Play On

Game Not over for Foreign Firms in China's eGaming Industry

By Ingo Bollmann and Johanna Bendien

"China is ousting the US as the leader in global eGaming turnover." Hardly a week goes by without some international media reporting on the magnificent successes of the Chinese eGaming industry. Tiny developers bud into global players in just a few years, throwing up new ideas and business models. With analysts predicting steady growth over the coming years, opportunities abound for firms with direct and indirect association with the industry, both foreign and domestic.

What does the eGaming industry in China really look like? What are the emerging trends in the coming years? And, more importantly, what opportunities and distinctive features does the Chinese market offer foreign firms? As so often is the case, the Chinese eGaming market is a prime example of the strict necessity to adapt the products of Western manufacturers to local markets.

Impressive Gaming Force

The differences between the Chinese and Western markets are already apparent when observing the platform structure of the target market. The eGaming market is normally split into three sectors, with differing hardware and software requirements: PC games are typically for individual or network gaming (and require a high-spec computer); consoles, such as Play Station and Wii; and by far the most important right now, online multiplayer games.

Number of Internet Users in China

Source: www.cnnic.cn 06/2009

For various reasons (high selling prices, lack of availability), PC and console games play only a secondary role in China. With over 90 per cent of the market, online games clearly dominate. According to official figures released by the China Internet Network Information Center (CNNIC), there were 338 million internet users in July 2009. China is the world's largest potential internet gaming nation, offering promising prospects.

Online games in turn are differentiated into two categories: Massively Multiplayer Online Role-Playing Games (MMORPG) and Casual Games. In the former, gamers assume a role and play together in a virtual world; in the latter, the user can play against other gamers without assuming a role or requiring a lengthy learning phase. With 77 per cent of the online market, MMORPG is clearly the biggest category, but major growth is predicted in particular for Casual Games.

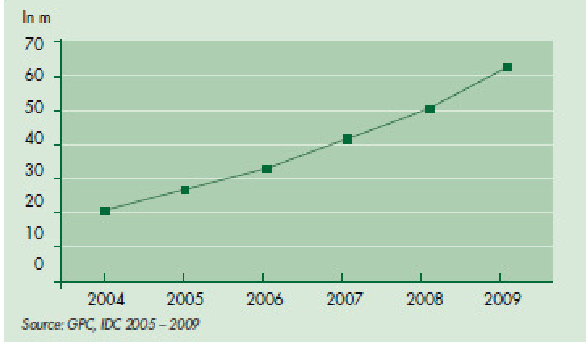
Growth Market

According to official figures, the number of Chinese who play online games on a regular basis has almost doubled from 26 million in 2005 to over 50 million in 2008 and was expected to have hit 62 million in 2009. When including casual gamers who only play occasionally, the total number of Chinese gamers reached over 200 million – representing 64 per cent of total internet users. During the same period (2005 to 2008) total Chinese online gaming market turnover increased from USD 553 million to USD 2.65 billion (RMB 1 = approx. USD 0.14). It is predicted to have hit between USD 3.39 billion and USD 3.83 billion in 2009.

These figures look all the more impressive when compared to the corresponding market volume of the previously largest online game market, the US, which declined to a mere USD 2.5 billion following the 2008 economic slowdown. Today, China accounts for 35-40 per cent of global online gaming turnover.

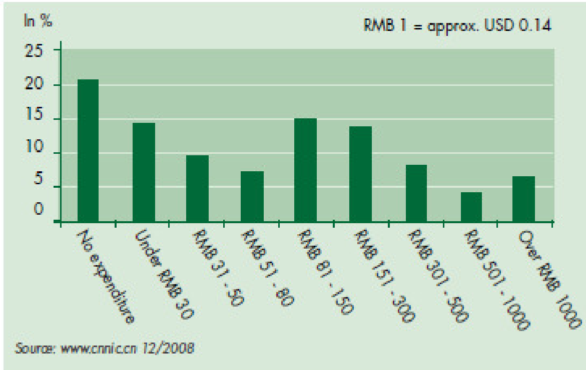
The lion's share of this turnover can be traced back to domestic online game operators, who, in most cases, are also the developers of the game. According to figures released by PearlResearch, six Chinese gaming operators – Tencent,

Number of Online Gamers in China



Source: GPC, IDC 2005 – 2009

Breakdown of Chinese Consumption for Online Games



Source: www.cnnic.cn 12/2008

Changyou, The9 (who until recently operated the American game World of Warcraft), Netease, Shanda, and Giant – each recorded annual sales in excess of USD 200 million in 2008.

In 2008, the online gaming market in China also contributed significantly to associated industries in the country, such as telecommunications and IT, adding an estimated USD 7.08 billion.

Current Trends and Changing Faces

Social factors influencing the rapid development of the market include, for instance, China's one-child policy. Remarkably, the playing of online games – as such a very isolated pastime – actually offers many teenagers social interaction, often the only kind they have. Chinese gamers are seldom found alone at home in front of their PCs; they prefer to meet up with friends to go gaming together in internet cafés.

So, who are these gamers? The current CNNIC survey identifies the main group as being 18-to 25-year-olds, with high school and college education. Their buying power is thus rather limited: 56.7 per cent of online gamers have a low monthly income (RMB 1000-2000) or no income at all.

According to the consumer spending graph, the share of gamers who spend merely insignificant amounts of money or none at all on their online gaming accounts for one third of the total. Similarly, one third of gamers make a considerable financial monthly contribution, while the remaining third spend a proportionately high amount on their gaming entertainment.

Though many users do participate in stereotypically intensive, highly time-consuming gaming, the survey also reveals another trend: Many gamers play several games simultaneously. It is not unusual to play one or more Casual Games alongside a MMORPG game. In China, the free-to-play Casual Games are almost as popular as the MMORPGs, reaching an ever increasing number of user groups via the many Social Networking Service (SNS) sites such as Kaixing101 or QQ.

White collar office workers often play small card or thinking games online while working. These easily accessible Casual Games have changed online game playing from an initially marginal to a mainstream phenomenon. China's online gaming market comprises not only the hyper-stressed, addicted gamers, but ever greater numbers of students and office workers; male and female, young and old. This growing gaming class no longer uses online games for entertainment only but also as a social platform.

The low-spending ability of young Chinese gamers is a driver for the online gaming industry as it is by far the cheapest leisure activity for many of them. This is made possible due to low internet service fees and the innovative payment terms for playing online games. For instance, playing World of Warcraft for 22 days (three hours a day) costs as much as a fast food meal. It is therefore hardly surprising that online gaming has by now developed into the most popular leisure activity of young Chinese.

Among the top sellers of online games in China last year, only three were foreign titles. These were the international gaming phenomenon World of Warcraft and two South Korean titles. One of the main reasons, but far from being the only one, is measures taken by the state to protect the local software industry. Since the video game industry is classi-

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fied as prohibited in the Industrial Catalogue for Foreign Investment 2007, foreign game vendors cannot be the operators of their games. The product must instead be marketed and operated by Chinese companies, via licence agreements through which they generate their income.

However, even this business model has its problems. The US games maker and developer of World of Warcraft recently wished to change its China provider but was blocked from doing so. A dispute between authorities in China over who controls regulation of the lucrative online gaming industry has created a deadlock situation. Furthermore, even joint ventures and foreign technology support enterprises are barred from the market. So far there is no telling if this will prove permanent. Entry into the market is no easy matter, but blaming government regulations does not do justice to the efforts of native gaming companies to develop their businesses.

"Made in China" Strategy

The success of domestic developers depends mainly on understanding Chinese tastes better. Many games revolve around Chinese heroic legends, with a corresponding "local" design. But the developers' knowledge of the market is even more important to their success. Consumer behaviour, buying power, and sales structures are the main areas in which the Chinese firms have a clear home advantage compared to foreign developers.

Domestic enterprises were the first to develop innovative, specially adapted payment terms for the local market. The monthly user fees for online games conventional in the West exceed the relatively small buying power of Chinese gamers. Local operators made a virtue of necessity and were the first to offer their games for free. With this free-to-play model, the games are configured to encourage the purchase of virtual goods – swords, gold coins, armour, etc. – in the game in order to progress or enable further character development. Although each transaction is only a few Yuan at a time, the sheer volume of users drives huge revenues and enviable profit margins.

Supplementary revenue options with this charging model are, for instance, corresponding platforms in the game design, where real life products are offered and sold. The income generated via these "in-game ads" is becoming increasingly significant. These innovative charging models quickly emerged as a guarantee for success and have now been incorporated into a majority of games on the market. Imported licensed games have also, in the meantime, been adapted to the new charging models, and have in some instances already been re-imported into the home markets with this modification.

Rewards Lie beneath the Surface

The market structure, buying power, distribution channels, user profile, and taste of Chinese gamers differ significantly from those of the Western markets. Foreign organisations must therefore adjust to China and, if necessary, also consider alternative business models. Granting online gaming licences may be highly successful considering the market size, but any entry into the Chinese market presents some stumbling blocks.

Therefore, it is more promising to utilise other models and sectors. The games in themselves offer an excellent marketing platform. By advertising inside Casual Games, companies can reach millions of consumers with their messages, regardless of market segment and product. In addition, there is also scope for co-operation in this sector. The growing market calls for professional in-game advertising agencies to handle overall implementation for Chinese companies, from canvassing of customers to technical realisation.

Such service needs offer considerable potential for foreign organisations. An example: US 3G content provider Artificial Life develops, hosts, and maintains a gaming portal for China's mobile telecoms provider China Telecom. China Telecom, among others, controls the sale and download of mobile phone games in the country.

Entering the Chinese online gaming market, albeit difficult, is not impossible. The obvious areas such as games development, games sales and operation, network operation, etc., are almost certainly closed. Instead, focus should be paid to the associated industries and future markets like in-game advertising, hardware, and mobile phone online games. The Chinese online gaming market offers many possibilities also for innovative foreign companies willing to develop and market complementary services and products. ■