The Videogame Market And Its Retail Crisis

By Paul Jackson

The global videogame market has experienced growth for the past decade — expanding to four times its (considerable) size in around 12 years. But it's not all been plain sailing. The changes in technology, connectivity, and commerce look likely to sink the physical videogame store chains in the medium term unless they act quickly. That has a knock-on effect for publishers and platform holders . . . not all of it bad from their perspective.

Note: This document collates a series of four blog posts on www.aardvarka.com between March 14, 2012 and April 11, 2012. The GAME group piece has been extracted to an appendix, as it represents analysis at a point in time prior to its restructuring, administration, and sale; it is included for completeness.

In the 12 years that I've been following the global videogame market, it has gone from a sizable niche industry of $14.7 billion in 2000 to generating between $64 billion and $74 billion, depending on who you ask (after all, what's $10 billion between friends?). The industry's focus has also altered in this time:

Gaming hardware has shifted from PCs to consoles to "devices." Even 12 years ago, consoles like the brand-new PlayStation 2 had started to refine what "gaming" meant, with sophisticated hardware — including one of the best DVD players at the time — and blockbuster titles. Much of the past decade has belonged to the console world. But in the past 1 to 2 years, we've seen the rise of non-dedicated gaming devices (such as Android smartphones and iPads) and the creation of mainstream 'social gaming.'

The console's "5-year rule" has ceased to be relevant. Back in the day, new iterations of popular consoles came along every 5 years — making use of more powerful hardware and new storage technologies. Sony was the first firm to flex (if not break) this rule in the modern console age; although it continued to release new consoles, it also kept selling its old platforms for years. However, the current generation of consoles has well and truly broken the old rule. Neither the PS3 nor the Xbox 360 seems likely to be superseded any time soon, despite having been available since 2006 and 2005, respectively.

Connectivity has moved from being the exception to the rule. It's sometimes difficult to remember what the gaming world was like in 2000. The PlayStation didn't have any connectivity out of the box; you got an analogue modem with the Dreamcast; and the Ethernet-equipped Xbox was still at least a year away in most territories. Everything you did on consoles (and even on many PCs), you did with physical media — no friends lists, no DLC, no patches.

Digital distribution has made PC gaming interesting again. Given all this, has the PC become redundant as a gaming platform? Far from it! Two (diametrically opposed) trends have kept it interesting:

1. **The rise and rise of social games.** As Zynga has shown, there is a massive appetite for social games either within social networks or via dedicated online portals. While mobile devices will, inevitably, become the dominant platform for these games, the PC currently still

dominates as the device on which to play Farmville, Triple Town, or Bejeweled Blitz — aided, no doubt, by Apple's iOS devices not supporting Flash.

2. **The digital distribution of "proper" games — and the rebirth of indie developers.** Led initially by Valve's Steam service, the distribution of PC games electronically has grown hugely over the past 18 months. Interestingly, this has allowed small developers who stood no chance of monetizing a "boxed" release in retail to do their thing; the Binding of Isaac, Super Meat Boy, and (my personal favorite) Dungeons of Dredmor are great examples here. Add to this great initiatives like the Humble Indie Bundle, and the PC gaming space is more interesting than ever.

Mega-publishers have been created. Firms like EA, Activision Blizzard, Square Enix, and Namco Bandai have grown from a decade of mergers and acquisitions — as some of their awkward names might suggest. This has been driven partly by games becoming multi-year, multimillion-dollar projects that favour larger-scale operations and partly by the need for diversification (as with Blizzard contributing World of Warcraft revenues to Activison).

Many other things have also changed, such as the rise of mega franchises like Call of Duty, battles over the second-hand market, MMORPGs, etc.; several of these warrant a whole post to themselves, but I don't want to labor the point here. All these changes are putting an obvious strain on some of the traditionally successful firms in the space. Most notably, boxed-game retailing on the high street is in crisis, GAME group in the UK being the starkest example of this — why? And what can be done to fix it?

How To Keep Videogame Retail Relevant

Globally, store-based videogame retail is suffering. In addition to the ongoing collapse of GAME Group in the UK (which is half-saved for now — sort of), NPD recently reported a decline of 34% year-on-year for store-bought games in January 2012 in the US, while hardware declined slightly more (38%). Admittedly, January can be a flaky month for retail, but the overall trend for physical software sales is down.

Why? Some of this is down to a struggling economy and cautious consumers, but it's also a natural side effect of the trends outlined in the previous post:

- **Hardware revenues are declining.** No new consoles for some months to come (aside from the PlayStation Vita) means reduced hardware sales; it's pretty much just accessories and add-ons like Kinect and Move.
- **Digital distribution cuts out retail.** Digital distribution means money flows directly to publishers (often via platform owners like Sony, Microsoft, and Valve). Even for shop-bought titles, downloadable content can extend play lifetime and put off the next boxed product sale. NPD also recently worked out that $3.3 billion was spent in the US and Europe on digital downloads in Q4 2011. Physical retailers would have seen virtually none of this (aside from selling gift cards).
- **Non-gamers don't see game retail as a desirable shopping "experience."** Most worryingly for game retailing, market growth is almost all in social or mobile gaming. Even if there was a physical product, would mainstream consumers go to GameStop for these?

So what can retailers do? They need to change people's perceptions of why a store is better than an online portal, otherwise they will follow music and book retailers into obscurity. While GAME group has had a stay of execution, it will need to do something different to secure its long-term future. Four foundations spring to mind (along with the current but declining day-to-day business of software sales):

- **Bring secondhand games to the fore (even more).** Secondhand game sales are a controversial topic that retailers have typically had to tip-toe around. Publishers get angry at what they see as the lost revenue of a new game sale, but for retailers, a successful secondhand game section makes better margins than new game sales. They have to be well managed to do this though; this means more selective game trading (what you buy, how much you pay), better inventory distribution across multiple stores, and even offloading excess stock via an online portal, partner, or eBay. Making the secondhand section look less like a post-hurricane garage sale would help, too. Of course, publishers may object to this — and come the next generation of consoles, they may pretty much kill this market by withdrawing physical media — but for now, they continue to bring in money in tough economic times.
- **Stop toying with online and go all out.** The game retail groups may have online portals and e-commerce facilities, some of which are even quite good, but they aren't Amazon or Play.com good! Retailers need to bring their unique high-street presence to their online offerings: order and pick up in store, trade in and drop off at store, virtual events, and local store forums should at least level the playing field with the big e-commerce players.
- **Make the stores more relevant.** Yes, I'm going to use the dreadful "retail experience" phrase — but I am going to try not to reference Apple Stores (darn — too late!). Physical game stores have limited square footage, a lot of stock, and cater to a young male audience; they are never going to be "minimal", "airy", or "smell good" — but they can change some things. Reduce front-of-store stock and countless racks and fulfill from the back room; introduce more demo pods and advice points. More interestingly, think about demo events, "parent evenings" where you explain things like age classifications and downloadable content — and refocus on supporting digital, with stored value cards, memory cards, and capacity upgrade advice. And always remember: customers without credit cards are your friends!
- **Get publishers more involved.** Publishers might not like an increased focus on secondhand, but game shops still remain one of the most effective ways of directly reaching the more active component of their customer base. It's time for them to help out more. Move beyond exclusive downloadable content (which costs publishers virtually nothing) and get publishers to provide previews and showcase material and to create competitions. Ironically, small PC game developers (most of which distribute digitally) may be the best bet here; they can offer show reels, demos, and individual levels that the in-store staff can support. This may also help revise the relatively poor image that store staff have in the eyes of the gaming community.

What It Means: The Failure Of Game Retail For Publishers And Platform Owners

As discussed above, game retailers have to radically change their strategy if they are to survive on the high street, but what does this major shift in consumer buying habits and, potentially, retailers' strategy mean for the titans of the videogame world: publishers and platform holders?

The good news:

- **More direct digital sales.** A decrease in the physical availability of the product is bound to spur the (already growing) trend in digital downloads — particularly for more obscure titles or add-ons that are unlikely to be stocked/discounted by non-dedicated game retailers. The boom in indie PC games is a clear example of this already happening; boxed PC games have been a highly fragmented market prone to piracy for years, and systems like Steam have enabled otherwise unlikely titles to make it big via secure digital distribution.
- **The long-term decline of the secondhand market.** As previously discussed, publishers have long considered secondhand games a thorn in their side, diverting sales from new titles — or so the theory goes. While an online secondhand market will continue to grow, the disappearance of high-street stores with lots of available secondhand titles (often shelved next to the same title, new) reduces impulse-buying opportunities.
- **A smoother supply chain.** Obviously, digital sales don't require holding inventory; in addition, much of the complexity of distribution, credit facilities, and returns will disappear if physical boxed games end up being distributed mostly via two or three massive online stores and major chains/supermarkets. However, there are significant downsides to dealing with only a few firms like WalMart, Tesco, or Amazon — see below.
- **Direct engagement with customers (or at least better information via partners).** What do you, as a publisher, know about your end customer — or how many units were bought in a particular state? Perhaps a buyer is tied into your loyalty program or online service — but that doesn't tell you where they bought from. By simplifying the supply chain and even selling digital goods directly, you gain insight into the buying behaviour of your customers and should be able to respond more quickly and effectively to their needs. Whether the big retailers like Amazon will share this information (even for a fee) is trickier; it depends whether they view the data as a revenue opportunity or a strategic advantage.

The bad news:

- **Supermarkets and multi-category retailers become the primary physical retail outlets.** You may have simplified your supply chain, but when Wal-Mart becomes responsible for 50% of your title sales, you become overly reliant on its largesse. And firms like Wal-Mart and Tesco negotiate hard for discounts. A secondary consideration is that, like books, videogames will become a loss leader for multi-category stores: pull punters in with $10 off Mass Effect 3 and then sell them $200 of groceries. As a publisher, you still get your revenue, but this exerts downward pressure on price points and devalues games.
- **Online retail is still a mixed blessing.** The gold rush in online shopping is largely over for most categories, including videogames. A few, well-behaved retailers dominate in multiple geographic markets; they don't tend to discount massively and do now take part in pre-order and limited-edition promotions. But their long-term strategy isn't necessarily obvious. Could Amazon become a leading competitive digital game distribution service? Will eCommerce (and rent-by-post) players jump into the gap left by high-street stores for secondhand games? The answer to both of these questions is probably "yes."
- **A short-term spike in the secondhand market.** A key strategy (as I see it) for those struggling physical stores is to up their game in secondhand and trade-in games. While long-term publishers and platform holders may be able to cut off the air supply to this market with digital downloads and a reduction in the number of physical game disks/cards, that is going to take some time. Be prepared for struggling chains to keep pushing the boundaries in terms of what they see as their right to exploit this (more) profitable segment.

- **The high-street showcase disappears.** Often overlooked — especially by people who see GAME and GameStop stores as somewhat grubby holes (guilty as charged!) — is the showcase that these venues provide for new titles and new game systems — however seemingly badly organized to an outsider. 3D-based systems are the clearest example here: you can't demonstrate a 3DS on TV or YouTube; you actually have to play with one in-person. Ultimately, this also means that videogames cease to hold a special place in consumers' minds (just like books and music) — as do dedicated stores where you can browse and be immersed in your hobby/obsession, rather than just picking up the latest Call of Duty while you do the weekly food shop.

Today's videogame market is such that both publishers and platform owners will probably benefit most from a slow, graceful decline in high-street videogame stores rather than catastrophic collapses — even if the threat of the latter accelerates plans around disintermediation.

Appendix: GAME Group: Scenarios For The Future (If It Has One)

I won't retread the series of events that have led to today's (dire) situation for GAME Group; instead, let's look at the three most likely scenarios for how this story ends:

1) Recover and survive. This is looking less likely by the day. GAME is in the classic death spiral: 1) cash flow problems lead to 2) suppliers tightening financial terms, which results in 3) an inability to service customer demand, causing 4) even deeper cash flow problems. Add in the crash in the share price from nearly £3 in 2008 to just 1p, and raising additional funds from banks or the market seems unlikely. Some reports are saying that cash is so short that it's unlikely GAME can pay the quarterly rents due at the end of March. Disposal of some assets like overseas operations (GameStop is reportedly interested in the Spanish and Portuguese operations) or prime retail locations *could* help the balance sheet long enough for the group to get back up to profitable trading, but this would be a long, hard slog, with suppliers and creditors continuing to view it suspiciously. Most recently, the FT reports (warning: pay wall) that OpCapita (the group that bought Comet for £2 last year) might offer GAME a financial lifeline — again, improving survival hopes or at least buying the firm extra time to come up with a strategy.

2) Get bought by another group (pre- or post-administration). If the current operations can't be saved, selling the whole firm (or at least the majority UK arm) to someone else is a real possibility. After all, this is a firm with a healthy revenue stream (£1.6 billion for the financial year ending January 2011) in a vibrant market — although admittedly the high-street element is struggling — and with a wide reach across much of Europe (the second-largest gaming market after North America, according to VGChartz). Again, GameStop is an obvious buyer here but is reportedly only really interested in those Spanish and Portuguese gamers, so the price would have to be a real bargain.

This raises another issue: why would anyone buy GAME Group at the moment when they can wait a month or so and buy a more attractive "prepackaged administration" firm without some of the baggage (i.e., creditors) that they will have to deal with in a straight purchase? The upside of purchasing it as a going concern (whether in or out of administration) is the continuity it allows the business; stores can stay open, staff be retained, and suppliers placated. Inevitably, efficiencies will be needed post-acquisition; stores *will* close and management jobs will disappear or be merged with the structure of the new corporate overlords, but this is still a much better outcome than the worst-case scenario . . .

3) Close down and be broken up. This is still a possibility, particularly given the difficult retail environment in many European territories. If a buyer can't be found for the firm as a whole, the administrators' duty is to get as much money back for creditors and shareholders as possible via any means. Overseas operations or the online store could be sold off as going concerns, but the UK may see piecemeal store-by-store acquisitions via management buyouts or selective site purchases by other retail chains (effectively what happened to Woolworths Group in the UK back in 2008/2009).

This last scenario is bad for the economy, bad for employment, and very bad for the game retail ecosystem. Without GAME in the UK, supermarkets become the dominant providers of in-person game sales, which means less title choice, fewer demonstration areas, and the loss of much of the secondhand gaming market. Sure, HMV (while *it* still trades) offers a good selection of games and more knowledgeable staff, but other than that, gaming retail risks being thrown back 20 to 30 years to a time when (usually excellent) independent shops struggled to make ends meet — but now with the added competition of online retail and digital distribution.

Scenario No. 2 is still the most likely outcome at this stage. This would mean that GAME survives (in some form) for years to come — with the question of whether it can adapt in the long term. Can videogame retail buck the depressing trend set by book, music, and DVD retail and stay relevant? I'll look at that in my next post.

About AardvarkA Research

AardvarkA Research was founded by Paul Jackson, an industry and industry analyst veteran with 20 years of experience in consulting, consumer technology, and analysis. The firm offers independent analysis of the consumer technology and media space with a forward-looking focus on both consumer behavior and industry strategy.

About Paul Jackson

Paul Jackson founded AardvarkA Research in January 2012 to bring truly independent research and analysis to the consumer technology and media market. His unique perspective comes from a recent spell acting as a Senior Marketing Insight Manager for Microsoft UK — dealing with analyst firms and procuring research for the business — along with his decade of experience as an analyst for Forrester Research. At Forrester, he created and subsequently led a number of key research areas, including innovation theory, videogaming, virtual worlds, PCs, augmented reality, and mobile technology.

Prior to this, Paul worked as a "digital guru" for a full service advertising agency and worked in strategic management consultancy for firms like Deloitte Consulting and Logica.

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