

Game Wars

Who will win your entertainment dollar, Hollywood or Silicon Valley?

THIS UNUSUAL "PREMIERE" had the glitz and glamour of a Hollywood film debut. On Feb. 10, in New York City's Little Italy, II Cortile, a restaurant decorated lavishly with faux alabaster statuary, was jammed with journalists, producers, corporate executives, and assorted hangers-on. Actors James Caan and Robert Duvall worked the red carpet, chatted with fawning TV folk, and posed for the paparazzi. The event: a sneak peek at the next installment of *The Godfather*.

But don't expect to see this sequel at the multiplex. It's a video game. Electronic Arts Inc., the maker of *Madden NFL Football* and *The Sims* video games, is borrowing some of Hollywood's marketing tricks in an effort to make its *Godfather* an offer you can't refuse. EA licensed the rights from Paramount Pictures and is hoping to build buzz in advance of the game's release before Christmas. The two companies joined forces to create a game in which players mimic the strategies of the Corleones. To climb the ranks in this crew of wiseguys, you'll need to use fear, violence, loyalty, and negotiating skills.

The convergence of Hollywood and Silicon Valley brings to mind another mafia credo: Keep your friends close, and your enemies even closer. EA and Paramount are pals today, but they might be fierce rivals tomorrow. The worldwide video game industry, with revenues of \$24.5 billion last year, overtook movie box-office receipts, and sales are expected to soar to \$55 billion by 2008, according to Price-WaterhouseCoopers.

While broadcast TV audiences dwindle and moviegoing stagnates, gaming is emerging as the newest and perhaps strongest pillar of the media world. So it's no surprise film studios, media giants, game makers, and Japanese electronics companies are all battling to win the Game Wars. "This is a huge shift we're seeing, and nobody wants to be left behind," says Sony Entertainment Chairman Michael Lynton.

The play is fast and furious. When EA on Jan. 18 spent \$800 million to lock up ESPN content such as X-Game sports competition for use in games for the next 15 years, it was just the latest jolt to an industry in which megadeals have become as commonplace as laser-toting ogres. Next came the news that Microsoft Corp. plans to produce the movie version of its *Halo* megabit video games, which have

raked in \$600 million since 2001, rather than handing the job to a studio. Every day there's merger talk as big game makers buy small fry and movie studios size up game outfits as takeover targets. "There's nearly as much action in the industry as in some of the games," says Lorne Lanning, head developer for Microsoft's *Oddworld Stranger* game.

New gizmos promise to make the current crop of games look as quaint as *Pac-Man*. Sony, Microsoft, and Nintendo are racing to be first out with new consoles later this year or in early 2006. They'll boast chips that pack the punch of a supercomputer, delivering super-realistic graphics and lightning-quick controls. The goal: making gamers feel like

they're living their games, not just playing them. "The advent of new technology...always invigorates everyone in the industry," says EA Chief Executive Lawrence F. Probst III.

Consoles are only part of the story. Gaming is exploding in all directions—going online, mobile, and global. On Web sites such as Microsoft's Xbox Live, 1.4 million hard-core gamers match up their reflexes in multiplayer shoot-'em-up games for bragging rights in cyberspace. Hip urbanites in China and South Korea are packing Internet cafes to play online games for as little as pennies per minute.

Not coming to a theater near you: A new *Godfather*



And even the tiny screen is grabbing attention, as cell-phone titles take gaming anytime, anywhere. By 2008, the markets for online and mobile-phone gaming are expected to top \$15 billion and \$13 billion, respectively.

Wrap it all up, and you have an industry that's changing shape while it races down the road at 100 miles per hour. Once just a hangout for teenage boys, gaming has grown up and gone mainstream, luring both genders and every age and interest group. These days, more adults play games than kids, and 39% of gamers are women. One is 38-year-old office manager Renne Cohen of Tinton Falls, N.J., who has cut way down on her TV time to play games like *Star Wars Battlefront*. "It's addicting," she admits. As media giants and game makers try to win the Renne Cohens

of the world, they're under intense pressure to outwit, outplay, and outlast their rivals—all the while navigating a fickle consumer market.

There's money to be made in surprising new ways. In China, online leader Shanda Interactive Entertainment Ltd. is building an eBay Inc.-like marketplace to let players buy and sell game characters or new colors for that favorite Ferrari racing vehicle—with Shanda taking a cut. And with game demographics trending older, advertisers are leaping in, getting their messages across through product placements, billboards within games, and sponsorships—and even hiring developers to build "advergaming." LG Electronics of Seoul has sponsored an online car-chase game in which players use an LG videophone as they zoom after bad guys modeled on Fox's 24 TV show. The ad angle is so promising that Nielsen Entertainment is setting up a new service for tracking gamers' likes and dislikes.

TOPS IN TINSELTOWN

WATCH OUT, HOLLYWOOD. For now, at least, the big game-industry players are calling the shots. They know the business and have strong records creating

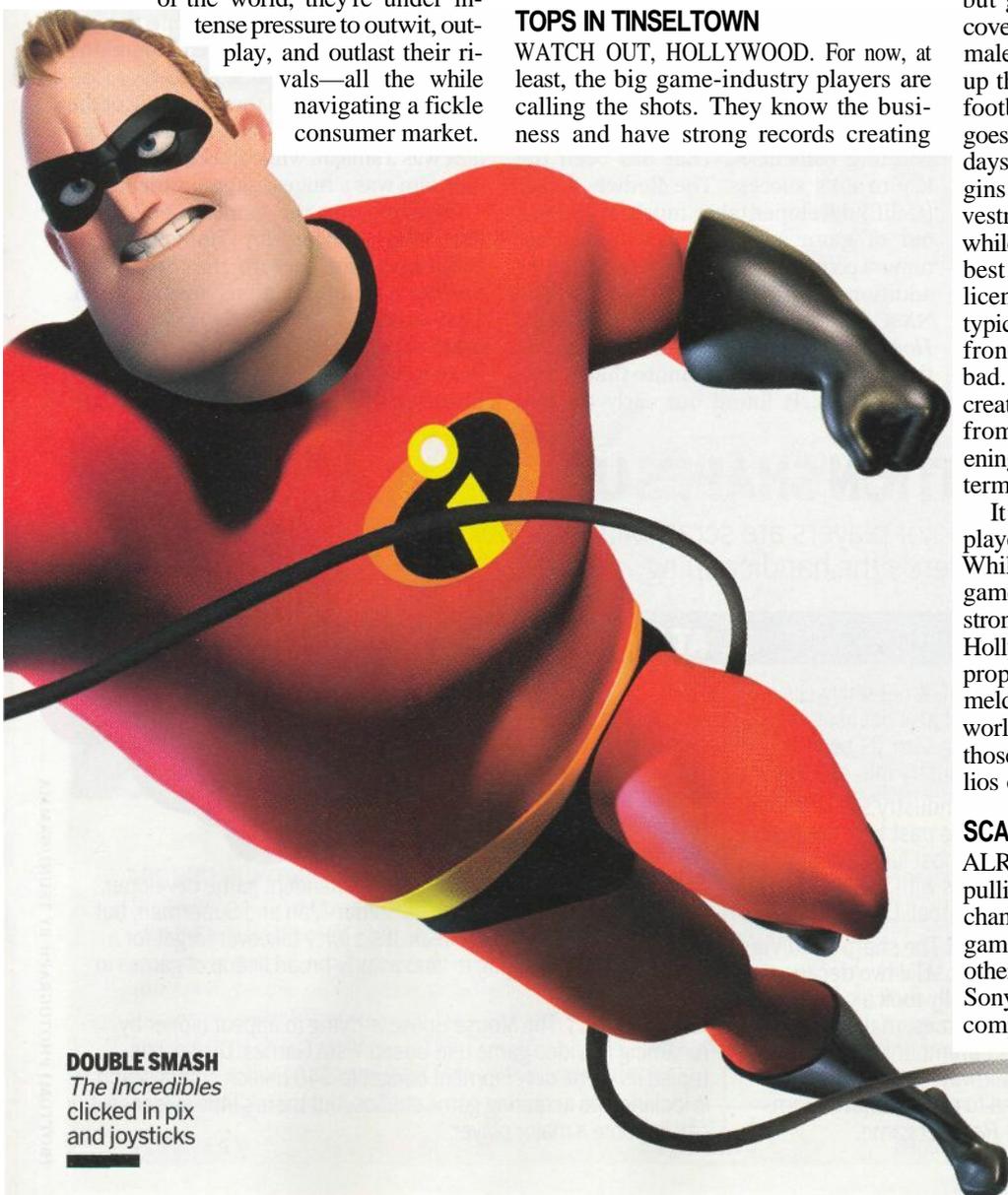
gaming hits—whether from movies or their own homegrown material. The game makers control armies of talented artists, engineers, and developers who understand the differences between interactive entertainment and passive viewing of movies and TV shows. And the console makers not only produce dozens of their own exclusive games but charge independent game outfits fees for every game sold that's designed for their console. The media companies are the newbies. Until they figure out how to design and market games more successfully than the game-industry leaders, they're going to be riding shotgun in this race.

Hollywood has no choice but to grab for the joystick, though. Not only do the media giants need the revenue growth, but games are siphoning off their most coveted customers: 18- to 34-year-old males. It's a generation that has grown up thinking of Madden as a game, not a football coach. What's more, the payoff goes straight to the bottom line: These days, the studios' operating profit margins average just 10%, according to investment bank Veronis Suhler Stevenson, while game makers average 15% and the best reap as much as 25%. When studios license a movie to a game maker, they typically get \$3 million to \$5 million up front against about 9% of the take. Not bad. But as the studios do a better job of creating their own hit games, they'll gain from both ends of the business, strengthening their hand in negotiating licensing terms as well.

It looks like the smartest strategy for players on both sides is to find partners. While the media companies need the game companies more, even the strongest game makers are looking to Hollywood for its bankable movie and TV properties. Success is going to require melding the talents and assets of both worlds. In the end, the winners will be those with the best and broadest portfolios of properties and alliances.

SCALING UP FAST

ALREADY, SOME strong players are pulling ahead of the weak ones. EA is a champ, for sure, thanks to its name-brand games and its ability to play well with others, such as Paramount and ESPN. Sony has the advantage of being the only company with a console, games, and movies, and it makes money leveraging those businesses against each other. And among the media giants, Viacom is an early favorite because of its scope and



DOUBLE SMASH
The Incredibles
clicked in pix
and joysticks

DIGITAL ILLUSTRATION BY JOE CALVIELLO/BW

track record of capitalizing on radical shifts—think MTV. Possible wild cards: China's Shanda and Korea's NCsoft Ltd. could extend their early leads as online pioneers in Asia and become global powers. Two big names most at risk are the powerhouses of family-friendly entertainment, Nintendo and Walt Disney Co. Both were slow to address the shift to older audiences.

It's all moving so quickly—and getting so expensive—that any company that wants to be a player had better get big fast. That's especially true for game makers. Not only are they bidding against one another to lock up rights to everything from movies to baseball stars to Arena Football brands, but costs for developing games are going sky-high. Five years ago, it cost about \$3 million to develop a high-end game; now it's \$20 million as games become more complex and require more artists and programmers. Microsoft spent \$40 million to create and market *Halo 2*. That's still far shy of the \$70 million average cost of a Hollywood movie, but it prices most small and midsize game makers out of the top of the market. "With a slate of releases each year, it's like rolling the dice with \$200 million every year," says Jay Cohen, vice-president for U.S. publishing at

Electronic Arts is king of the franchises, with 007 and Madden

French game maker Ubisoft Entertainment.

The top five game developers last year accounted for 56% of the industry's more than \$7.3 billion in U.S. software sales, according to investment banking firm Harris Nesbit Corp. And the strongest players are rushing to bulk up even more. No.1 EA, with \$3 billion in annual sales, in December bought a 20% stake in Ubisoft for \$87 million, eyeing its hit titles such as *Myst* and *Tom Clancy's Splinter Cell*. Rival Take-Two Interactive Software Inc., maker of the smash *Grand Theft Auto* games, in January responded by snapping up sports game developer Visual Concepts Entertainment from Sega.

NO MAGIC FORMULA

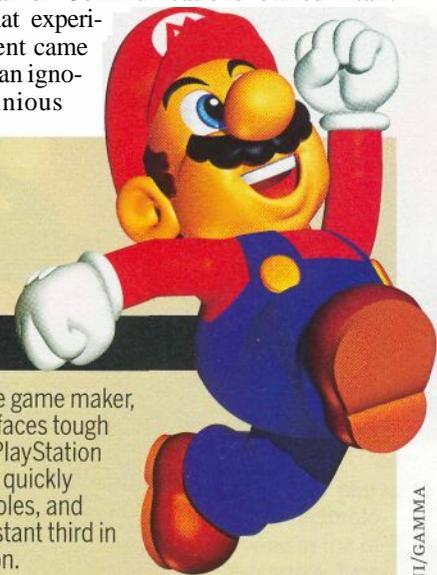
WITH ONLY 5% of all games reaching the 1 million "hit" mark, it's vital for game makers to build up a portfolio of winning franchises. That has been the key to EA's success. The Redwood City (Calif.) developer takes much of the risk out of game making by keeping customers coming back for their favorites. In addition to *Madden* and *Sims*, it has NASCAR, James Bond, and the *Medal of Honor* shooter series—totaling 27 game titles last year that sold more than 1 million copies. It found out early on that

sports fans are willing to plunk down \$50 every year for essentially the same game but with updated team rosters.

When it comes to dealing with Hollywood, EA has decided to make alliances rather than buy a studio of its own. "We looked at buying a movie studio, but we have relationships already with New Line, Paramount, Warner, and MGM," says EA's Probst. "We think that's a better approach than owning one property and being confined to that portfolio." And when it decided to expand its portfolio of franchises, it bet on stories such as *The Lord of the Rings* and *Harry Potter* that already had huge fan bases.

Still, nobody, not even EA, has a magic formula for what works and what doesn't in the new world of movie and game cross-pollination. Before he became governor, Arnold Schwarzenegger stumbled for a video game released at the same time as his *Terminator* flick, but even he couldn't make the Atari Inc. game a hit. EA's *Catwoman* was a dud. On the other side of the coin, the video game *The Chronicles of Riddick* was a smash, while the Universal Studios film was a huge disappointment.

Psyching out the gamer mentality is particularly trying for Hollywood. Its tribulations go back to the '80s, when Warner Communications owned Atari. That experiment came to an ignominious



HOW THE COMPETITION SHAPES UP

With video games exploding, major players are scrambling to grab huge chunks of the business. Here's the handicapping.

LIKELY WINNERS

SONY The Japanese giant is a triple threat. It not only sells hardware and a huge catalog of games but also licenses the gaming rights to its movies such as *Spider-Man*. Its newest hardware designs promise to send the industry into overdrive.

ELECTRONIC ARTS The game software industry's 800-pound gorilla is getting even more powerful. In the past two months, EA has locked up some of the industry's most lucrative segments by signing exclusive multiyear deals with the National Football League, ESPN, and the Arena Football League.



SUMNER REDSTONE The sharp-eyed Viacom CEO, who bought MTV two decades ago, last year personally took a controlling interest in Midway Games, maker of *Mortal Kombat*. Now his Paramount units are collaborating with Midway. The Paramount studio just agreed to make a movie from Midway's *Fear & Respect* game.

AT RISK

NINTENDO The venerable game maker, parent of Mario Brothers, faces tough competition from Sony's PlayStation Portable. Microsoft also is quickly earning its stripes in consoles, and Nintendo could place a distant third in the next console generation.

ACTIVISION The second-largest independent game developer has lucrative franchises such as *Spider-Man* and *Superman*, but its sports lineup has been weak. It's a juicy takeover target for a Hollywood outfit looking to land a fairly broad lineup of games in one fell swoop.

WALT DISNEY The Mouse House is trying to appear hipper by renaming its video game unit Buena Vista Games. Disney has tripled its game development budget to \$40 million annually and is looking into acquiring game studios, but there's little evidence it can become a major player.

(BOTTOM) PHOTOGRAPH BY TSUNI/GAMMA

end in 1984 after Atari released the ill-fated game *E.T.: The Extra-Terrestrial* and gamers hated it. Five million game cartridges ended up buried in a landfill. Warner wasn't the only studio to stumble. In Hollywood's second foray into the game sphere, in the late 1990s, Viacom and Fox Entertainment Group had years of flops, while DreamWorks abandoned its game unit after only two years.

WEEKEND WONDERS

TINSELTOWN'S BIGGEST flaw was arrogance. Hollywood moguls looked down on the jeans-wearing geeks who were making the hottest games around. Instead, the "suits" saw the world in terms of nice, neat movie-like story lines—and didn't understand that in games, the players become actors in their own stories.

Game economics also threw them: While a studio could recoup the cost of a dud through home rentals and sales, pay-per-view, and cable and network deals, even the most wildly popular games typically sold well only for the first three months on the market. And many merely saw games as an extension of a movie or show instead of creating unique content for the gamer sensibility. The ultimate wake-up call that the game folks were really on to something came when Microsoft's *Halo 2* raked in \$125 million the day it went on sale on Nov. 9—better than *The Incredibles* movie did in its entire debut weekend.

It looks like the best bet for the media companies is to work with rather than fight the game makers—at least initially. That's the strategy of Viacom CEO Sumner A.

THE STAT
39%
The percentage of video gamers who are women

Redstone. In fact, the octogenarian is emerging as Hollywood's No. 1 game fan. He doesn't play Donkey Kong or Doom himself—his idea of a good time is playing with his dog, Murray, and watching his tropical fish in his Hollywood Hills mansion.

But Redstone spotted games as a comer two decades ago, when they were out of fashion, and began making personal investments in a company that's now Midway Games Inc., maker of the gory *Mortal Kombat* martial arts series. Since then he has watched the value of his 76% stake soar to \$670 million. During an interview at his home on Feb. 8, he recalled his prescient purchase of the fledgling MTV back in 1985. "I didn't have to be a teenager to see that MTV was going to change the world," he says. "And I don't have to be a gamer to see the cultural shifts that are coming with video gaming."

Now, Viacom's businesses are getting plugged into games, too. (Redstone recused himself from those discussions because of his conflict of interests.) The Paramount unit is working with Midway on projects—agreeing to make a movie from Midway's upcoming shooter *Fear & Respect*. Meanwhile, Viacom's Nickelodeon TV channel has moved aggressively to cross-market its key characters, including *SpongeBob SquarePants*

—and to create new ones for gaming.

Others in Hollywood are racing to forge their own alliances with the techies. Director Peter Jackson, creator of the blockbuster *Lord of the Rings* trilogy, is working with Ubisoft to develop a *King Kong* game that will come out at the same time Universal's remake is released on Dec. 14. And Pixar Animation Studios brought together its *Incredibles* creative team in January with THQ Inc. writers and artists to come up with a sequel to the game that will keep the story in consumers' minds, even though a movie sequel has not been announced.

Some of the entertainment giants still plan to go it alone. Warner Bros. Entertainment Inc. and Disney believe they're better off owning game-development businesses rather than focusing on alliances. But this time around they plan on tapping people who really understand games—and the game industry—to produce their titles. They are separately said to be considering acquisitions of THQ and Activision, game makers with strong portfolios and proven records. "The question is whether to build or buy," says Kevin Tsujihara, Warner's executive-vice president for strategy. "In the long run, we think it is better for the studio to be in control of the quality of a game built on an asset we've created." That's why Warner last year hired Jason Hall, co-founder of the Monolith Productions studio that is making an online version of Warner's *Matrix* movie, to start Warner's own game division.

Has Hollywood figured out the game business? Not by a mile. Disney, which had a game hit with its *Kingdom of Hearts* game for young kids, is struggling to produce hits for older players. So now it's tripling its game budget, to \$40 million annually, to buy small companies and create games from films like Miramax Film Corp.'s *Kill Bill* series. Having its own in-house game-development operation could give it stronger leverage with game makers when they come calling to try to license its properties—but only if it produces some bona fide hits.

In a sprawling market where controlling a broad portfolio of businesses is crucial, nobody is positioned better than Sony.

Unlike any other players, it already has assembled all the pieces of a true

GIRL POWER
It's not just a guy thing anymore



video game empire. It sells hardware with its PlayStation consoles and is rolling out the PlayStation Portable handheld worldwide on Mar. 24. It makes games such as the popular *Gran Turismo* racing and *EverQuest* online. And it owns Sony Pictures and MGM movie studios, whose Spider-Man and James Bond franchises have been megahit games for Activision and EA. The combination has helped Sony sell 80 million PS2 consoles worldwide.

The real payoff for Sony comes in game software sales. While Sony and the other console makers sell their hardware for a loss, they typically make \$5 to \$10 in royalties for every game sold on their platform. PS2 has had more than 2,000 software titles, with more than 775 million total game copies sold. Sony courts independent game makers such as EA to make games exclusive to its console. And it develops its own games—exclusive software to keep fans loyal to the hardware. Sony's game business has for years propped up its consumer-electronics division, which accounts for two-thirds of the company's profits.

The biggest threat to Sony is not one of the traditional entertainment giants.

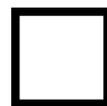
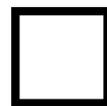
**Consoles,
games,
movies—
only Sony
has it all**

It's Microsoft. In the past year, the software giant overtook Nintendo as a strong No.2 in the high-volume U.S. market for game consoles with 24.9% share, vs. 56.4% for Sony and 18.7% for Ninten-

do. Analysts believe Microsoft will gain share, but they don't expect it to unseat the champ. Sony's next-generation technology is expected to out-dazzle Microsoft's, and it has a larger slate of exclusive games from the hottest small game studios.

But in this fast-morphing business, nothing is certain. A company that makes a wrong move could itself start looking like an ill-fated character in *Doom* or *Halo*—reduced to a smoking heap on the floor. With both opportunities and risks increasing each day, and new players vying for power, it will require all of the wiles and muscle of the Godfather to win. ■

*-By Ronald Grover in Los Angeles
and Cliff Edwards in San Mateo,
Calif. with Ian Rowley in Tokyo
and Moon Ihwan in Seoul*



Anúncio