

## When a Little Becomes a Lot: The Emergence of Microtransactions in Video Games

By Henry Blackman, Pricing Analyst

Used, abused, taken advantage of, and exploited; microtransactions in video games have been frustrating consumers since their introduction to mobile applications in the mid-2000s<sup>1</sup>. But what first appeared as an opportunity to upsell additional content to willing consumers quickly resulted in angry tweets, international news features, and even lawsuits. But why are microtransactions one of the most successful & disruptive innovations the entertainment industry has seen during the age of digital gaming? And perhaps more importantly, what can we learn from the last decade of development?

As costs for researching and developing increasingly complex games quickly grew, smaller game and application developers recognised they would be unable to obtain sufficient revenues through a traditional pay-to-play sales structure, requiring them to become creative once more. As a descended relative of what many refer to as a 'Freemium Model', in-app purchases rapidly began sweeping through the daily lives of Gen Y & Gen Z consumers, much to the frustration of parents worldwide. Horror stories emerged from both sides of the Atlantic, with one child in the US spending \$6,000 in a single game, and close to \$2,200 in one hour. Many gaming platforms soon faced litigation and Apple settled with the FTC to make customer refunds of \$32.5m in 2014.

Although isolated consumer frustrations quickly became apparent, the concept had landed amongst many developers. Helsinki based firm *Supercell*, creator of free-to-play games *Clash of Clans* and *Clash Royale*, soon posted 2015 revenues of \$2.3bn, a highly impressive feat given just the 4 games and 213 staff under management. The strength of their finances can be attributed to the intelligent use of in-game currency, which obscures true costs and separates users' mental accounting from the purchasing decision. By loading credit onto a user account through cashless transactions, the



pain of payment is significantly reduced. Working across many industries, we regularly observe increases in impulsive consumer spending when the emotional burden of payment can be reduced or alleviated.

Whilst the fluctuating exchange rates for in-game currency are incomprehensible to most, one thing is very clear to consumers: buying in bulk makes it cheaper. This use of secondary price discrimination puts pressure on customers to commit to the game from the beginning, improving both customer loyalty and lifetime value.

Given that many platforms store customer payment details for ongoing subscriptions, publishers actively employ loss aversion theory by prompting users with opportunities for one-click purchases at key points to prevent the loss of progress, items, lives etc. This method isolates moments in which a user is likely to have higher demand or be less sensitive to price, and then presents the offer to avoid the negative event.

After observing strong financial performance of microtransactions elsewhere in the industry, EA released the highly anticipated *Star Wars: Battlefront II* in 2017, which was chock-full of additional content available to buy. Unfortunately for the gaming giant, consumers were immensely dissatisfied when they discovered the base game, which cost \$60-80, would not give them access to all the content to which they felt entitled. It was quickly reported that unlocking a given 'hero' would take up to a week of invested time, or could immediately be bought for an additional \$80. Before long, the derogatory term 'pay-to-win' was used by irritated customers who felt misled and taken advantage of. The perception of fair pricing was greatly diminished for the majority of players, as additional payment

<sup>1</sup> Other roots draw from Microsoft's Xbox

beyond the purchase price of the game was required for them to be competitive with peers.

“ Many developers are pushing microtransactions too heavily ”

As a result of the extreme dissatisfaction from a previously loyal customer base, the firm's response became the most downvoted comment in *Reddit.com's* history. Many felt a boycott would be the best response, leading to missed sales targets for both game and in-game content. The commercial model collapsed after just 5 months on the market, with EA removing additional purchases in March 2018 and leaving just the initial cost.

Despite the considerable teething problems making headlines for close to a decade, publishers and consumers are making progress towards reaching an equilibrium that is changing the marketplace for good.

“ Developers could get the money they needed through additional content from their games, but players wouldn't be taken advantage of ”

The 'micro' in microtransactions refers to the increasingly prevalent, low value, high touch offer that is used by game publishers to reduce the polarity between those who pay for extras, and those who don't. With a new costume for your character "only" costing \$2-5, consumers spend an ever-decreasing amount of time on their purchasing decision, allowing publishers to increase the rate of conversion from low yield customers to high. This behavioural change is often referred to as the foot in the door effect, where small and seemingly insignificant purchases can act as a gateway to regular, high frequency buys. Despite the low purchase price, with ~100m active users and up to 10 new costumes per week, the economics quickly add up.

Breaking down additional content into small chunks allows for consumers to only buy the parts that they want, as well as giving producers valuable insight into where customers truly derive value.

Acknowledging the successes and failures of games past, developers have learnt that selling additional content must enhance the experience to the user, without directly affecting the mechanics of the platform. In the instances where peer-to-peer interactions distribute utility, such as online gaming, it is imperative that those buying additional content hold no unfair advantage over those who don't. This ensures value is driven to all members and encourages growth. Through this model, *Fortnite:Battle Royale* was soon able to achieve 125m active users in June 2018, and post revenues of \$318m for the month of May 2018. Despite the firm choosing not to charge customers to download or play *Fortnite*, the average user spends \$58 on the in-game store, making it the most successful free-to-play game of all time.

“ Post launch monetisation content is becoming increasingly accepted and desired ”

*Apex Legends* was published by EA in February 2019, reaching 25m users in its first week under the same model, clearly having learnt from their previous *Star Wars Battlefront* experience. With adaptations to character aesthetics being sold through microtransactions without impacting the actual game play, creators *Respawn* have put together a high quality and polished product that they willingly give away for free, financed by a captive market of players seeking to differentiate themselves online.

Since mobile, console, and PC technology penetrated the mainstream, consumers have grown more attached to all forms of technology, and the application of microtransactions may spread far beyond video games. The opportunity to make small enhancements to a user's experience beyond the minimum required functionality may be applied to the consumption of alternative forms of media. Sports broadcasters may adapt the augmented heads-up display shown on live sports broadcasts, or Newscasters may tailor 'breaking news' banners to a customer's preferences.

But what principles can the wider business community learn from these examples?

- 1) Devaluation dissatisfies. When creating on-sell opportunities, firms must avoid changing the consumer perception of the core offer. Adding additional content and features should not

detract from the utility obtained when those additions are not selected.

Like many inefficiencies in pricing, a lack of understanding around what consumers truly value separates success & growth from failure & reputational damage. At Pearson Ham, we observe this can be done through a range of market research techniques and analysis of demonstrated behaviours through data.

- 2) Timing is everything. The price sensitivity of a particular consumer is not constant and finding the right time to prompt for upsell is key.

Price elasticities are often simple concepts for business managers to understand but can be phenomenally challenging to calculate in reality. However, statistical methodologies and machine learning can be employed to distinguish noise from signal and provide invaluable insight to customer sensitivities.

- 3) Bigger isn't always better. In-app purchases are easy for consumers to buy because they are cheap but represent the initiation of a change in consumer behaviour that creates a gateway to ongoing spending in potential perpetuity.

Acknowledging and understanding the behavioural economics that filter consumer purchasing decisions is imperative when altering any elements of a commercial model. There are over 150 recognised biases, of which we observe 12 have specific pertinence to decision making around price.

## About Pearson Ham

Pearson Ham is a specialist pricing consultancy. We offer a bespoke service, tailored to your business strategy. We take great pride in our collaborative approach and are passionate about finding and unlocking value where you didn't know it existed.

Our approach is insight-led and influenced by your industry, market and customers. Our experience, our commercial knowledge and our key analytical skills help you better understand the world in which you are pricing, for both your business and your sector.

As trusted experts, we use our insight, analysis, implementation and monitoring framework to design tailored pricing strategies that optimise your profits, margins and overall business performance.

Our award-winning team is a mixture of consultants and industry practitioners, but ultimately, we are all pricing specialists. We have broad experience across a wide range of sectors, so not only can we apply our same-sector intelligence, we can also bring our knowledge of other sectors to your business.

## Contact us

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