

# Video-game business still grappling with digital distribution

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Being able to buy and play high-end video games without leaving home may still be a way off, but the industry isn't waiting for its fate to be decided by outsiders.

Spooked by what has taken place in the music and movie businesses, the [video-game industry](#) is taking its own steps to get ahead of the curve as technology develops to the point that gamers need not visit a retail store to buy disks or cartridges to play the latest titles.

But those steps have been relatively small, for the most part. Complicating matters is the fact that [game makers](#) must tread carefully to avoid upsetting the retailers who play a crucial role in their business right now.

"I think it's going to happen sooner than most people think," said Doug Creutz, video game analyst for Cowen & Co. "Console makers dig it. Publishers have some fear about what happens when they break away from retail model, but at end of the day, they can cut out the retailer and cut down on used-game sales and piracy. There's lots of reasons for them to like it."

He added: "For retailers, it's a disaster."

Digital distribution already exists in the game industry, to some extent. Microsoft Corp. offers hundreds of games for download over its Xbox Live service, and Sony Corp. offers a similar service with its PlayStation

Network. Nintendo recently launched its own online channel through its popular Wii console.

But the games offered over those channels are typically older titles that consume less bandwidth, and which retailers would be loath to give shelf space. Publishers typically don't make a major new title available for download until it's had a run in the retail store, just like movie studios don't launch a DVD on the same weekend as the film's theatrical opening.

Creutz says that is likely to change in the relatively near future.

"With Microsoft offering one-year-old titles for download now, we are certainly less than two years away from seeing a triple-A title released for same-day download," Creutz said. "If you can do it for a one-year-old title, you can do it for a new one. The technology threshold has been crossed."

## WHO WINS? WHO LOSES?

Makers of game consoles already are working on digital distribution models. By controlling both the box and the online store, the companies can effectively cut out the middleman by selling directly to consumers.

Game publishers also have reason to favor digital distribution. Such a model would likely cut down both on used-game sales, for which publishers receive no revenue, and piracy. They could arguably also capture more revenue without having to split with retail partners.

Retailers would have the most to lose under a digital distribution model, which is why many are taking steps to keep a foothold in the new market.

Big game retailers such as GameStop and Amazon.com sell cards that gamers can buy to purchase points over online game sites. Sony announced a deal on Wednesday to sell digital access codes to PlayStation Network games over Amazon.

Nick Parker, a former game executive for Sony and Nintendo who now runs an independent consulting firm in London, said retailers are likely to make their own investments in digital distribution technology to stay in the game.

"Retailers are going to be in the new market, but their models are going to change," Parker said. "That's why they need to get involved in the technology side of it."

Publishers such as Activision Blizzard and Electronic Arts have supported trial efforts at digital distribution, but are also wary of alienating their retailer partners. Some also see a gaming future outside of the consoles themselves. At an investment conference last month, Activision CEO Bobby Kotick said the company expects that "many of our products will be playable on the television independent (of game consoles) over time."

## MOBILE PROGRESS

The most notable progress on digital downloads is actually taking place on the mobile gaming side.

In the past week, Sony launched a new version of its PlayStation Portable console called the PSP Go. The small handheld console offers a slide-out control board but features no slots for disks or cartridges. All games are purchased through Sony's online store and downloaded to the device through a WiFi connection.

The company is keeping its regular PSP, which uses game disks, on the market. Peter Dille, who serves as senior vice president for the PlayStation business, said the PSP Go is designed to appeal to a different type of gamer.

"This is the first all-digital platform for Sony, and maybe even for the industry," said Peter Dille, senior vice president of marketing for PlayStation. He said the device is targeted to consumers "who are already very comfortable with digital," who won't miss the disks and cartridges normally associated with game devices.

Nintendo's latest handheld device called the DSi also allows users to buy and download games through a wireless connection.

Analysts do not expect the PSP Go to become a major seller for Sony. Rather, they think the device is part of the company's efforts to test the waters of digital distribution.

"The PSP Go is a bit experimental for Sony. I don't think they're expecting it to be the next big thing," said Parker. "I think they are trying to see if they can educate the user on how to use it."

## THE IPHONE THREAT

Both Sony and Nintendo face new competition in the mobile space from a formidable rival: Apple Inc.

At recent media gathering, Apple showed off updates to its of iPods, and took a swipe at both Sony and Nintendo in pointing out that more than 21,000 games are available on the company's App store for its iPhone and iPod Touch devices.

In an interview with the New York Times, Apple CEO Steve Jobs said

the company's customers saw the iPod Touch in particular as a strong gaming platform.

"We started to market it that way, and it just took off," Jobs told the paper. "And now what we really see is it's the lowest-cost way to the App Store, and that's the big draw. So what we were focused on is just reducing the price to \$199."

Game console makers have typically written off Apple as a major threat, noting that their games were far more appealing to gamers compared to the more casual fare common on the App Store. But the PSP Go and Nintendo DSi are widely seen as efforts to add more functions to the devices.

"Early on, they did not see Apple as a real threat. Now they do," Creutz said. "When Apple says they are coming after your market, you have to pay attention."

## ONLIVE ON THE HORIZON

One drawback to the idea of distributing video games though the Internet is bandwidth. Even over a broadband connection, a big action title like "Call of Duty: Modern Warfare 2" would take several hours to download onto a console.

This is why the idea of streaming games has gained interest.

In March, a startup called OnLive emerged from stealth mode and made a splash at the Game Developers Conference in San Francisco. The company demonstrated a system that allows gamers to play big games over a network -- with only a small router and controls instead of a large console and game disks.

The company has since been on the road, demonstrating the technology that could have uses in other markets, such as video conferencing. OnLive also raised an undisclosed amount of venture capital financing last month, with telecommunications carrier AT&T Inc. and movie studio giant Warner Brothers as participating investors.

A representative from OnLive declined to comment for this story. In a blog posting, CEO Steve Perlman said the funding gives the company "a serious jolt of rocket fuel" as its beta testing progresses.

"Over the last decade, we've seen an enormous upheaval in the media business as the written word, photos, music, and video have been steadily moving away from physical media to online delivery," Perlman wrote. "One major category that still remains largely based on physical discs is fast-response interactive media -- in particular, video games. And, of course, OnLive's goal is to enable that last remaining transition."

Not everyone is convinced that full digital distribution is near.

Eric Handler of MKM Capital Markets believes network bottlenecks will slow the trend for the [video game](#) sector for the next four or five years, at least for full-game streaming.

"I could see the next console cycle having more streaming games, but I don't think we're there yet," he said. "I think it's the direction we're headed in, but these things tend to take longer than people think."

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