Innovation and Marketing in the Video Game Industry
Avoiding the Performance Trap

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GOWER
Introduction

The public has no sense of how fast things are moving ... It's like going from bows-and-arrows to the space age.
Ralph Baer, inventor of the first video game console

For most of the video game industry’s short history, console makers and developers have been searching for a holy grail of high performance and realism. However, the recent surge in popularity of underpowered consoles and simple games over cutting edge technology and big budget titles suggests that a new paradigm may be at hand. Examples include the success of the Wii over the PlayStation 3 and Xbox 360, the DS over the PSP, casual PC games over first-person shooters, and music games over big budget action adventure titles.

Everywhere one looks, simplicity and ease-of-use are triumphing over depth and complexity. Netbooks, portable music players, and point-and-shoot digital cameras are a few of the product categories that have emerged to serve the needs of the mass market of consumers who require simple and easy-to-use products and services. In his best-selling book Crossing the Chasm, Geoffrey Moore (2002) argues that success in high-tech markets depends on “making the transition from an early market dominated by a few visionary customers to a mainstream market dominated by a large block of customers who are predominantly pragmatists in orientation.” This transition is called the chasm and the key to crossing the chasm is to make the mainstream market materialize. However, achieving this leap requires a different strategy than what one might use to lure early adopters of technology. The reason is that the mainstream market has different values and requirements than the early market. Although all industries are affected by this reality, the case of the video game industry is particularly compelling.
The Social and Economic Impact of Games

This book is the first attempt to understand the business of video games from a marketing and innovation perspective. Why academia has not given more consideration to an industry that has a revenue-generating capacity that rivals film and music remains anyone’s guess. We suspect it has something to do with a reluctance to investigate a medium that is often considered juvenile.

Yet video games should no longer be viewed as the exclusive domain of antisocial teenage boys, but rather as part of the commercial mainstream. Their impact on society is far reaching. For example, leading edge innovations in processor design, computer graphics, and artificial intelligence are all being driven by the video game industry. Game software is used to train soldiers for battle, to train pilots in flight controls and navigation, and to provide rehabilitation services to hospital patients.

Video games have demonstrated resilience amidst the economic crisis that began in 2008, when the world economy suffered its worst downturn since the Great Depression. Countless retailers closed shop for good, including electronics giant Circuit City, which declared bankruptcy in late 2008. Millions of American homeowners were forced into foreclosure and unemployment reached levels not seen in more than 30 years. Yet throughout the crisis, the video game industry remained resilient, continuing to grow year after year. In 2008, worldwide sales of video game hardware and software passed $50 billion, more than double the annual sales posted in 2004 and 2005, and $5 billion more than in 2007.

In less than a decade, more than one billion video game consoles have been sold worldwide. Video games are now one of the leading forms of media consumption, with sales rivaling the most successful Hollywood blockbusters. Marketing executives in a wide range of industries are turning to video games to promote their products through movie tie-ins and in-game advertisements.

So what makes video games so appealing? Why are people willing to spend hundreds of dollars on a video game console and hundreds more on software at a time when they are being forced out of their homes and are cutting back on purchases of clothing, fuel, and other necessities?

One theory holds that as the cost of outside entertainment rises, more people choose to stay home and participate in inexpensive forms of entertainment.
When gasoline prices hit record highs in the summer of 2008, the term “staycation” was invented to describe the families who “are trading in their travel plans for a stay-at-home vacation.” Petroleum was not the only product reaching record highs. Between 1996 and 2004, concert ticket prices increased by an average of 82 percent, five times the rate of inflation. In 2008, the average concert ticket cost $66. Movie tickets also rose to an average of more than $7. For a family of five, a night at the movies could easily surpass $80, factoring in popcorn, drinks and other incidentals. No wonder more people were choosing to stay at home.

Yet the “staycation” phenomenon only tells part of the story. If it were the only factor determining game sales, one would expect to see revenues rise and fall along with gasoline prices and other commodities. Instead we see a constant rise in game sales year after year.

Innovation has played a major role in the long term success of the video game industry, as game publishers and hardware engineers design products that meet the needs of ever widening segments of the population. In the past three decades, video game companies expanded their reach by offering violent adult-oriented games for men, social and fitness games for women, educational games for young children and, most recently, mental acuity games for senior citizens. In 2006, Nintendo became the first video game company to have a booth at the American Association of Retired Persons (AARP) Annual Conference, where it promoted memory games that may delay the onset and progression of Alzheimer’s disease.

The Performance Trap

One would think that the largest and most well-known companies in the industry would be the ones to benefit most from this expanding market. Yet industry leaders Sony, Microsoft, and Electronic Arts (EA) find themselves struggling as development costs skyrocket and design problems result in product delays and unprecedented warranty charges. The most successful companies were not those offering state-of-the-art consoles and software, but those that provided innovative products that reached new audiences while keeping development costs low.

Ever since it transformed itself from a toy company into one of the world’s leading providers of electronic entertainment, Nintendo has been a leader
In product innovation. Its latest sensation is the Wii, a game console that has maintained high levels of consumer demand for the past several years. Manufacturers typically drop prices within a year or two of a product’s launch in order to attract late adopters. Not so for the Wii. Three years after it was introduced, retailers continued to have trouble obtaining sufficient stock to meet customer demand. During that time, Nintendo console sales have outpaced the competition by an order of magnitude, despite the fact that the Nintendo Wii is easily the least powerful and least versatile among current generation consoles. Even the PlayStation 2, which was first introduced in 2001, offers features that are not available on the Wii, such as DVD movie playback.

Nintendo was able to reach new audiences by implementing product features that appealed to non-traditional gamers. Examples include the Nintendo DS touch screen console that can be used for education, museum tours, and traditional games. The most revolutionary innovation is the Wii console’s controller, known as the Wii Remote (or Wiimote for short). It challenges the stereotype of inactive gamers by turning the game console into a fitness device that is used for physical therapy in hospitals and senior homes.

Why is it that Sony and Microsoft, two of the largest and most successful companies in history, find themselves unable to compete against Nintendo and its underpowered console? The history of technology provides us with some clues. It is not unusual to find technically superior products that failed or sold poorly relative to technically inferior competing products. Some failed because they used closed standards that limited external innovation and, as counterintuitive as it may sound, some failed because product development managers failed to make technological compromises that help satisfy customer needs.

How can making sacrifices in features or performance help satisfy customer needs? Don’t customers want the best products that money can buy? Not necessarily. The Sony Betamax is a classic example. Introduced in 1975, Betamax tapes were smaller and provided better definition than the competing VHS format introduced by JVC the following year. When RCA sought a video format for its new home-movie cameras, it initially approached Sony. However, Sony engineers were unwilling to extend the recording time of Betamax tapes because it would compromise video quality. RCA then turned to JVC, which owned the VHS format. RCA knew that VHS was inferior, but because JVC was willing to accommodate RCA’s request for longer recording times, it won the contract. RCA realized that consumers valued the convenience of
not having to carry around spare tapes more than higher picture quality. JVC then went on to license its technology to other third-party manufacturers who significantly undercut Sony’s price. In 1988, Sony abandoned the format and began manufacturing VHS players.

Designers and engineers are often energized by breakthrough technologies that allow them to accomplish tasks they only dreamed were possible. In the process, they often lose sight of the real goal—fulfilling a customer need. They succumb to what we call “the performance trap.” In Betamax’s case, consumers valued longer playback times more than video performance.

Some managers in our executive and high-tech MBA courses have told us how excited they were about a new technology, only to see it fall short of market projections. When they were developing these wonder products, they didn’t consider that customers might not care about spec sheets. Even if the product outperformed the competition, was the difference enough to warrant a higher price or the effort needed to migrate over to the new product?

It doesn’t matter if you are designing a $5 remote control or a $5 million supercomputer, the lessons are the same. When a technologically superior product fails to live up to its market potential, it is usually because it offers features that are inconsistent with consumer needs.

Sometimes new products have indirect costs that are known to the customer, but are not readily apparent to product designers. Microsoft Windows is a perfect example. Despite years of complaints about poor performance and security flaws, the operating system continues to dominate the home PC market. Although Linux, UNIX, and Apple OSX offer clear advantages over Windows, users have little reason to switch. Most are willing to accept the inherent problems associated with Windows if it means they can avoid installing and learning a new operating system. Other features, such as the ability to run popular software programs and share files with other PC users, often outweigh security problems, which can remain unnoticed for years.

Although this lack of knowledge about customers is occasionally the fault of the product engineers, more often marketing managers are to blame. Marketing executives need to be vigilant throughout the development process to ensure that customer needs are understood and clearly articulated to other functional groups. The best way to do this is to use cross-functional teams of marketing, engineering and R&D personnel to develop new products and services. By so
doing, individual members can more easily share important information that can impact the design and development of the new product. Marketing’s role is not to dictate the design of the product or worry about technical specifications, but rather to ensure that customer requirements are being met by the underlying technologies and design architecture. As we will see later, the reliability of the Xbox 360 was partially compromised when marketing managers decided to redesign the external case to make the console appear more attractive.

Despite the Xbox 360’s hardware failings that are the focus of the chapter titled *Rings of Death*, Microsoft did several things right. For example, it decided to deliver content differently by building the Xbox 360 around an immersive online experience known as Xbox Live. Although Xbox Live got off to a slow start, with only 20 percent of original Xbox users subscribing, the strategy eventually paid off. The company’s foresight and unwavering determination in online gaming have allowed it to become the leader in an important and quickly growing niche.

Sony’s problems began long before the PlayStation 3 was released. In pre-launch announcements, marketing literature, television advertising, and industry trade shows, Sony repeatedly declared that its console was powered by a “supercomputer on a chip,” with performance and graphics beyond anything the world had ever seen. And Sony was right. The problem was that all of the impressive benchmarks and specifications did not translate into real world differences. Games developed for both the Xbox 360 and PlayStation 3 looked and felt nearly identical. Lately, Sony has taken steps to remedy the problem by helping developers learn how to take advantage of the PS3’s unique hardware and by improving its online services.

**Historical Precedents and Future Directions**

The lessons we are going to examine are not new. Almost every success and failure in the video game industry has historical precedents in other industries. In fact, long before video games became part of the human experience, we find countless examples of technically superior products that either failed or sold poorly relative to technically inferior competing products. Although we may occasionally draw upon examples from other industries, the focus of our discussion will remain centered in the video game industry as we examine how really new and radical innovations can be used to open new markets and win
market share from technically superior products that have become mired in performance traps.

Early chapters will consider the history of video game innovation, including events that led to the great video game crash of 1983 and the subsequent rise of Nintendo as the dominant console maker. We will examine how Shigeru Miyamoto, a Japanese graphic artist and musician, reinvented the industry and became the tour de force behind Nintendo’s ascendency. Later, we will see how Sony finally broke Nintendo’s monopoly, when other more experienced console makers failed and how the Sega Dreamcast provided the blueprint for the eventual success of the Xbox and Xbox Live.

The last half of the book focuses on recent innovations in video game hardware and why low-performance consoles are outselling their high performance counterparts. In particular, we will try to understand why the Nintendo DS and Nintendo Wii are outselling the Sony PSP, Sony PlayStation 3, and Microsoft Xbox 360. We will look at innovators in game software and find out why small independent studios are creating games that put big budget titles to shame. Some major studios like Take-Two Interactive and Square Enix have found ways to thrive by adapting to the changing business environment, while others like Electronic Arts have faltered by clinging to outdated strategies.

Lastly, we will look at trends that will influence the future direction of video gaming and electronic entertainment. They include mobile games for smartphones, cloud gaming, and Microsoft’s Project Natal, a product that promises to eliminate the need for game controls by responding to gestures, voice commands, and even emotional states.