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Pricing Digital Games

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A scientific overview and analysis

Scientific Article

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Abstract

Pricing digital games

This article contains a theoretical discourse of the pricing theories and methods used for pricing different kinds of digital games. The purpose of the article is to convey an introduction to games pricing theory as well as point out some recent developments and upcoming trends for reference. The article was conceived through the use of literary and digital references from a number of sources such as Kotaku, Gamasutra, Edge Magazine and Forbes, relying both on original and previously published content.

The article contains an overview by Forbes Magazine detailing the price breakdown structure of Gears of War for the Xbox 360, published in 2006. Furthermore, the development of games pricing and the rising production costs are explored using quotes from leading industry executives. Some, such as Valve's Gabe Newell theorize about the current business model as well as pricing and are asking themselves for how long it can be sustained and where the evolution is heading.

An important part of the article pertains to the development and use of digital distribution by games developers and publishers alike. Digital distribution is offering companies new ways in which to price their products and cut costs without impacting net profit in an excessively negative manner.

Finally, the article explores different methods of pricing games by deduction for retail outlets and digital distribution alike. The article identifies that a model for evaluating individual games pricing might be useful and that factors often overlooked by publishers and retailers such as the perceived value of a game, can have dire impacts on its sales figures. With the current "Hollywood" business model, where a lot of effort is concentrated into developing a few "blockbuster" titles that use up a lot of resources such considerations can be of vital importance to the product's commercial success.

Keywords

Digital Games, Computer Games, Console Games, Pricing, Perceived Value, Digital Distribution

1 Introduction

Digital games are expensive. In a world where all is relative this statement may not be as final as it sounds, but one might suppose it holds a fair amount of truth from the point-of-view of the consumer. A subject heavily and constantly debated is that of digital piracy whereby software is distributed amongst potential consumers, albeit without any recompense finding its way back into the hands of publishers, developers or holders of intellectual property. KTH (Royal Technical University) Professor Roger Wallis in his hearing at the Pirate Bay-trial in Stockholm voiced the opinion that piracy and digital distribution may in fact have been a beneficial factor in increasing sales of physical goods¹. The Swedish game developers association (Dataspelsbranschen) strongly disagree however², and claim that the reasoning behind this does in fact not entail sales figures of computer games. Regardless of the veracity of these claims, the fact remains that piracy is a prominent function in distributing digital entertainment, though this is probably more true of computer than console products. An interesting subject for discussion would be whether it has affected the pricing of games, but it's one that this article won't delve much further into. What's been attempted to establish so far in this article is instead that in all likelihood pricing might be one of the factors detrimental in games sales and influential in the appeal of piracy. But is it really pricing and not the structure of games or their distributive chain or development costs which affects consumer behaviour the most? More food for thought.

1.1 Aim

The point of discussion herein focuses on supplying the reader with an overview of some methods by which games are priced today, emergent pricing models and compares them with a few classical pricing models. To an extent an attempt will be made as well to explore new or alternate methods of generating revenue and try to determine where the industry is headed in its pricing evolution.

1.2 Method/Material

This article was written solely by use of digital and literary sources. Much of its content was gleamed from articles published by Edge, Gamasutra and Kotaku. These were then followed up via their respective original sources and correctly referenced herein.

¹ <http://www.dataspelsbranschen.se/blog.aspx?i=333>

² <http://www.dataspelsbranschen.se/blog.aspx?i=335>

2 Empirical data – What determines the pricing of a game?

In a feature article Forbes Magazine illustrates a cost breakdown structure of the game Gears of War, priced at \$60 USD for the Xbox 360 in 2006.³ Here's a basic summary per unit:

- 25%/\$15 - Art Design
- 20%/\$12 - Programming and Engineering
- 20%/\$12 - Retailer's Cut
- 11.5%/\$7 - Console Owner Fees (to Microsoft/Nintendo/Sony)
- 7%/\$4 - Marketing Costs
- 5%/\$3 - Marketing Development Fund (print circulars/banner ads, etc.)
- 5%/\$3 - Manufacturing Costs, Packaging
- 5%/\$3 - Licensing Fees (personality rights, character and story licenses, copyrights, trademarks, etc.)
- 1.5%/\$1 - Publisher Profit
- 1.5%/\$1 - Distributor Fees
- 0.3%/20¢ - Corporate costs (management, overhead, legal fees Wink)
- 0.05%/3¢ - Hardware Development Costs (Developer kits, demo units etc.)⁴

This does not mean that the pricing model used for the game is a cost-based one. It just shows where the revenue ends up. In order to understand these figures however, a reference for the value chain of the industry might be helpful. According to Deutsche Bank⁵, the standard approach is the one presented in *Figure 1* of the appendix to this article. There are of course variations of this and with the advent of digital distribution some parts of the value chain are excluded altogether, but as a general model the figure included in the appendix explains the structure of the business as well.

In its article Forbes also states via interviews of prominent industry representatives that the development costs have risen greatly during the last few years, while the price tag largely remains the same. Hence, there is an increased economic risk associated with developing and publishing a game.⁶ To avoid dependence on an ever-increasing number of sales, alternatives have been

³ http://www.forbes.com/2006/12/19/ps3-xbox360-costs-tech-cx_rr_game06_1219expensivegames.html

⁴ <http://www.daledietrich.com/gaming/forbes-why-gears-of-war-costs-60/>

⁵ Kerr, Aphra; *The Business and Culture of Digital Games*; 2006; p.66

⁶ <http://www.msnbc.msn.com/id/3078404/>

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explored these last few years such as subscription fees for online games and digital distribution in order to cut costs. The fact of the matter is that the industry continues to grow however – according to DFC intelligence the video market worldwide will have a revenue of about \$57 billion USD in 2009.⁷

Gabe Newell, president of Valve Software – the company which owns Steam, the world’s most prominent commercial digital distributor of games for the PC at this time of writing presents some interesting statements. He stated in his keynote speech at this years DICE summit (Design Innovate Communicate Entertain) that experimenting with pricing via Steam yielded extremely increased sales of their game Left 4 Dead by up to several thousand percent. Covering this story, Edge magazine also adds the conclusion that games are incorrectly priced.⁸

An interesting feature of the digital games industry is its ”lifecycle” model, whereby hardware such as a console or part is made obsolete by varying degrees as PC/Console manufacturers reinvent their products. The escalating advancement of technology is one of the contributing factors to rising development costs, but also drives the pricing of the gaming platforms themselves.⁹ So on top of purchasing a gaming platform (computer or console) a consumer also needs to pay for each and every game. As previously mentioned this may be a one-time cost, but with the success of online games such as World of Warcraft subscription methods have also appeared. This has led to an approach similar to the movie industry where publishers try to go for ”blockbusters” within different game genres. The EEDAR (Electronic Entertainment Design and Research) research company notes that many of these ”blockbusters” in fact continue to be popular throughout an entire ”lifecycle” of a particular gaming platform and as a result have affected pricing. The reasoning behind this is that such titles are continually restocked by retailers during their ”lifecycles” and therefore take up an increasing amount of shelf-space, leading to lower prices as a means of gaining a competitive advantage. The EEDAR seems to be of the opinion that this is an approach which will garner little lasting success and recommend publishers to continue experimenting with game pricing however.¹⁰ Also, the EEDAR believes that the current pricing levels will not change soon, but stress the point that this pricing is closely tied to the products value as perceived by the customer. To quote exactly – *”large marketing budgets and/or large development costs do not necessarily equate in the customer’s mind to premium price points on retail shelves”*.

⁷ <http://www.dfcint.com/wp/?p=222>

⁸ <http://www.edge-online.com/features/valve-are-games-too-expensive>

⁹ <http://www.msnbc.msn.com/id/3078404/>

¹⁰ <http://www.eedar.com/analysis/expose.aspx>

3 Analysis – Emergent trends

Understanding the structure of the business and the driving cost factors behind the products is paramount to grasping how games are priced. This is all very much in line with the theory of pricing as detailed by Baines and others in the textbook *Marketing*. But an important feature lacking is a model detailing just which factors affect not only the pricing but also the purchase of a digital game. Comprehensively, a cost-based approach to pricing disregards the fact that it's not just the cost of developing and distributing a product which decides its value.¹¹ As proven by Valve Software president Gabe Newell's statements and those of the EEDAR, perceived value can have a great impact on games sales. The segmentation in the mainstream games industry would seem to be centred around a genre-based structure at a glance, which is another sign pointing to a path that strays from textbook marketing by disregard of pricing as a means of market segmentation. In an article published at Gamasutra, Tom Hunter – CEO of Compass Rose Games, compares this to the way the automobile industry has segmented its market using pricing, with product offers ranging from cheap or functional to luxurious and their perceived value used as a determining factor.¹² In its industry textbook on how to price digital printing, the GFF (Grafiska Företagens Förbund) – an association for the Swedish printing industry, lists no less than 18 factors which can affect the price of printing products.¹³

So, in the end, by which textbook methods are games priced? The answer is not straightforward, though a competitor indexation is self-evident if one looks at the retail situation where a lot of new titles are nearly an identical price. With the rise of digital distribution, a logical conclusion would be that the price of games where a physical copy is not included would instead entail a lower price tag. For "blockbuster" titles this has generally not been the case.¹⁴ Since the majority of costs are still those of developing, marketing and licensing – the prices for these titles has remained largely the same. It has however allowed smaller, so-called "indie" developers and publishers to encroach the games market via a pricing segmentation process. Their products, largely aimed at consoles, the PC or Iphone may have a lower perceived value but at the same time lower development and distribution costs, allowing them to experiment with pricing to a higher degree. There are limits to this however since there are still license fees to PC/Console manufacturers and exposure via platforms for digital distribution (such as Steam) to pay for.

¹¹ *Marketing*; 2008; p. 392-404.

¹² http://www.gamasutra.com/features/20050920/hunter_01.shtml

¹³ Grafiska Företagens Förbund; Prissättning och produktkalkylering; 2003; p.12-13.

¹⁴ <http://kotaku.com/390641/rein-big-publishers-will-run-digital-distribution-too>

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The digital distribution platform opens up for new ways to experiment with pricing however by use of textbook methods. A rate-of-return (ROR) pricing model has seen previous use and is in a way pretty much standard since products will sooner or later go on sale or have their prices lowered as they near the end of their “lifecycle”. But with digital distribution, ROR-pricing can be utilised to a much higher degree, allowing early adopters willing to pay a higher price some exclusive advantage by participating in online tournaments or getting a head start at being ranked in a game. In theory this ought to influence the perceived value and allow for it to be used as a pricing method in conjunction with ROR-pricing. As digital distribution is just making its first serious early-majority impact there will doubtless be more evolving trends. Theodor Bergquist, CEO of GamersGate theorises in an interview at Gamesindustry.biz that he believes digital distribution will continue to grow immensely and possibly put a lot of the retail market out of business within a few years.¹⁵ Gabe Newell of Valve Software states his belief that the company will soon earn more from digital distribution than from retail copies.¹⁶

But what about the price tags found in retail stores today? By the use of a cost breakdown structure when pricing a digital game whether as a publisher or retail outlet we would most likely arrive at the use of the cost-plus pricing method or activity based pricing.¹⁷ These methods rely on a cost breakdown structure in order to calculate mark-ups, and as stated earlier this would likely be adjusted by use of a competitor index in the games industry. Also, demand-based pricing have seen some use, whereas for example Take Two while being a marketing partner for Sega in 2004 priced some of its sports products at a considerably lower level than competitor EA.¹⁸ This is a clear example of penetration pricing utilised by the digital games industry through retail outlets.

Finally, retail outlets also price used games. These are of course physical copies and since publishers and developers only gain revenue from firsthand sales this is a business practice viewed with displeasure by most major publishers, although common practice among retailers.¹⁹ As publishers see it, this decreases their earnings. Pricing used games is relative to a number of factors, amongst them how long the game has been out, rarity, exclusive first-user content and of course, the perceived value of the game.

¹⁵ <http://www.gamesindustry.biz/articles/the-gate-keeper>

¹⁶ http://www.forbes.com/2009/02/18/videogames-digital-distribution-technology-internet_0218_videogames.html

¹⁷ Marketing; 2008; p. 405-411.

¹⁸ http://www.gamasutra.com/features/20050920/hunter_02.shtml

¹⁹ http://www.gamasutra.com/view/feature/3872/as_recession_deepens_used_games_.php

4 Conclusions

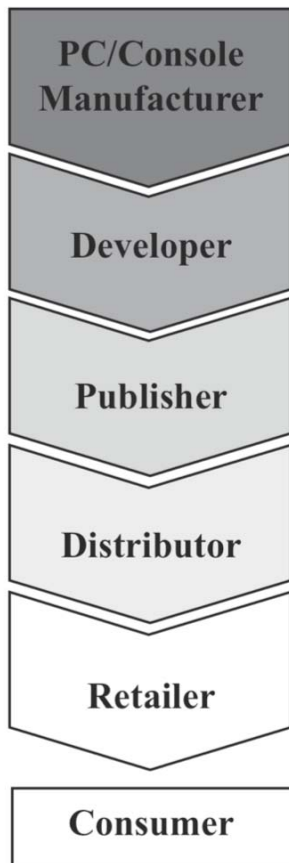
As the world currently weathers an ongoing recession coupled with the ever-ongoing advance of digital technology, one of the subjects of marketing theory – that of pricing, is sure to be a hot topic in the days to come. Within the digital games industry, a number of factors currently affect sales figures and recent evidence seem to show that pricing as well as piracy may be one of these. Bold claims are made that the pricing and distribution models utilised by the industry today may soon be subject to radical change, and that current business models cannot sustain themselves in the face of evolution.

By evaluating which factors affect the costs of developing, publishing and distributing the digital game equivalent of a “blockbuster” we can gain an understanding of what lies behind the price tag. And through that understanding patterns become evident, allowing us to identify several pricing methods utilised by different companies and segments within or in relation to the industry. An important matter of notice is that the advent of digital distribution and online subscription gaming will probably according to industry representatives themselves have a massive impact at the way games are sold, distributed and priced in the near future. Also, as new pricing methods appear so too does new market segments develop – affecting the perceived value of the industry’s products in new ways. The remaining question is what type of impact this development will have on the structure of the business and its value chain?

The purpose of this article has been to supply the reader with a brief overview of the cost breakdown structure for games development and how digital games are priced. Aside from this, we also hope that it has in some coherent manner managed to shed some light on one of the most important aspects of marketing – namely that of pricing.

5 Appendix

5.1 Figure 1 – The Digital Game Value Chain



Source: Deutsche Bank (2002)

5.2 References

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