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From Packaged Goods to Video Games: Eleven Months of Insight - Keynote Address from the 2009 Game.Business.Law International Summit on the Law and Business of Video Games

Mike Hogan

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Delivered by Mike Hogan, Chief Marketing Officer, GameStop Corporation

I am glad to be here today for a number of reasons, especially because I am relatively new to the video game industry with less than a year of experience. I thought this would be a great opportunity for me to hear some of the speakers and learn more about the subject. Also, speaking from a GameStop perspective, we are very interested to develop a deeper relationship with the Guildhall School at Southern Methodist University, and we want to be a champion of gaming and innovation. We are currently looking at a number of things where we can work together to foster increased innovation in the gaming industry.

I should begin by explaining the title of the presentation here: "From Packaged Goods to Video Games: Eleven Months of Insight." I have spent most of my career working with packaged goods, and because of that, I have a certain worldview which colors the way I see things, and some may call it consumer-centric. I am sure most of you here know a lot more about the video game industry than I do, and—what I want to do today is give you an introduction to the video game industry based on my own perspective.

About ten years ago, when I left PepsiCo and went to Dean Foods, my work was in Dallas, and it continued to involve marketing and the food business. The transition was simple, but I found a different world when I arrived. The business outside of packaged goods saw the world in a very different way, and it was a great learning experience for me. After three years at Dean Foods, I started and ran a consulting business for about six years. One interesting thing about being a consultant is that you become a student of various industries because you work across many different businesses. The entire practice of consulting is based upon the premise that what you have learned in one industry is applicable to another. About a year ago, I made the decision to give up consulting and come to GameStop. Basically, I decided to give up all of my other clients to focus on a single client, and of course, it was a great opportunity to learn about the video game industry.

First, I will spend a few minutes giving an overview of the video game industry, and second, I will highlight some of the key video game trends and changes. Before I made the decision to come to GameStop, I talked to a few friends who are former PepsiCo employees that worked with packaged goods and are now working in the video game industry. One worked at Activision and the other worked with Nintendo. I called each of them and asked, "What

do you think about this?" They both told me essentially the same thing, which was, "You are familiar with packaged goods and three or four percent growth. This whole industry grew thirty-five percent last year, so what more do you need to know?" There are not many industries that are growing at the same rate. At the same time, rapid growth creates some real challenges, and I want to talk about a few of those.

What are some of the challenges the video game industry faces? I will look at this from both a retailer and holistic perspective. Then, I will talk about some of the challenges that GameStop faces and what we are doing to capture the opportunity inherent in those challenges to grow the industry and our business.

My view of a typical new technology or innovation life cycle within an industry is that a new technology comes along and it lives in the niche world for a while. Specifically, it is a specialty area where a few people are very interested in the technology, but most people do not know much about it. Then, something happens, and there is a period of mainstreaming where the technology suddenly takes off, and many people want to be involved in the technology and the surrounding business opportunities. Consumers find out about it, people jump in, and the technology gets on a very steep growth curve. Obviously, the growth begins to flatten out or mature at some point, but it does not necessarily flatten out and die. Eventually, the technology reinvents itself, and you get another growth curve.

The video game industry has been a vibrant industry, but four or five years ago, this industry was less than half the size that it is today. It was not on the radar screen for many people. The industry is clearly in a "main-streaming" cycle as household penetration is growing eight or ten points per year. The industry is now growing twenty to thirty percent a year. I think we are relatively low on that mainstreaming and many years of steep growth are ahead. Next, the industry will face maturing and redefinition. For example, only a few very affluent people could afford cars at the early stages of that industry. Then, automobiles became mainstream and every family had one. Cell phones and many other technologies are going through the same thing. I believe the video game industry is very much in its infancy and on a very steep growth curve with much to come in the future.

In 2007, the video game industry grew to about eighteen billion dollars. That is double the amount from just a few years earlier. The final numbers are not in for the full year of 2008, but the current estimate is going to be around twenty-two billion dollars. These calculations are based on a retail view of the industry, which looks at hardware and software, the console, and the PC. At $18 billion, the industry is in pretty good company. In fact, the video game industry is already bigger than movies in the theater, bigger than the music industry, and is closing in on categories like toys and home video. This is significant from a competitive perspective—as the industry gets big-ger, it gets on more people's radar screens. If you are a mass market retailer, and you are looking at what is going on in your stores, you are thinking movies and music are not growing, but the video game industry is an area

that is growing a large amount. Accordingly, businesses now give much more shelf space in their stores to video games at the expense of other industries that are not growing.

Regarding household penetration, seventy-two percent of the U.S. population plays video games. This could be playing on an Xbox console, on your cell phone, or an online game on your computer. Console penetration, specifically household penetration, is now about fifty percent, so half the households in the U.S. now have a gaming console. If you look at revenue generated by console sales, you will see that there has been over seventy million gaming consoles sold year to date. Looking at the retail market, GameStop has a twenty-two percent market share, Wal-Mart has twenty percent, and others such as Best Buy and Target round out the remaining large retail players. Amazon is also coming on the scene and growing share dramatically. Perhaps the most interesting thing is the fact that thirty-one percent, almost a third of the total industry, comes from other retail sources. Therefore, many people are interested in the video game industry, and a number of places sell a Wii or Xbox these days. However, not everybody carries a full line, and everybody wants to jump into the video game industry because it is such a profitable area to be engaged in right now.

Next, I will discuss some trends and changes I think are very interesting in the industry. The first trend is a broadening consumer base where video games become mainstream and household penetration grows. If the video game industry's penetration is ten percent of the population, you can have a very narrow and well-defined group of people using your product. However, if your penetration gets in the sixty and seventy percent range, it is pretty much everybody who is using your product. So, we are seeing the video game industry growing, and the consumer profile of the video game purchaser is shifting.

The second trend is accelerating innovation. One exciting aspect about the video game industry is that even with dramatic growth, video game developers are accelerating the innovation in this technology area. Innovation is increasing, not decreasing, and I think one of the primary reasons is that in the past, they have tended to require development around one specific consumer target and one specific gaming occasion. However, video game developers now have a much broader selection of consumers that they can target, and a much broader selection of occasions that they can service. Said another way, gaming is much more than just hardcore gaming these days. Hardcore gaming is alive and well, but several other types of gaming exist as well.

Next, I will discuss product life cycles. Generally, if you have some big game titles launching as a developer, you are going to make it or break it based upon one or two key bets. In many cases, even just the first few weeks after those games launch might make or break your year, and that is still generally true. However, some trend data may suggest that there is an emerging part of the industry where the life cycle of the product might look more like packaged goods, which presents some interesting implications.

Lastly, I will discuss the role of online gaming. As a retailer, GameStop is excited about this because all of the data that we have indicates that online gaming enriches the user experience, and that people who play online spend a little more time playing games and buy a lot more games.

Who is the heavy game buyer? If you talk to a lot of people, they will tell you that they know exactly who the heavy game buyer is and what he looks like. He plays Massively Multiplayer Online games online like World of Warcraft. He plays hard-core shooter games like Halo 3. He is male and thirteen to thirty years old. He plays twenty hours or more a week, and he plays hardcore titles. All of these characteristics are true to a certain extent. There is absolutely a group of heavy game buyers that looks exactly like this, but it is not as big as you might think. We did some research and looked at purchases. The key thing here is that we did not just look at how many hours you play video games. We also looked at how much you buy, which provided us with an interesting insight because the traditional view would say you are a hardcore gamer if you play twenty or more hours a week, you are an avid gamer if you play ten to twenty hours, you are a casual gamer you if play five to ten hours, and if you are less than that you are a parent exist to buy games for other people. It is a simplified segmentation, not entirely untrue, but it does not represent and accurate view of what is going on in the market today.

What we found is that about sixty-five percent of the population purchases video games, meaning they have purchased one in the last year. Out of that sixty-five percent, twenty percent of those buyers buy fifty-four percent of all the purchases in the video game industry. These are the heavy purchasers in the industry. On average, the people in this sample are buying about eighteen software titles a year, so they are buying a lot of games.

What do these people look like? We found that forty-three percent of heavy users are female, forty-seven percent are over the age of thirty, sixty percent play less than fifteen hours a week, sixty-three percent are married, and—interestingly enough—they play across all genres of games. Furthermore, there is the traditional hardcore user, the more avid user, and the family gamer. A few interesting things came out of these categorizations. Historically, if you were a parent, you were classified in the group called parent-buyer/non-player, but in the sample of heavy users, about half of them were parents and only about twenty percent fit into this category of parent-buyer/non-player. Most of the parents are actually players, and that makes a lot of sense. When we do the qualitative analyses, we talk to people who would say things like, "I was playing Madden with my kids last night, and we played for a while, but after they went to bed, I booted up Grand Theft Auto and played for a couple more hours." Accordingly, we are finding that a lot of the traditional stereotypes are not true. It is not true that the hardcore gamers play only the hardcore titles, or that the people who do not look like hardcore gamers only play music and sports games. We found that a heavy gamer is just like a consumer in any other industry. For example, if you are a heavy potato chip eater, you might eat many snacks of different types; if you are a heavy gamer, you play a lot of games, and you play across a lot of

genres. This holds much promise because there are many people who are potential heavy gamers. However, there are also some real challenges, because it is not clear how broadly a video game business has to be to appeal to the consumer and get them in your stores.

Next, let us look at who is the new gamer. We looked at some research we received from Nintendo that looked at the demographics of who is the new gamer, which consists of people who just started gaming within the last year. Two in five of the new gamers are female. So again, forty percent of the people becoming part of the video game industry consumer base are female, and about half of them are age thirty-five or older. Gamestop has observed that the people currently buying games make up a broader group than you think. They have grown up with games, and their kids are now playing games. We are, however, also finding that many new people are becoming part of the video game consumer base, which defies the traditional demographic definition.

One of the good pieces of news coming out of this is that developers can develop against many different targets, such as action games like Call of Duty. In fact, there is now Call of Duty 4, which was a huge success and grew about twenty percent over the prior year. Action games are alive and well, but so are family games. Think about Mario-type games that the whole family can play. Music is an interesting genre as well. My daughter, who would never have thought of playing a video game on a console, plays Guitar Hero World Tour on the Xbox, but to her it is not a video game—it is music. It is funny when I talk to some of the folks at Activision. The comment they made to me was, "Do not think of Guitar Hero as a video game, but think of it as a music experience with a video game component." There are many people who are interacting with this without even thinking of it as a video game. Then, you have a phenomenon like Wii Fit. What is Wii Fit? Is it a game? Is it an exercise program? Is it a general fitness regimen? The idea that video gaming is capable of playing in people's lives is expanding dramatically. I could liken it to something like cell phones and PDAs—it is no longer just a thing you talk on, but it is your window to the Internet, your texting device, and your email. It is a "whole communication" device.

With the success of Wii and Nintendo DS (DS), we can now develop games against that target. About forty percent of the games we saw come out on DS last year were targeted primarily at females. In fact, about fifty percent of the new users we are seeing using the DS were female. What we are seeing is that there is a broad array of consumers that you can develop against, and there is a broad array of occasions or needs in their lives that video games can fulfill. It is almost to the point where the term "video game" does not do justice to what these products are anymore. That is one of the reasons why we see continued innovation and accelerating growth in the industry.

Consider a new strategy we are doing at GameStop, which in the world of packaged goods is no big deal but in the world of video games is pretty new. January is generally the time when everybody goes on a diet and joins

a health club because January is all about talking about the "new you," the "better you," the "better body," or the "better mind." So, we have an event called "Shape and Sharp," which means shape the body and sharpen the mind. We are featuring products that fit that theme, including everything from Wii Fit to Brainage for DS. What is different about this is that we are trying an occasion-based, thematic promotion, as opposed to something that is just centered on the launch of a new title. In fact, there is no new title supporting this. The featured products are products that have been on the market for a while. It will not be the single biggest thing that we do this year, but it will be big, and it will be interesting. We think it is an opportunity to begin to speak to a much broader group of consumers about a much broader array of products.

Similarly, think about twenty years ago in the grocery business—the Super Bowl was not a big event. It was just a game that happened. When the food industry thought about beer and snacks, what they would focus on were Memorial Day, Independence Day, Labor Day, and the other traditional holidays when people do things or get together to have picnics or parties. Then, they started focusing on other holidays, including the Super Bowl and Halloween. The industry essentially created its own promotion spike and consumption spike around those occasions. The question is: what is going on in the life of the consumers where we can make gaming more relevant, and we can create our own spikes in the video game industry? That is one of the things we are experimenting with.

Another thing is product lifecycle. Traditionally, if you launched a new title, ninety percent of the sales in its whole life are going to be done in the first ninety days. In fact, there are a lot of titles where ninety percent of the sales of the title happen within the first week. The World of Warcraft launch last year resulted in about ninety percent in the first forty-eight or seventy-two hours. You have a very loyal community of users anticipating the release of this title who run in and get it as soon as possible to play the game, beat it, and then move on to the next thing because there are ten more new games launched the next week. I am not here to tell you that this is necessarily going to change. In fact, in certain genres we see that compressing. However, what we do see happening is that as the market expands, the consumer base broadens, and not every consumer wants to consume games that way.

Think about a fifty year old mom who is interested in buying Brain Age for her DS. She is probably not going to reserve the title and come into a midnight event to pick it up in order to be the first person on her block to play it. This could be, but we are not banking on it. So, the new video game lifecycle curve looks much more like what you would see in the packaged goods world. First, you launch a title, and then you begin to build a user base, you build word of mouth, you build repeat, and the sales of that title increase over time as opposed to peaking at launch and then dropping off. I do not see the whole video game industry heading that way, but I think there is definitely going to be different models of what the lifecycle of a given product is going to be.

Another trend is online gaming. According to MPD, fifty-six percent of people who play video games say they also play online. Online gaming has a very broad definition and means whatever the people think it means. It could mean I logged on and played an online MMO. It could mean that I was playing on my Xbox, and I was playing online against my friends, but it could also mean that I went online to play solitaire on my PC. What is interesting about this is that, again, forty-seven percent of these folks are female and twenty-three percent of them say they play ten or more hours a week. It is not just what people do at the traffic light or when they have a few minutes because ten hours is a pretty significant commitment. Now, fifty percent of that is sort of card, puzzle, or word games, so it is very focused on that sort of casual online game area at this moment, but we see it really growing. About three percent of these people say they are playing online games on their cell phone, while nineteen percent of these people say they are playing online on their console, and ninety percent say they are playing online on their PC. It is very PC centric today, but again, we see that growing a lot in other areas as well.

I want to spend a few minutes talking about some of the challenges facing the video game industry. The first one is the standing competitive set. As the industry grows and mainstreams, the consumer base changes, and the competitive set changes. Taking a very console-centric view of the world for a moment, you have console gaming manufacturers like Sony, Microsoft, and Nintendo. You have big publishers like EA and Activision, and you have dozens and dozens of other significant publishers out there. Then you have retailers like GameStop, Wal-Mart, and Best Buy. As the industry expands and the consumers profile broadens, those sets are redefined.

Think about open platform games. Obviously, a PC is an open platform for gaming, but what about cell phones and iPods? What about all the open platform things that are happening today in the world of mobile devices and casual online games? Another interesting thing is the notion of casual online games that are ad-supported. You have these console games that sell at a certain price that have a very high development cost, and you also have much simpler games that are essentially free to the user, operating on an ad-supported model. How do those two types of games coexist? If you are a publisher or developer, what does that say about your competitive set?

Next, consider expanded retail. We at GameStop were going through data in December and looking at the end of the year market share. One of the things we saw was the proliferation of stores with small market shares. None of these are that big—they are one-half of one percent or one-quarter of one percent, but they are emerging and they are names that you would not expect, like Kroger, Kohl's, and Costco. There are many people out there who, unlike GameStop, are not gaming specialists at all. In many ways, they are just mass merchandisers, and they are saying, "We would like a piece of this category because we think it is significant, and we think it is really growing." Non-traditional retail is also growing. We have seen what Amazon.com has been able to do, and it is making a lot of inroads, particularly in this non-

traditional audience. Also, eBay has become a very big factor within the business. .

Each of these companies will have an impact on the industry in its own way, and whether you are a retailer, a publisher, or a developer, you are going to find that this is going to change the definition of the traditional competitive set. As a retailer, if I am just looking at what Wal-Mart and Best Buy are doing, I could be missing a big piece of the puzzle.

Another way to look at the expanding competitive set is this: if I am in the position of a company like Microsoft, I am concerned about my market share of console games versus Sony or versus Nintendo. Furthermore, I am also concerned about other things in your living room, like the cable box or the satellite box. Therefore, there is an even bigger battle going on here, and it is really the "entertainment" industry as opposed to just the "gaming" industry.

I want to talk briefly about intellectual property (IP) management and piracy. Everyone is probably familiar with the game Spore that was launched by EA in September of 2008. It is an interesting game with a lot of hype around it, and it was digitally sold online. During the first week it was available, it was essentially hacked and dumped on file sharing sites, and the estimate to date is that 500,000 illegal copies were downloaded world-wide. We have spent a lot of time talking to EA about this, and it is obviously a big concern for them. I am bringing this up to say that this is not a small issue, and it is one that is probably not going to go away any time soon.

Another interesting challenge is the cost of innovation. Three or four years ago, it may have cost $5 or $10 million to develop a video game product, particularly if you were developing on a PS2 platform, and an additional $5 to $10 million spent on marketing that big title. The total investment was between $10 to $20 million going into the market. Today, if you are developing on a PS3 platform and conducting a global launch of a title, you are seeing numbers in the range of $20 to $40 million for development and $20 to $40 million for the market launch. Thus, all of a sudden, a $10 to $20 million investment now turns into a $40 to $80 million investment, and the question becomes how you pay that back. One of the things this phenomenon is leading to is new revenue streams.

Let us think about the movie business for a minute. Traditionally, when studios launch a new movie, they obtain revenue from the release in theaters. It looks very much like the video game curve: ninety percent of that revenue is going to occur in the first sixty days. They are also moving toward global launch plans. If I am launching it in the States, why not go ahead and try to launch it all at once to make a much bigger deal about it with relatively the same amount of money? Sequels are a big deal since it requires less investment in truly new IP and more investment in proven IP. That makes a studio feel more comfortable paying its investment back on video release. The quicker the movie comes to video indicates how well it did in the theaters. Merchandise is a big deal, as are TV rights and digital rights. The point of this is to show that if I am running a movie studio, I must also think of all the

potential revenue streams that I have in order to pay back this huge invest-
ment that I have, which is not uncommonly $50 or $100 million or more.
We see many same things happening on the video game side.

Video game developers and marketers are always looking for extra rev-
enue streams. New releases create box software sales. Special editions are
also a big deal because they are able to carve off a piece of the market that
may only be a small piece, but in our business, it is not uncommon to sell
100,000 to 150,000 copies of a special edition of a big game at a $20 or $30
dollar price premium. Digital add-ons are another issue—after you buy the
game, do you want to buy additional maps later on? If you think about the
game The Sims, there is an entire business to sell clothing and other things
you can have for your Sims characters. Those are typically micro-transac-
tions, but if it is done well, we think is a pretty significant opportunity. We
expect to see companies bringing more revenue streams in the video game
industry to fund future innovation.

Next, I will discuss the challenges that we see from the narrowing of the
video game industry. From the GameStop perspective, five years ago, we
could have said if we are number one with this hardcore gamer who is this
male age thirteen to thirty playing twenty hours a week, then we are doing a
good job. If you can only do one thing in the industry, that is the one thing
that you want to do, but I do not think that is true anymore. In an expanding
industry, there is a broader consumer profile, and we need to know that we
can do multiple things well. We need to know that we can satisfy the needs
and preferences of multiple consumer types.

A second challenge is brand differentiation. The good news is that
growth in the video game industry is very strong, and it will continue to grow
as it continues to mainstream. At the same time, the inherent challenge is
that many investors want to enter the video game industry. As a result, you
have to ask the question, what are we doing that is unique and different that
other people cannot do or will not do and that will provide a unique experi-
ence for our consumers? How do you maintain your unique edge as the
industry grows?

Third, embracing technology as a retailer, one of the inherent challenges
is to say, "This is an industry that is about technology, and technology is a
good thing. What is going on out there and how does it spell an opportunity
for us as a specialty game retailer?" We think that there are many technol-
ogy-related or technology-driven opportunities. Some research we did last
year is quite illustrative. One question was, "What is the outlet that you shop
most often when you buy video games?" We were not surprised to see that
we were the number one choice, by a two-to-one margin, for "hardcore
gamers" deciding where to shop for video games. It obviously spells oppor-
tunity because there are still many people not shopping at our stores, and we
would like them to shop with us as well. The part that did surprise us was
when we went and talked to mothers, who said, "I am buying video games
for others in my household," so largely non-gamers or light gamers. We also
came out number one there, so we walked away saying, "The good news is

we are already doing better than we thought we were because we know that we need to be number one in both of these targets." It is not enough for us just to sell to young male gamers; we need to sell to the rest of the heavy gamers out there. The opportunity for us was "top of mind awareness as a place to shop." Our core gamer top of mind awareness number is ninety-eight percent aware of us. I have no idea who those two percent of core gamers are who have not heard of GameStop, but nevertheless they are out there somewhere, and we love them and want to reach them. However, it was only about forty percent when we were talking to moms, so we said, "Wow, sixty percent of moms who are shopping for video games do not know who we are?" Then, we looked at our customer satisfaction data. We do about 10,000 or so surveys every week. Everyone who comes in our store gets an offer on their receipt that says if they go to this website and tell us about the experience, they can win something. We also do a couple of thousand outbound phone calls for consumer research, so we have a very robust database. We ask the yes-or-no question, "Would you recommend GameStop to a friend?" Overall, we were getting about ninety percent of the people who said yes, which is obviously very high customer satisfaction. We noticed that when looking at just women it was ninety-eight percent. Therefore, only about forty percent of moms know who we are, but the ones that are coming to our stores are having a great experience. The question is how to build awareness, and obviously it is a broad target and takes a lot of marketing dollars to build awareness with that broad of a target, so that was a challenge for us.

Let us talk about GameStop's efforts at brand differentiation. What are the things we are doing to help insure that as the video game industry grows, we can continue to deliver a compelling and differentiated experience for our consumer that will keep them wanting to come back for more? Here are a couple of things we are doing. One is having unique content and events. We have always done some of this, but now we are moving even more aggressively towards this direction. I am going to give you a few examples.

The first is the notion of unique product features or unlocks, including in-game content. The idea here is what would you rather have: a premium like a hat or a keychain, or something that is in the game, which does something? Clearly, what consumers want is something that is in the game.

The second is midnight events, which have been very successful for us. Think about the product lifecycle curve. I will give you a perspective. Take a title like Grand Theft Auto, which launched in April of 2008. I think we have sold around 1.5 to 1.6 million copies to date. We had about 800,000 reservations for that game, meaning 800,000 people came to GameStop and put down a deposit because they wanted to get the game early. Many of these people wanted the premium edition, which is the reason they come, and about sixty percent or seventy percent of those people showed up at our stores at midnight to pick up the game. We had hundreds of thousands of people coming to several thousand stores at midnight. There was also consumer promotion with Red Bull at 800 stores sampling products, and we also had Doritos involved. It was a really interesting event, but it was targeted

largely at the traditional core gamer audience. What are we doing to speak to this traditional core gamer audience, and what are we doing to speak to this broad game and broad purchaser audience, as well? We know that we need to find a way to do both of those effectively.

Another effort at brand differentiation is having an engaging store experience. We believe that we have a very good store experience today, and our research would support that even though it could certainly be better. The issue is that what is good enough today is not going to be good enough two or three years from now. There is a lot of money being invested in this industry. There is also a lot of new technology. What are we doing to ensure that the experience we are offering two or three years from now is head and shoulders above not only what we offer today, but also above what anyone else will be offering two or three years from now? Here are a few examples. If you pre-ordered the game Call of Duty: World at War at GameStop, you received an unlock code for an M1A1 rifle. It is a rifle that would normally be unlocked at level fifty or fifty-five—well into the game. All the other players will be jealous—well, jealous and dead in the video game. It is not only a unique premium, but something that can potentially give you competitive advantage in the game.

On Guitar Hero, we had two offers. One was that if you pre-order the game at GameStop, you have the opportunity to come in and capture yourself or your friends playing the game, upload it to a website for voting, and the grand prize winner and their friends get to come and get digitized. Then, they will become avatars in the next edition of guitar hero. You could not buy these things, you could not pay enough money for them, and they are unique in the world of the gamer.

Another one we had was with the Microsoft Gears of War launch. When you pre-ordered at Gears of War at GameStop, we had these midnight events with five to six hundred thousand pre-orders, and when you come to the midnight event, you got a token that you could take and use online with Xbox Live to download this unique weapon called a gold hammer. So again if you come to the event, you have the unique experience from the event, but you also get the experience in the game. That is very much the direction we are trying to go as a specialty retailer because we are focused on bringing that experience to light in a way that you cannot in other environments.

We are trying to focus on having a compelling message from an advertising standpoint. We have traditionally spoken to the core traditional heavy gamer, the young male audience, and we think that we need to continue to speak to that group. The message is pretty clear: it is about getting what you want. Looking at the holiday, about forty percent of the year's sales are in the months of November and December. There is very high seasonality, and what we needed to do was go out and speak to these audiences. We developed many executions, and our executions against these core gamers were focused around the notion of getting what you want. We cannot advertise to everyone who buys Christmas gifts because that is an incredibly expensive proposition, but we can advertise to those people who are most concerned

about getting a Christmas gift from GameStop. The question is how to ensure that you get what you want. How do you know it is the right game? How do you know it is for the right console? What happens when your grandmother comes in and gets you Call of Duty, but it is really the PS3 version and you have an Xbox 360? So the notion is getting what *I* want.

Then we said, "Okay but we also want to go after the heavy gift *giver*, and the message we have to get there is this notion of value." It is no surprise that this past Christmas was all about value; there was less money being spent than in the year before, so people were looking for the great value, and the idea here is that you can get them everything that they want.

That is the direction that we are heading, and I think that creatively what we are trying to do is to be champions of all the fun that is in the video game industry and bring that to life. We are really trying to bring to life, particularly for the heavy gamer, the unique experiences that we can offer at GameStop, and then increasingly, we are trying to broaden our messages, which is a real challenge because it is hard to know how to buy advertising efficiently against that audience. It is one thing to say that fifty percent of heavy game purchasers are female and over the age of thirty, but you cannot just base advertising on all women and all people over the age of thirty. Accordingly, figuring out how to do the targeting is a bit of a challenge. We are working our way through with the message we communicate to the consumer base, and we are pretty happy with where we are in that so far.

Having an engaging store experience is another area in which we know that we want to raise the bar. I mentioned that we believe we have a very compelling consumer experience today. Of course, consumer experience is everything: it is not just what happens in the physical store, but it is your experience with the people in the store, your experience with our website, and your experience with before-and-after customer service. So, we are looking at ways that we can enhance that.

We just opened our first new concept store about a month ago. It is under the radar at this point because we are opening many of them, and we are testing many things and partnering with a number of other players in the industry like Nintendo, Activision, and EA to work on specific consumer opportunities. The concept store GameStop has a much bigger, more open feel—somewhat of an open loft feeling with a high ceiling and very contemporary looking stained concrete floor. It is roomy and looks contemporary. One of the things we learned from research is when heavy gamers come into a store, the first question they always ask is, "What is new?" Sure, they know how it works, they know that they can walk over to the Xbox section, they can go through and all the titles are organized alphabetically, and they can see what is new: maybe there is a new release section on the side. However, in our concept store, you can walk into the store, and there are monitors right there in front with a listing of either top selling new titles or most anticipated upcoming titles that you can reserve. There are other monitors that always have special offers. If you come at any given time, we probably have twenty or thirty special offers like unique in-game content, a premium, and a

tournament, which is something that happens uniquely with GameStop and uniquely with a specific title. Each of the three major console sections has an interactive kiosk with a touch screen, and the idea is that as a consumer, I can come in and essentially shop the whole store from that kiosk. I can search for a specific title; if I type in "Halo," it will bring up every Halo title ever launched. I can also search categories such as "top sellers," "best games for kids under 12," or "top rated games by *Game Informer.*" The idea is to allow people to slice the onion as many ways as they want. One of the things we tend not to think about is how our stores are not the biggest stores in the world, but in an average GameStop store, you have 3,500 items for sale. Even the most sophisticated gamer cannot keep track of 3,500 games, so the question is how do we help people, in this age of abundance, to manage to that abundance and find what they want? We are doing trying to find more ways to help them do that.

Another thing we are doing is trying to create a space for kids. This was modeled after what you might see in the Apple Store. The idea here is to create a place you can come in and experiment with handhelds. There are two DSs and two PSPs, and you can come in to play whatever is new. We have already redesigned this unit because it is only about the height of a fire hydrant—it was originally only 2½ feet or so off the ground. We found that about half of the people who were coming in and using the handhelds were adults, so we had a lot of knees knocked. Now, two stations are much higher up and two are much lower down, but again we are kind of working our way through that.

Lastly, what are we doing to embrace technology? We have a pretty good partnership with Microsoft today, and we are looking to expand that further and find more ways that we can leverage things such as Xbox Live. For example, we did a tournament last year around Nintendo Super Smash Brothers, and we had about 3000 stores and 220,000 people participate. What can we do to make this even bigger, and how can we use the online component to enhance it? I believe we are the number one seller of Xbox Points Cards, which are used for online play. Thus, we embrace that as an opportunity. We did a text message promotion around Grand Theft Auto's release that was hugely successful—there were hundreds of thousands of entrants. On the DS, many of our stores have download stations in the store where you can bring your DS in and download a game wirelessly. We think this promotes play, and it promotes hours spent related to the video game industry. Then, there is MLG, Major League Gaming. We have had a partnership with them for a few years now. This is essentially an online gaming organization that runs leagues with professional players. Currently, we are trying to offer the opportunity to come in and compete in one of our tournaments to win the right to become a pro player. Think about it as a draft or the equivalent of getting your ticket to the PGA Golf Qualifying School. We are excited about that partnership as well.

In conclusion, we are very excited about the video game industry. We think the innovation is great. We are excited that the industry is growing and excited about how much the penetration is growing and about the broadening

of the consumer target. We see much innovation against that, and we expect the strong growth to continue. The key to the growth of the industry is continued innovation because there are more games being developed to appeal to different consumer targets for more occasions and more needs. From our perspective, the key to success is continuing to deliver this compelling and differentiated consumer experience while raising the bar for competition. We certainly do not have all the answers, but I have shown you at least a few of the things that we are doing. As you can see, we are trying to experiment and move forward aggressively in many areas to raise the bar and increase the compelling experience.