

TRENDS IN DIGITAL GAMING: Free-to-Play, Social, and Mobile Games

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The Number of Gamers is Increasing

Parks Associates' study *Online Gaming and Digital Distribution* found that an astounding number of people in the U.S. play some kind of videogame on a regular basis.

135 MILLION PEOPLE play at least one hour of games per month (compared to 56 million in 2008).

GAMERS ARE DEFINED **>>>** **INDIVIDUALS** IN A BROADBAND HOUSEHOLD WHO **PLAY AT LEAST ONE HOUR PER MONTH**

ON ANY PLATFORM.

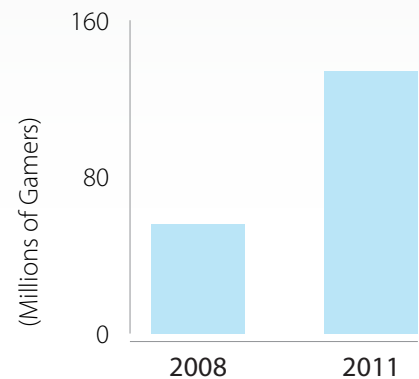
Most of these new gamers are casual gamers and have been attracted to the gaming world by social or free-to-play games through new, convenient platforms such as smartphones and tablets. Online, and especially mobile, gaming is transforming the industry, changing it from one focused essentially on packaged goods sold at retail to one that provides services to consumers.

Instead of ending support of customers after they buy individual game titles, game companies now focus on building gamer communities and developing ongoing relationships with their customers. The positive effect of this approach is that game monetization can be extended beyond the point of sale. Unlike traditional offline games, the online world allows the industry to earn revenue even when people play the same game repeatedly.



Online Gaming and Digital Distribution is a survey of U.S. gamers that quantifies their gaming and spending habits and determines their gaming preferences and future intentions.

The Number of U.S. Gamers increased 241% from 2008 to 2011



Source: *Online Gaming and Digital Distribution*
© Parks Associates

About 80% of U.S. gamers play either free-to-play online games or Facebook games.



In general, Facebook games, also referred to as social games, can be free-to-play and vice versa, but in the *Online Gaming and Digital Distribution* survey, Parks Associates asked respondents to distinguish between their Facebook games and the free-to-play games they play outside the social network (e.g., on a PC). Therefore, the two categories of **free-to-play games** and **Facebook games** as referenced in this whitepaper are exclusive.

Free-to-play Games

The premise of free-to-play games is in the name—players can play for free and open their wallets only when they need virtual items or upgrades to enhance their gaming experience, an approach broadly referred to as the microtransactions model. The mechanics of gameplay vary—they can be synchronous or asynchronous—and examples of free-to-play games include *MapleStory* and *Lord of the Rings Online*.

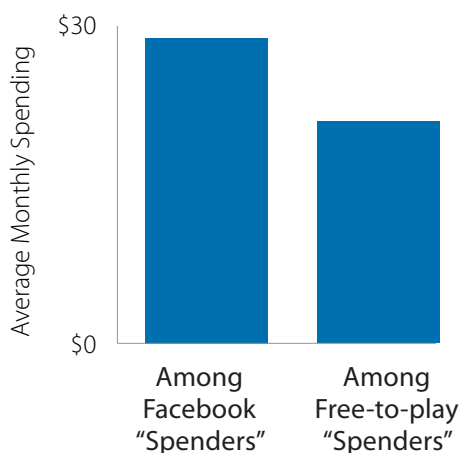
The main advantage of this business model is to remove the barriers of retail cost and subscription fees, which tend to be formidable disincentives to play games, especially for casual gamers. Those segments who do not consider themselves “gamers” are much more likely to spend a substantial amount of money on free-to-play games than they are to purchase games at retail outlets. For example, in the game *Lord of the Rings Online*, players have the option to buy extra quests,

cosmetic gear, rare mounts, experience boosts, and more to enhance game play.

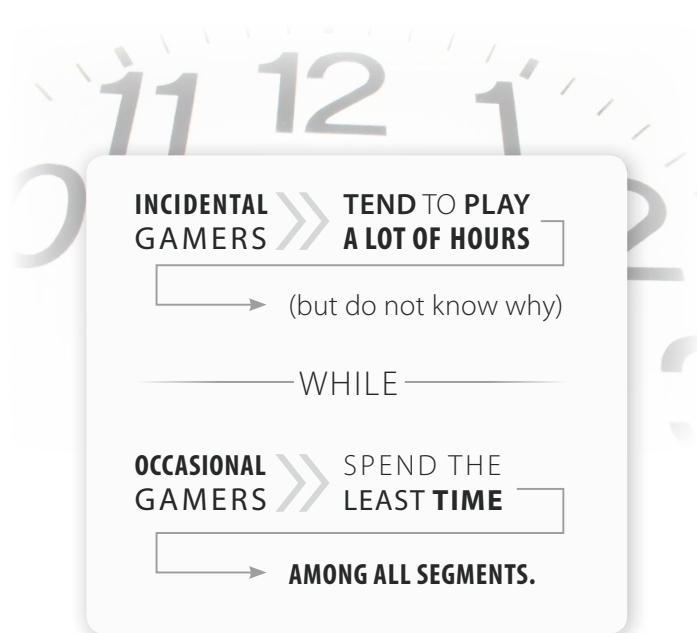
Players often cite the microtransactions model as a way to reduce their gaming expenditures because it allows them to spend according to their budget and play patterns. However, Parks Associates research reveals that people who spend money on these games tend to spend amounts that are comparable to the cost of traditional games.

In particular, gamers who spend money on Facebook games average about \$29 USD per month in spending while those who pay for virtual goods and upgrades in free-to-play games spend about \$21 USD per month on average. These amounts are not too far from the \$24-\$27 per month spent by incidental and occasional gamers on new console games.

Average Monthly Spending for Social/Facebook & Free-to-Play Games (U.S. Broadband Households)



Source: *Online Gaming and Digital Distribution*
© Parks Associates



The most important benefit of monetization models based on virtual items is that there is no maximum amount that players can spend on each game.



In the traditional retail model, the maximum amount earned per gamer by a publisher is mostly limited to the purchase price. In free-to-play games, the game experience can be monetized virtually forever, as long as the game engages its user base.

Obviously, the biggest challenge for this type of game is convincing enough people to become paying customers. Currently, the large majority of gamers do not pay any money to play Facebook or free-to-play games.

MOST TITLES MONETIZE ONLY 5-10% OF THEIR ACTIVE PLAYER BASE.

Social/Facebook Games

Facebook games (also referred to as social games) have some unique characteristics that set it apart from other online games.

- **Social games are layered on top of social networks.** They utilize the underlying social network platform and need to conform to its guidelines, which usually include privacy, spamming, and monetization constraints.
- **Social games are asynchronous multiplayer games.** Gameplay is designed as asynchronous (instead of synchronous, as in traditional videogames). This setup eliminates the requirement for players to be online at the same time as their opponents and allows social games to be played without huge commitments of time.
- **Social games are extremely viral and can scale up their user base in a short period of time.** Zynga's *FarmVille* gained 10 million daily active users in its first six weeks in the market; *CityVille* reached 20 million users in 11 days¹, making it the fastest-growing game in history.
- **Social games are mostly casual in nature and require little up-front development costs.** However, since social games are ongoing services, expertise in providing Internet services and customer care is essential to a company's success. It is not uncommon for operational and service costs to account for 70-80% of a game's total cost. Finding cost-effective infrastructures to accommodate huge customer bases of millions of players is critical.
- **Social games provide impressive amounts of user data.** Game developers are able to fine-tune their games after launch, based on users' behavior. They can detect lapses in user interest and take measures to revive interest in the game (such as launching new virtual items, special offers, etc.). These steps are nearly impossible (or prohibitively expensive) to do with traditional boxed games.

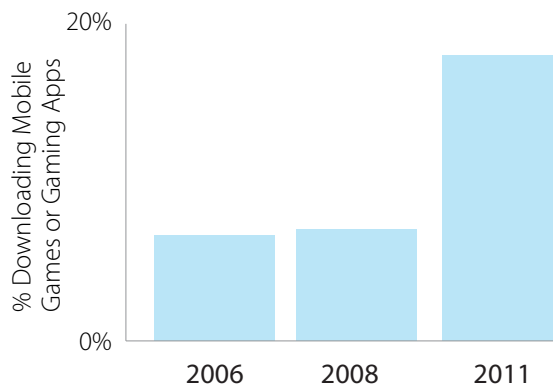
¹ <http://www.allfacebook.com/cityville-reaches-20-million-users-in-11-days-2010-12>

Monetizing Games on Mobile Devices

The popularity of online games and digital distribution of games has increased along with the number of devices people can use to access and play videogames. The most popular gaming device among U.S. broadband households is a computer or laptop, followed by the “traditional” game consoles (Xbox 360, PS3, the Wii). Not surprisingly, the use of game consoles and mobile gaming devices drastically decreases as the age of the gamer increases. Additionally, young consumers (18-34) are more likely than general broadband households to use their mobile phones to access and play games.

The number of mobile phone gamers has exploded in parallel with the increasing success of smartphones.

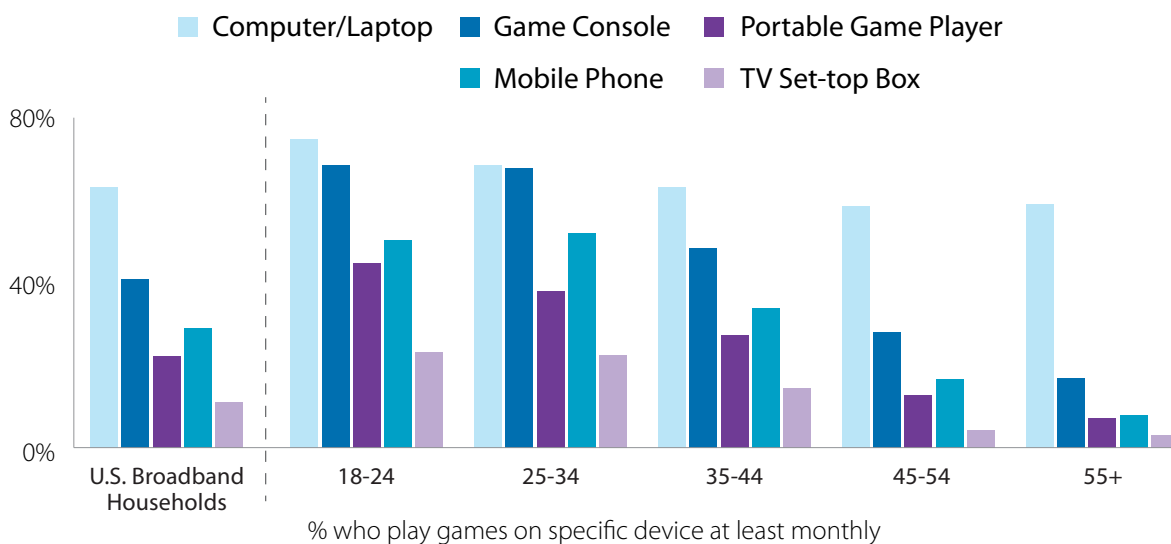
U.S. Gamers who download Mobile Games or Gaming Apps



Source: *Online Gaming and Digital Distribution* | © Parks Associates

TODAY, ABOUT 18% OF ALL GAMERS DOWNLOAD GAMES ON THEIR PHONES, COMPARED TO 7% IN 2008.

Preferred Gaming Device, by Age



Source: *Mobile Cloud Media and Access Platforms* | © Parks Associates

Revenue Models—Mobile Gaming

Revenue models for mobile gaming vary considerably as each developer/publisher chooses the best combination of monetization options for its games.

| Carrier | Strategic Efforts |
|---|---|
| Outright purchase | This model, similar to the traditional retail business model, capitalizes on volume by charging a purchase price. It is the easiest model to support because it does not require constant updates to the gameplay but potentially leaves money on the table by not up-selling to current customers. |
| Free game upgradable to paid version | The challenge is to offer a compelling gaming experience at the initial level while holding back some features that will convince customers to upgrade to a paid version. |
| Free game with in-app purchases (microtransactions model) | If in-app purchases are properly implemented in the gameplay, they can generate more revenues than outright purchases. This approach has quickly become the most successful monetization model. |
| Free/Advertising-based | While advertising can generate significant revenue for the top-selling games (e.g., Rovio's <i>Angry Birds</i> is estimated to generate \$1 million per month through advertising ²), it is not significant enough to sustain most titles. |
| Subscription-based | Publishers charge users a monthly subscription to play a specific game (i.e., <i>Order & Chaos Online</i>) or a collection of games (i.e., Exent's <i>GameTanium</i> service). |
| Hybrid model | None of the models above is mutually exclusive. The best model is a hybrid model that combines multiple revenue streams from a variety of models. |



² According to Peter Vesterbacka, Rovio Mobile's Chief Marketing Officer, quoted by TechCrunch, December 2010, <http://techcrunch.com/2010/12/03/angry-birds-android-1-million-advertising>

Impact of Tablets and their Monetization Potential

Tablets will have an enormous impact on the size of the mobile gaming market and its monetization potential. As of Q3 2011, 71% of adult and 79% of teen tablet owners play games on their tablets at least one hour per month.

Nearly all of the top 25 paid iOS and Android games are priced at \$0.99. This low price point has made games accessible (and tempting) to larger audiences. However, the real monetization innovation in mobile gaming is the introduction of in-app purchases.

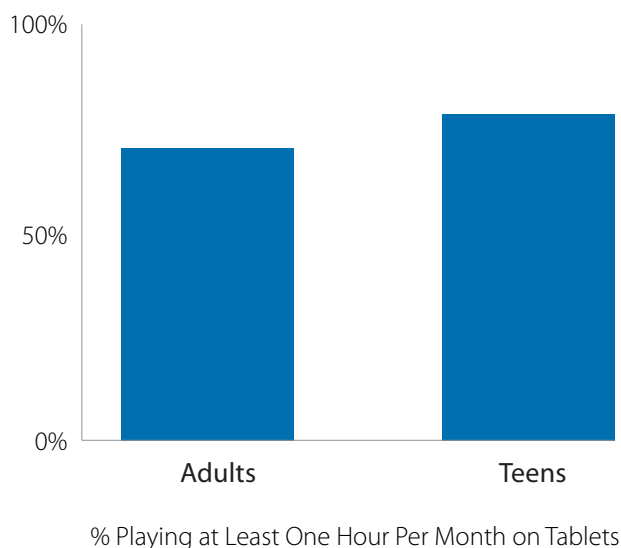
In-app purchases are equivalent to microtransactions on PC-based free-to-play games, but mobile gaming takes the microtransactions model to the next level by integrating the game with user accounts. Games running on smartphones and tablets have indeed a significant advantage, compared to their counterparts on PCs: they can rely on payment systems (via app stores or carriers) for which players do not have to sign up separately.

In other words, microtransactions based on impulse purchases are greatly facilitated on mobile devices and therefore generate significant incremental revenues. For example, in Poker by Zynga players can buy chip stacks using their iTunes or Android accounts.

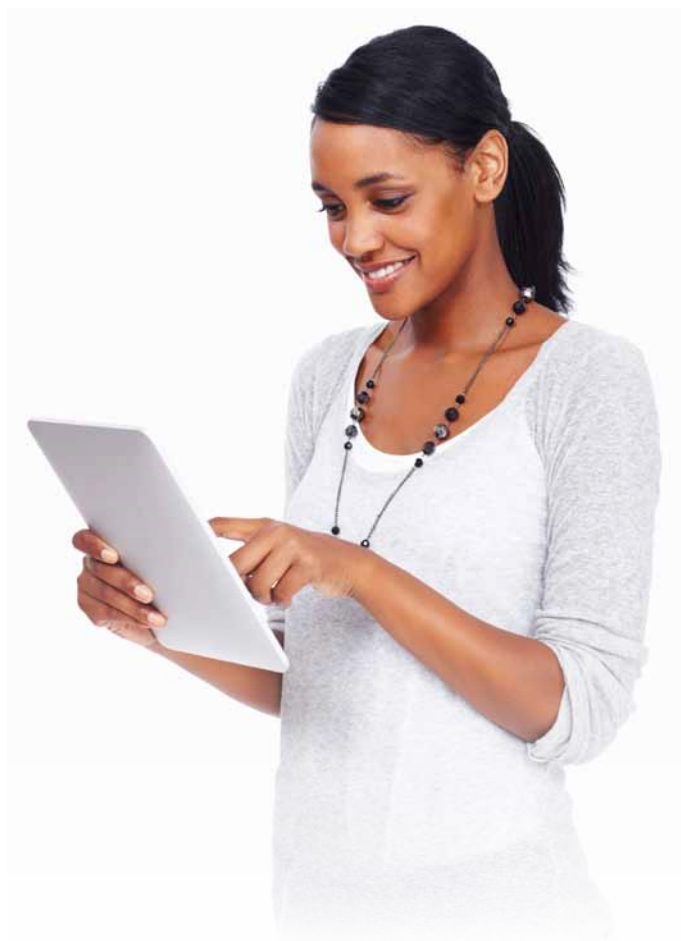
As a result, mobile games can yield high amounts of spending per user. In particular, most of the top 25 grossing games on both iPhone and Android devices can be downloaded for free.

In this way, mobile gaming is poised to expand U.S. gaming revenues over the next several years by processing hundreds of thousands of gameplay-related microtransactions for a broadening population of gamers.

Gaming on Tablets (U.S. Tablet Owners)



Source: *Online Gaming and Digital Distribution* | © Parks Associates



About the Author



PIETRO MACCHIARELLA

Pietro Macchiarella joined Parks Associates following an international career in the wireless industry. He has worked in management-level positions throughout Europe and the U.S.

In his role as a research analyst, Pietro covers home entertainment media with specific focus on video gaming, digital music, 3DTV, and connected CE devices. Pietro's research interests also include global residential energy management, with a particular focus on international deployments.

He earned his degree in business administration from Università Commerciale Luigi Bocconi in Milan, Italy. He also has an MBA from Iona College in New Rochelle, NY.

INDUSTRY EXPERTISE: Video Gaming, Digital Music, Connected CE devices, Mobile Services, 3DTV, Residential Energy Management



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The company's expertise includes new media, digital entertainment and gaming, home networks, Internet and television services, digital health, mobile applications and services, consumer electronics, energy management, and home control systems and security.

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