McKinsey&Company

Gaming Expands Its Presence in the Digital Universe

Insights from McKinsey's Global iConsumer Research

McKinsey's Global iConsumer Research Initiative

Our global research delves into the digital lives of consumers– how they use devices and platforms, and how they make decisions about which to use when. By the end of 2010 we had surveyed more than 100,000 consumers across North America, Europe, India and China. These consumers ranged from 13 to 64+ years of age and are weighted to reflect the general online population in North America and Europe while in India and China we also accounted for offline users. We asked respondents to answer 400 questions that cover how they conduct a range of activities, from core communications like e-mailing or socializing, to consumption of major types of content (video, audio, games, etc.) to commerce and creative applications. We stratified our sample across topic categories among the 400 questions in order to ensure full topic coverage while maintaining response quality. While the consumer data in our research is self-reported, we have compared it to actual observed behaviors to validate its accuracy.

In 2011 we expanded the iConsumer research to Japan and South Korea and are in the process of launching full-scale research throughout Latin America.

Gaming Expands Its Presence in the Digital Universe

McKinsey's iConsumer research details the digital behavior of consumers across the globe, providing companies in the high tech, communications, media and entertainment industries with uniquely deep insights into how consumers purchase, think about and use digital products and services. 2011 marks the fourth year of our survey, which asks over 400 questions about all dimensions of digital life. One of the dimensions we explored was gaming—who does it, how they access games, where they play and for how long, and how much they spend on hardware, software and services.

This paper focuses on three aspects of the evolution of gaming behavior and business models:

- The casualization of gaming details how players are increasingly gravitating to the casual game genre driven by cost, innovation and social connectivity.
- The clear and growing shift to online, cloud-based and mobile games challenges traditional revenue and monetization models of developers and publishers of games as well as traditional retailers.
- Delivering a satisfactory gaming experience across all platforms is becoming more complex, requiring more and different capabilities in pricing, segmentation and cross-industry partnerships than most gaming companies have.

The near ubiquity of gaming mirrors that of consumer technology itself, making it imperative that companies understand the challenges that these shifts portend, and seize the opportunities inherent in them.

(Nearly) Everyone's a Gamer

Far from being the province of teenage boys or tech junkies, gaming is ingrained in every demographic. People of any age of both genders who want to game can find something that appeals to them, and play it with thousands of others at the same time.

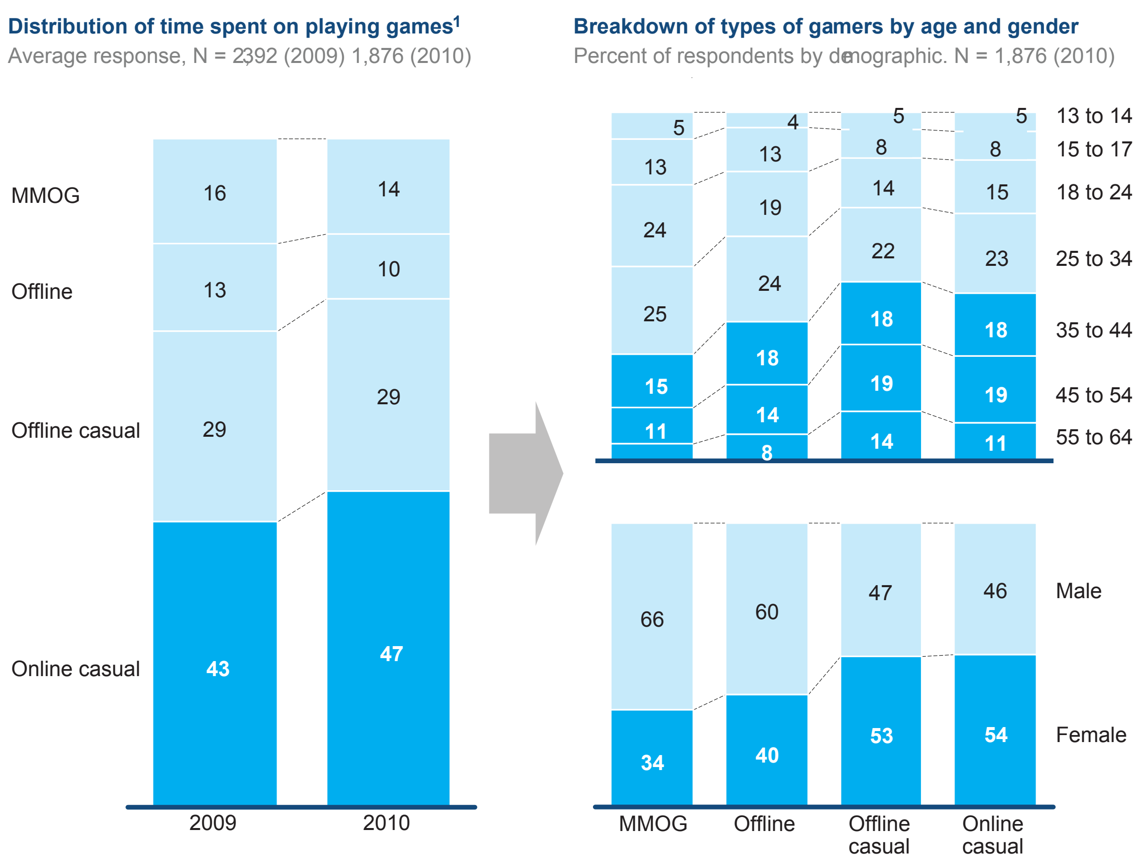
We broke down the population by gaming attitude, format, age, gender and geography to determine why some formats and types of games take hold while others wane, and more importantly how those shifts impacted other formats. The offline and online gaming formats analyzed included:

- *PC (e.g., MMOGs, casual online games, Facebook games, traditional multiplayer online games)*
- *Home console (Playstation, Xbox, Wii)*
- *Handheld console (e.g., Sony PSP, Nintendo DS)*
- *Mobile phone (e.g., iOS and Android games)*

The Broader Appeal and Subsequent "Casualization" of Gaming

Despite its name, the level of engagement in casual/social games can be quite broad and intense. We found that 70 percent of PC gamers play casual games, and 50 percent play casual social games. What's most interesting is that casual online games appeal to all segments, including hardcore PC gamers who are now spending time and money on casual offerings. This format shows the highest growth rate, with participation increasing from 43 percent to 47 percent among those surveyed (Figure 1).

Figure 1: Growth in Casualization of Gaming



1 G11. Of the total time you spend playing games on a PC, what percent do you spend on these types of games?
Sources: iConsumer 2009-2010, U.S. 13-64 year-old internet users; G11

Casual games have won an intense following, with more than 20 percent of gamers playing daily.

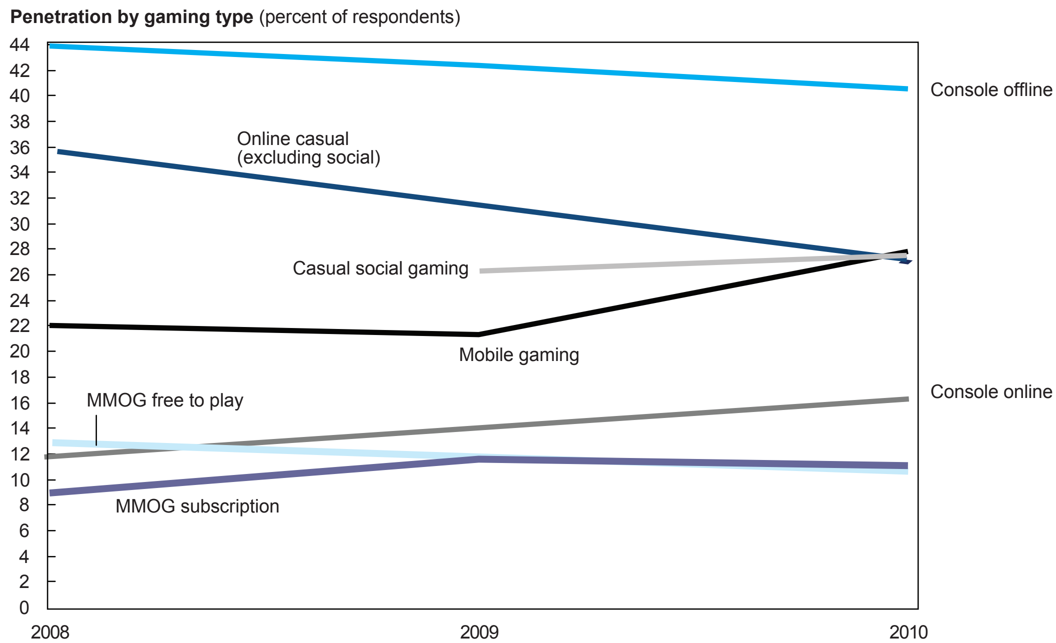
What's more, for some of these gamers it is "must have" entertainment, with 20 percent playing daily and the majority spending a sizable chunk (more than 10 percent) of their social networking time playing games. We also found that casual games have continuing appeal, with the majority of players continuing to play for six months or more. There are clear demographic differences relative to other game genres, however: players of casual games skew older (nearly half are 35 +years old, versus 31 percent for MMOG) and female (54 percent versus 34 percent for MMOG).

The growth of casual online games raises a number of issues for developers and publishers, chief among them, what does it portend for the future of traditional console gaming? The current console cycle is mature, with penetration close to its historical peak. On top of that, less disposable income, a thriving used game market and the decline of once popular genres (e.g., rhythm games) have flattened console software's growth trajectory, settling at a de facto "new normal." Although enhancements such as motion controls injected some life into the current platforms (especially for dance and fitness fans, and families with kids), they have not been enough to reverse the overall downward trend. Thus while offline console games (the choice of many younger, hardcore gamers) still dominate in terms of absolute penetration (Figure 2a), the loss of momentum compared to the rise of connected/online formats, especially casual and social games, is stark (Figure 2b).

That casual/social games are the fastest growing segment is not surprising. Unlike traditional games, casual and social games deliver a much more accessible experience that integrates seamlessly with other social activities, are non-threatening, and offer immediate rewards compared to competitive, more complex genres. Developer and publisher offerings in casual/social are becoming increasingly diverse and more sophisticated, and when combined with better data mining capabilities allow targeting of users with unprecedented level of precision and effectiveness.

Figure 2a: Consoles Losing Momentum to Online Platforms

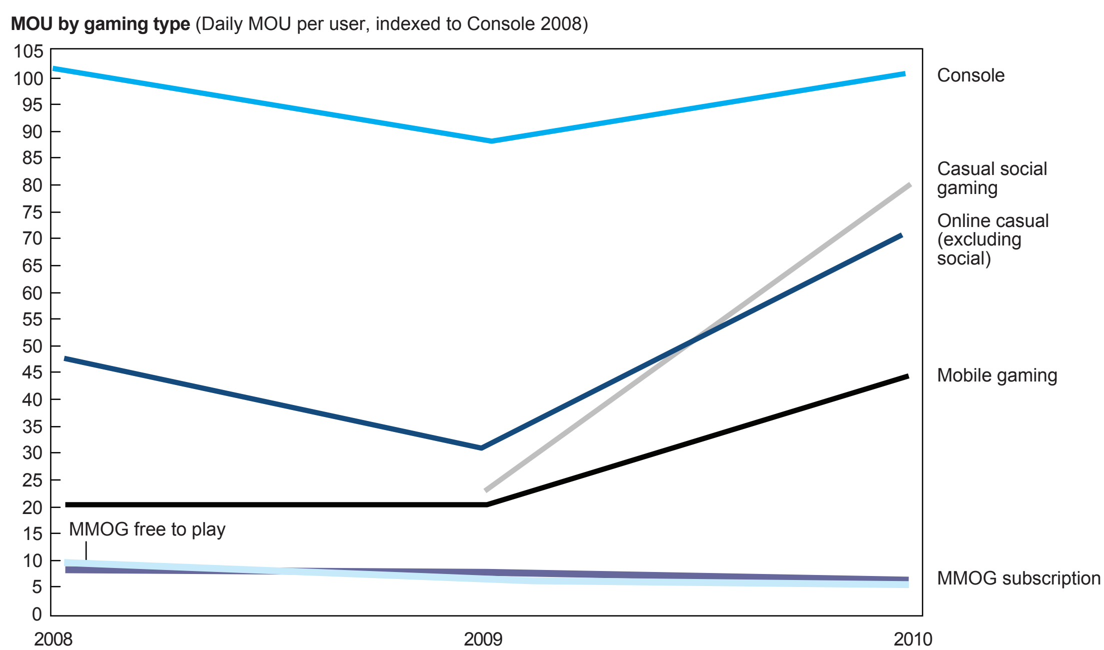
Historically, offline consoles were platform of choice…



Source: McKinsey iConsumer Survey 2008, 2009, 2010; McKinsey analysis; IDC; PwC; Veronis Suhler Stevenson

Figure 2b: Consoles Losing Momentum to Online Platforms

…but current usage growth shows shift to connected gaming



Source: McKinsey iConsumer Survey 2008, 2009, 2010; McKinsey analysis; IDC; PwC; Veronis Suhler Stevenson

Monetization of Gaming Follows Consumers Online

With more hardcore gamers moving to downloads as well as playing casual online games, all digital gaming may be here sooner than many think.

Another critical driver of penetration for social games is their lower cost to consumers, as most of them are free-to-play (FTP). The FTP model has shown great momentum and is quickly taking over traditional subscriptions, even among hardcore games: core gamers are showing greater reluctance to pay for subscriptions driven in part by high prices and product stagnation.

In fact, with the exception of the World of Warcraft juggernaut, most subscription games have not been able to sustain a healthy revenue stream, eventually converting to free-to-play. Perhaps in the clearest indication that subscription games might have had their day, Blizzard's next big project is rumored to be free-to-play and more casual in nature, despite the company's success in subscriptions with the WoW franchise.

Monetization in FTP games depends in large part on microtransactions and is surprisingly robust for virtual items and currency. Trends we discerned show that:

- For casual games, both social and non-social, monetization levels are similar and average about $9 per month, though the revenue streams differ (social games rely on microtransactions versus download fees and premium subscriptions for non-social traditional games).
- Almost 50 percent of subscription MMO users leverage secondary markets, with slightly higher monetization (~$11 per month), further confirming willingness to pay for virtual items.

The casual and social gaming experience available online and related monetization rates show that the addressable gaming market is order of magnitude bigger than traditionally thought. The shift toward these experiences underscores the importance of lower upfront fees, flexibility, convenience and ease of access, and also points to several implications for members of the gaming ecosystem:

- While subscriptions offered a compelling model to generate revenue previously, evidence shows that the model is bordering on obsolescence. The availability of high-quality content for free is pushing developers/publishers to adopt FTP models to gain traction and deliver tiered services to reach the entire addressable market.
- Traditional brick and mortar retailers will also need to redefine their business model as digital platforms become central to the acquisition and enjoyment of gaming.
- Finally, although mobile gaming has been around for a while, monetization has been mostly underwhelming outside of a few key franchises, and still driven by volume, not price (e.g., Angry Birds).

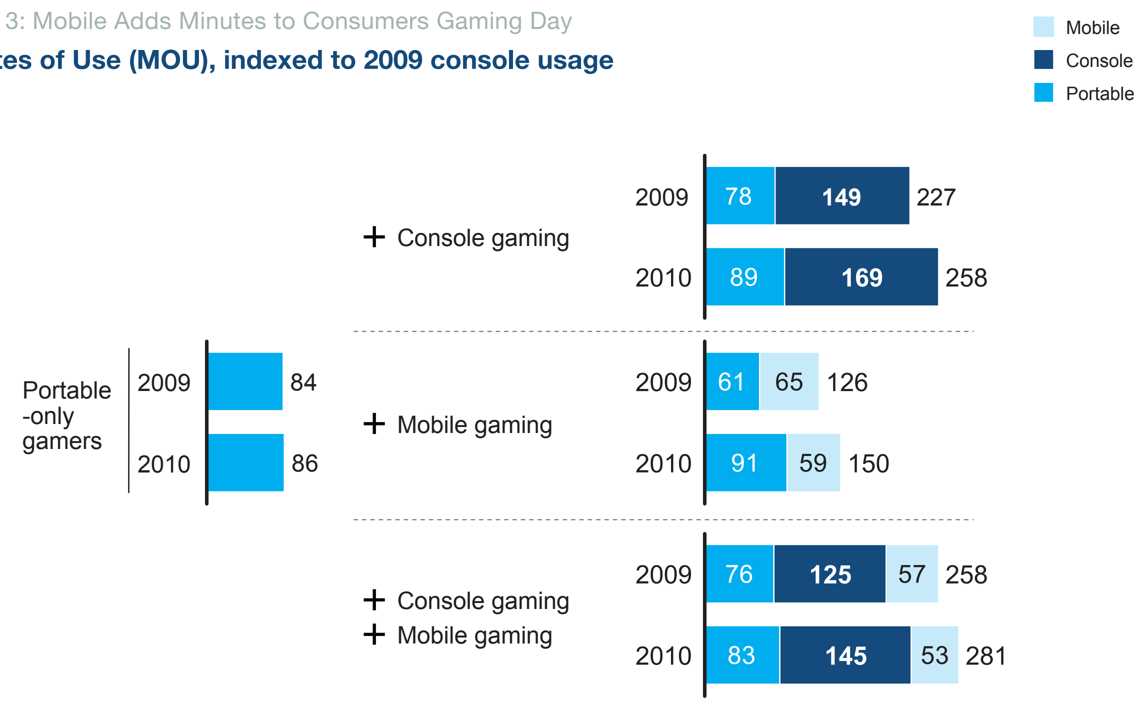
Surprisingly, we found that the majority of mobile gaming takes place in the home, and does not cannibalize time spent on other gaming formats.

But mobile is the future. We found that minutes playing mobile games are generally in addition to, not in substitution of, gaming on other formats—with the exception of portable handhelds (Figure 3). In fact, we found that 70 percent of respondents play mobile games in their home, with users rating mobile devices higher in entertainment value and ease of learning than other platforms.

These shifts show that many dimensions of gaming are changing, and companies will need to adapt quickly to maintain position. This is particularly true in the mobile space, which remains curiously thin. Consumers' attachment to their mobile devices and desire for a cheaper, more social gaming experience are pressuring developers in the mobile ecosystem to create relevant features on mobile. But, as discussed below, there are significant hurdles to delivering the mobile gaming experience consumers desire.

Figure 3: Mobile Adds Minutes to Consumers Gaming Day

Minutes of Use (MOU), indexed to 2009 console usage



Source: McKinsey iConsumer Survey 2008, 2009, 2010; McKinsey analysis

Evolution of Gaming Requires New Business Models and Capabilities

The move to web-centricity heralded by HTML5 and the pronounced desire for multi-device mobility are already reshaping the gaming ecosystem. Established developers and publishers are finding that they need new revenue models, business structures, analytic capabilities and partnerships to keep pace.

Dynamic, segmented pricing takes root. FTP games and a robust used market will require many participants to rework their revenue models. Digital distribution is leading the way in pricing dynamics, with weekend deals and half-price specials, pioneered by Steam, challenging traditional retailers' stiffer pricing schemes. Deeper segmentation, with strategies to manage cannibalization and migration, will be critical to maintaining customers' interest. Companies that traditionally charged $30 to $60 for new games now have to manage the transition to lower price points and to incorporate variable schemes (micropayments) in their products, while investing in new products or services.

Deeper customer and operating analytics needed. Beyond new pricing strategies, companies will also need better analytic, customer management and alliance development capabilities with more gaming shifting online, to the cloud and mobile. The current mobile game environment especially feels like the pre-social gaming online environment: casual in nature, highly fragmented, with no established business model. This will not be enough for success where a fully networked experience requires a broader range of analytic capabilities. These include tracking player usage and network performance data, business intelligence capabilities to transform those data into actionable insights, as well as customer analytics to deliver well-positioned offers for each segment of players.

Game developers will also have to delve into the intricacies of reducing churn and service disruption credits. Multi-channel marketing will also become more important as gaming competes with other forms of entertainment. In short, it will be a steep learning curve for many companies that previously succeeded based upon creative talent.

In addition, we believe gaming 2.0 will be driven by social mobile capabilities, a yet largely untapped opportunity. The most significant driver of adoption of browser-based social games was Facebook, whose pre-formed communities allowed social game publishers such as Zynga

to quickly scale distribution. Zynga also leveraged deep Customer Lifecycle Management (CLM) capabilities to drive adoption and monetization. Yet even Zynga admitted in its IPO filing that it has "limited experience developing games for mobile platforms." To close that gap it went on a shopping spree to acquire mobile assets and capabilities (e.g., Newtoy, DNA Games and Five Mobile among others) with the goals of re-purposing its most popular games for mobile and creating new mobile-specific properties.

Cross-industry partnerships take shape. The shift to online and mobile gaming and the slower growth in some platforms means that the industry will evolve its structure too. Zynga is already developing its carrier relationships (e.g., working directly with AT&T to populate that company's Android-based gaming portal) to build scale early. Several other companies are quickly ramping up their assets and capabilities to capture the mobile gaming opportunity.

With run-rates for top grossing iOS games exceeding $3 million a month, it's clear that people want mobile games and are willing to pay for them. It is equally clear that the capability and infrastructure challenges to delivering mobile, social games are significant, and will require game developers to think beyond the game and anticipate behavior and needs when gamers can access games from a number of screens. This is particularly true if HTML5 renders differences between mobile devices negligible and puts the browser at the center of the consumer gaming experience. Success will require tightly and seamlessly integrating the network and social dimensions in a new and exciting way for consumers and a lucrative way for developers and advertisers.

The shifts in consumers' gaming behavior documented by iConsumer will require the industry to respond with more sophisticated pricing, customer management and multi-channel marketing strategies, as well as new business models and alliance structures.

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Like most consumer technology, gaming has evolved and expanded in predictable and unpredictable ways to reach nearly every demographic and generate revenue through an array of offerings. Indeed, gaming now has the potential to create synergies but also clashes with other sub-sectors. These include high tech and communications providers, from carriers to social media companies to equipment manufacturers and software developers. As gaming becomes a primary form of entertainment—that is, a substitution for other media—content developers in TV, film and elsewhere will be affected. Our research shows that gaming in the future will look much more like an integrated service business, rather than a creative product business, with all the opportunities and challenges that that transformation brings to developers, publishers and their business partners.

For more information on McKinsey's iConsumer research, please contact:
Bertil_Chappuis@McKinsey.com
Ewan_Duncan@McKinsey.com
Enrico_D'Angelo@McKinsey.com

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