xbox) see value in quality exclusive games for console launches. George believes “[exclusive games] will matter early -- when the early adopters are deciding which console to buy.” McCaffrey adds that the proof can be found in history: “The Xbox may not have survived without the killer app that was Master Chief’s first outing.”

This presents a challenge for new and lesser-known devices, since publishers are reluctant to invest in consoles that have yet to prove they can reach a mass market. Traditional marketing strategies like placing interactive kiosks at retail stores are effective, but carry a large cost that smaller manufacturers may not be able to fund. New consoles also do not have the same name recognition as more established companies that have already made big investments in marketing campaigns for previous machines. While many of these new devices run on recognizable platforms like Android and Steam, console familiarity (or lack thereof) creates an obstacle that makes both mid-sized and large publishers hesitant to invest too much of their research and development into new platforms.

11 http://www.ign.com/articles/2013/02/12/the-state-of-console-exclusives
much or too early in obscure hardware.

**Publishers are more willing to invest in platforms that require lower capital investment** like mobile or social. On the other hand, consoles, especially brand new ones, require a large capital investment, something that publishers approach with strong risk aversion. For this reason, many of the companies that are developing new consoles are playing on consumers’ desire to have an alternative gaming experience by employing these new lower-cost games.

Bringing new and different games to players alone will not be enough if the games do not live up to consumer expectations and bad games can cause permanent damage to the reputation of new devices. One of the biggest selling points for the OUYA was the offering of indie and mobile games for the TV screen. However, early reviews complained that many of its games for their poor translation to the new platform. In a review titled, “I kinda hate my OUYA,” VentureBeat’s Rus McLaughlin said, “[Given] the incredible amount of prematurely self-published material I had to slog through [on the OUYA], I’m more inclined to pick up BombSquad from Apple’s App Store.”

Quality publishers are becoming increasingly less reliant on boxed sales as digital sales have continued to surge upwards. EA’s unboxed revenue grew more than 250% in just two years and will overtake physical revenue by 2014. Despite *Battlefield* 4’s release temporarily bolstering retail sales to an estimated $539MM, this year EA’s digital game sales will surpass physical sales for the first time, and that trend will continue. Therefore, publishers are looking for ways beyond traditional boxed sales to access profits, seeking digital platforms to bolster revenue. Physical sales are by no means obsolete, but publishers’ access to distribute both boxed and unboxed content will be key.

At the end of the day what will matter most for consoles is the ability to offer quality games to consumers. However, it has become more difficult for game studios to find exceptional designers that make exceptional games. Richard Garriott, a prominent game designer and creator of *Ultima*, bluntly said he thinks “most game designers really just suck.” He later clarified that what he meant was “finding or growing NEW great game designers is hard,” and that it is increasingly more challenging for consoles to offer the great games they need to satisfy consumers.

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12 [http://venturebeat.com/2013/06/20/i-kinda-hate-my-ouya](http://venturebeat.com/2013/06/20/i-kinda-hate-my-ouya)

13 [http://www.pcgamer.com/2013/03/19/richard-garriott-game-designers-suck](http://www.pcgamer.com/2013/03/19/richard-garriott-game-designers-suck)

14 [https://www.portalarium.com/images/docs/Words%20Taken%20Out%20of%20Context.pdf](https://www.portalarium.com/images/docs/Words%20Taken%20Out%20of%20Context.pdf)
While many publishers are remaining mum regarding how much funds they are committing to different platforms, we at least know where a number of exclusives will live. Nintendo, of course, has its trove of originals like *Wii Sports* and the Super Mario franchise. PlayStation 4 currently boasts 30 exclusives, including *Diablo III*, *Final Fantasy XIV*, and *Infamous: Second Son*. Although Xbox One will share popular Day One blockbusters with PS4 like *Call of Duty: Ghosts* and *Battlefield 4*, their exclusives are less anticipated. Steam has already claimed the third installment of the *Arma* series and with the release of the Steam Box will likely obtain more exclusive content while the OUYA and GameStick are pushing for the appeal of indie games not available on the more popular consoles.

The bottom line is quality consoles need quality games in order to stay afloat. And as the industry learned 30 years ago with early flops like Atari 2600’s *E.T.*—speculated to be a major player in the video game crash—bad games can mean the death of a console. In order to find success in the rising sea of competition, next-gen devices will need to offer notable games that both attract and retain players.

**Insight:** The success of new hardware depends on great content.
ABOUT

DIGITAL RIVER, INC.

**Founded in 1994, Digital River, Inc. is a recognized global leader in cloud commerce.** Offering a multi-tenant SaaS-based commerce solution, digital marketing services, and back-office payments capabilities, Digital River works with gaming companies around the globe to help them achieve their online revenue objectives. Digital River’s value for the gaming industry stems from its proven expertise and experience in the digital download space, its global focus and footprint, and its modular commerce ecosystem that allows companies to build solutions that are tailored to their businesses and consumers’ needs.

Digital River’s commerce offering includes site development, hosting, order management, fraud prevention, export controls, tax management, digital and physical product fulfillment, subscriptions and recurring billing, multi-lingual customer service, advanced reporting and analytics, and a wide range of e-marketing services.

A global organization, Digital River today handles more than $22 billion in annual online transactions, displays sites in over 30 languages, transacts in 170 different currencies, and supports more than 200 payment methods. For more information, please visit [www.digitalriver.com](http://www.digitalriver.com).

SUPERDATA RESEARCH, INC.

**SuperData provides market intelligence on the online, digital and mobile games industry.** We collect digital point-of-sale data directly from publishers and developers—including 12 of the top 25 worldwide publishers—to give our customers unparalleled monthly insights into the unboxed games market. This allows us to identify key trends, evaluate marketing spend, establish accurate revenue estimates and analyze market changes for popular online games, including MMO, FPS, casino, virtual world, mobile and social games.

**SuperData publishes industry-relevant key performance indicators.** Using our proprietary dataset of 2.85 million paying digital gamers each month, we establish monthly benchmarks such as monthly active users, conversion rates, ARPPU and title-level revenue estimates. Customers use the data to evaluate their performance, identify key growth opportunities, assess revenue potential, optimize their efforts, and better understand their audience’s wants and needs.

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