The New Game in Town – An Update on the Players and Deal Structures in the Video Game Industry

Nick Abrahams and Kate Hynes survey the video game industry and typical deal structures in video game production.

Overview

The interactive entertainment industry is booming, with all the key indicators for the market pointing upwards.

New hardware, such as wireless mobile phones capable of downloading games and next generation consoles, are supporting the demand for interactive entertainment. The development and availability of online software (along with the accessibility of broadband internet) is also facilitating growth.

Computer and video game software sales in the US grew six percent in 2007 to $9.5 billion – more than tripling industry software sales since 1996.

In Australia, PricewaterhouseCoopers forecasts that consumer spending on all entertainment and media content will grow by 5.3 per cent from $11.8 billion in 2006 to $15.2 billion in 2011 – with spending on the internet (up 8.1%) and interactive games (up 6.9 %) spearheading the growth.

Australia is part of the Asia/Pacific video games market – the largest in the world which spent $US11.7 billion in 2006. PricewaterhouseCoopers projects the Asia/Pacific market will maintain its leadership through to 2011 reaching US$18.8 billion, growing at 10% annually.

In Australia, spending on video and interactive games actually stalled in 2006 as consumers waited for the arrival of next generation consoles and games. Reports this year indicate Australians spent $1.3 billion on video game software and game consoles in 2007 - an increase of 43% from 2006.

In 2007, the Nintendo DS (titles include *Nintendogs* and *Brain Training*) was the highest selling console followed by the seven-year-old PlayStation 2 (*Buzz* and *SingStar*) and Nintendo's radical Wii (*Wii Sports*).

Nintendo has sold 1 million DS hand-held and 300,000 Wii consoles in Australia, while there are more than 2.2 million PS2s in Australian homes.

While outsold by Wii, Microsoft and Sony were happy with the performance of the more expensive Xbox 360 and PlayStation 3 consoles. Sales of the PS3 were higher than Xbox 360 for 2007, bringing the new machine's install base in Australia to 155,000.

Microsoft says Australians spent more money on Xbox 360 products (consoles, software and accessories) than on any other next-generation platform in 2007, and third-party publishers sold more 360 software than on Wii and PS3 combined. There are more than 300,000 Xbox 360s in Australian homes. Xbox 360 also hosted the best selling console game of 2007 - Halo 3 - which sold more than 120,000 copies.

The figures from independent market research group GfK showed that Australians bought 15.4 million games in 2007, including 6 million in the three months leading up to Christmas.

Market profile

Contrary to popular belief, most gamers are not teenage school boys. For example, the average age of players in Australia is 28 years old.

Reports in the US state:

- the average game player is 33 years old and has been playing games for 12 years;
- in 2007, 92% of computer game buyers and 80% of console game buyers were over the age of 18;
- 38% of all game players are women (women over the age of 18 represent a significantly greater portion of the game-playing population (31%) than boys age 17 or younger (20%));
- in 2007, 24% of Americans over the age of 50 played video games, an increase from nine percent in 1999.

Key market players (International)

Electronic Arts Inc.

EA is the number one video game publisher in the US, and develops games under the brand names EA Games, EA Sports and EA Mythic. Distribution of titles for third-party labels is also a part of its business and in addition EA publishes games based on Hollywood movies such as *Lord of the Rings, James Bond* and *Harry Potter*.

EA develops games for Sony's PlayStation 3, Playstation 2 and PSP (Playstation Portable) platforms, Microsoft's Xbox 360 and Xbox, Nintendo's Wii and DS (and GameCube), as well as games for PC and mobiles.

It generated revenues of $3 billion plus for the fiscal year of 2005. The company's most successful products are sports games published under their EA Sports label, games based on popular movie licenses and games from long-running franchises like *Need for Speed, Medal of Honor, The Sims, Command & Conquer* and the later games in the *Burnout* series.

In January 2008 EA acquired game makers, Bioware and Pandemic Studios. Pandemic Studios is a video game developer notable for creating destructible environments that is based in Los Angeles, California and Brisbane, Australia. Recently, their major hits have been *Full Spectrum Warrior, Star Wars: Battlefront, Star Wars: Battlefront II, Destroy All Humans!* and *Mercenaries*.

Sony Corp

Sony is one of the biggest media conglomerates in the world with revenue of $70.303 billion in 2007.

A part of its business includes developing, producing, manufacturing and marketing home-use game consoles and software.

In 1994 Sony launched the PlayStation (later PS One). This successful console was succeeded by the PlayStation 2 in 2000, itself succeeded by the PlayStation 3 in 2006. The PlayStation brand was extended to the portable games market in 2005 by the PlayStation Portable.

Due to its dominance and popularity over the years, games for the PS2 are the most available.

Games based on popular movie licenses are popular, along with long-running franchises like *Grand Turismo* and *SingStar*.

Nintendo Co Ltd

Nintendo is based in Japan and is a world leader in interactive entertainment market. Nintendo is Japan's third most valuable listed company with a market value of more than US$85 billion.

The console development of Nintendo has been the most extensive. The first Nintendo Entertainment System (NES) (titles included *Super Mario Brothers* and *Donkey Kong*) was the most successful gaming console of its time in the mid-80s and into the 90s.[1] Super Nintendo (1990) followed, and was preceded by Nintendo 64 (1996), Nintendo GameCube (2001) (which competed with PS2 and Xbox) and Wii (2006). Its portable consoles started with the Game Boy line and have moved to the Nintendo DS (2004) and DS Lite (2006).

Nintendo's main line-up of video game systems currently includes the Nintendo DS Lite and Wii. The Game Boy Advance, and GameCube are still somewhat prevalent but no longer produced.

As of 2007, the Nintendo DS and Nintendo DS Lite combined have sold 64.79 million units in Japan alone.

Activision, Inc.

Activision, Inc. is an American publisher for interactive entertainment software products. It is involved in two operating segments – publishing and distributing. Its first products were cartridges for the Atari console and it is now one of the largest third party video game publishers in the world.

Like EA, it also develops games for various consoles. The company has a focused on the action sports category and movie spin-offs. Other games include *Doom* and *Quake* sequels, *Call of Duty* and the *Tony Hawk* and *Guitar Hero* franchise.

In December 2007, it was announced that Activision would merge with Vivendi Games – the new company will be called Activision Blizzard.

Vivendi Games (or Sierra or Blizzard) has been a major developer of games for PCs (initially), including the *Half-Life, Crash Bandicoot* and *Warcraft* titles.

LucasArts Entertainment Company LLC[2]

This company is a developer and publisher of interactive entertainment for video game consoles and personal computers. Its top selling titles are based on the *Star Wars* and *Indiana Jones* films.

Sega Corporation

Sega initially rivalled Nintendo in the hardware games market (MegaDrive and Dreamcast) but is now solely concentrated in creating games for its rivals' systems.

Key market players (Australia)

Some Australian companies work with the international publishers to produce games, while others are carving out their own independent niches.

Australia's games production companies produce $100 million worth of games a year according to the Games Developers Association of Australia. Analysts say this figure is growing bigger every year.

Transmission Games (IR Gurus)

IR Gurus specialises in making games for the PC, Xbox and Playstation 2 and is developing games for PS3 and Xbox 360. It is in its tenth year of running and is located in Melbourne, Australia. It's popular titles include *AFL Premiership* and *Heroes of the Pacific*.

Atari Melbourne House

Formed in 1977, this company has undergone a few name and ownership changes. Most recently known as Infogrames Melbourne House, Atari is now its present name. The firm is part of one of the world's biggest computer games companies: Infogrames Entertainment. Titles include *Grand Prix Challenge* and *Transformers*.

Blue Tongue Entertainment Ltd

Founded in 1995 and located in Melbourne, Blue Tongue Entertainment Ltd makes games for PC and the popular consoles. Titles include Starship Troopers Terran Ascendancy, Jurassic Park Operation Genesis, and the Nicktoons series.

Krome

Brisbane based Krome Studios is Australia's largest independent games development studio. Titles include *TY the Tasmanian Tiger* (which is wholly owned by Krome Studios), *The Adventures of Jimmy Neutron Boy Genius; Barbie Beach Vacation; Barbie Sparkling Ice Show.*

Deal structures

The deal structures in the games industry are, generally speaking, comparable with deal structures in the film industry.

Games studios develop the games and the publishers (eg EA, Nintendo) distribute them. The critical question is who pays the cost of the development of the game, thereby taking the lion's share of the financial risk, and consequently, the lions share of the returns.

Whilst many publishers have their own studios (such as EA Melbourne), the publishers often acquire fully-developed titles from independent studios or source the development of games by independent studios (eg Krome Studios).

Generally speaking, there are two basic deal structures for game development:

1. Development Deal:
   - (a) the studio is engaged by the publisher to develop a game;
   - (b) the publisher has complete control over the development (including creative control);
   - (c) the studio receives a services fee for developing the game;
   - (d) the intellectual property is assigned to the publisher;
   - (e) the studio, generally speaking, is not entitled to a royalty return;
   - (f) in terms of intellectual property, development deals tend to fall into two categories:

     (i) existing entertainment brand (eg *Enter the Matrix, Starship Troopers, Jurassic Park*) usually based on a blockbuster movie;

     (ii) new entertainment brand (eg *Lara Croft, Doom, Quake, Guitar Hero, Warcraft, The Sims*) being a new brand first launched via the games market; and
   - (g) With existing entertainment brands, negotiations occur with the original intellectual property owner to acquire/licence the copyright to develop the game.
2. Distribution Deal:
   - (a) the games studio develops the concept;
   - (b) the studio (or investor) pay the development cost for the game;
   - (c) the studio/investor enter into a distribution arrangement with the publisher who distributes using a retail-style distribution model;
   - (d) the intellectual property is retained by the studio; and
   - (e) the studio gains recoupment/royalty rights.

Issues for consideration

Following is a non-exhaustive list of some considerations for entertainment-branded gaming development (ie: leveraging an existing property onto a game platform):

1. Who is paying for the development and how does the risk/return flow in relation to the investment made?
2. Who will be doing the development (eg will the publisher develop using an internal studio or will an independent studio be engaged?)? Considerations here are the skill sets of the relevant studios, the game engines the studio has and the consoles it is expert in.
3. Is the intellectual property licence for a single game or a series of games (eg consistent with a series of films)? Will there be options to acquire the rights to develop sequels and what are the financial considerations around sequels (eg are sequels more or less risky? Are there development savings in sequels?)?
4. What are the arrangements for associated merchandising and in-game advertising revenue?
5. Access to actors (for character voices, personality rights etc) and whether these rights were secured in their cast agreements. Bringing well known actors to the table is a strong bargaining position.
6. Access to sound tracks and music rights, particularly for well known theme songs will also be an issue for consideration, and access to these rights will also assist in the bargaining position.

Conclusion

The game business now exceeds the film business globally and is growing at a much faster rate. Much can be learnt from the business and legal models of the film and television industry to develop Australia's participation in the big budget game development world.

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(Endnotes)

1. See: http://en.wikipedia.org/wiki/Image:Nintendo_entertainment_system.pnghttp://en.wikipedia.org/wiki/Image:Nintendo_entertainment_system.png.

2. Lucas is a good example of how games, music and movies are starting to merge together, often under the umbrella of the big entertainment companies. Another example (not related to Lucas) is the *Enter the Matrix* game which carried on plot lines developed in the *Matrix* films.