



2009 E3 Expo

State of the Industry Address

“Leading the Entertainment Industry through a Difficult Economy”

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Good afternoon, and welcome to the 2009 E3 Expo. Our industry today stands at the forefront of the entertainment world. Over the course of this address, I will focus on how we attained this enviable position, and why these characteristics bode well for our future – even as we face our own challenges during this difficult economic time.

First, let me say that we are delighted to have with us this year a sharply expanded group of industry stakeholders, including game developers, retailers, investor analysts, industry partners, and both foreign and domestic media. Thank you for joining us to celebrate the entertainment software industry’s recent successes, preview our latest innovations, and – perhaps most importantly – share your perspective on the future of our industry.

In a year in which economic conditions forced many industries to scale down trade shows and other signature events, the computer and video game industry has proudly expanded the E3 Expo. We feel confident that the upgraded event reflects our industry’s artistry, originality, and exciting potential for future growth.

Our most recent sales figures are suggestive of this growth potential. Despite a difficult financial climate, our industry is performing exceptionally well. In the tough environment of 2008, overall computer and video game industry sales climbed to a record \$22 billion. Entertainment software sales, which accounted for \$11.7 billion of the total, increased 22.9%. During December alone, sales revenue reached \$5.3 billion, the first time our industry topped \$5 billion in any single month.

While we are confident about the future, we cannot ignore the current challenges facing the global economy. Our industry has held up far better than most during this terrible recession, but some companies in the computer and video game industry are feeling the effects of the downturn. The results for the industry overall in March and April were not favorable, with sales down 17 percent in each month compared to last year.

There is no silver lining for the companies and the individuals who have been affected. Yet, the experience is an unmistakable demonstration that our industry is no longer a bit player on the fringe of the economy. We are a significant part of that economy and not immune to its ups and downs or the rules of the marketplace. Yet, we know we can minimize our vulnerability to these “rules” if we leverage our growing creative talent and strong consumer loyalty to embrace the new business opportunities within our reach.

As everyone in this room knows, our business cycle is such that we always close the year faster and stronger than any other form of media. Nearly 45 percent of our industry revenues come during the fourth quarter.

More importantly, our interactive community, artistic creativity, entertainment quality and superior technology – a combination of attributes unique in the entertainment industry – have captured the hearts, minds, and imaginations of entertainment-hungry consumers.

Even in the soft environment of March 2009 according to NPD, consumers spent one of every three entertainment dollars on video games, more than they spent on any other form of entertainment. In another sign of the industry's growing impact, a March Nielsen PreView report revealed that gamers spent 64 billion minutes playing games last December, ranking behind only the four largest television networks in usage time.

Now more than ever, computer and video games represent the entertainment industry's most highly sought-after commodity. Across the entertainment world, the biggest news, greatest innovations, and most highly anticipated products originate in the video game industry. A majority of prominent entertainment and technology companies made a concerted effort in recent years to align themselves with the business; those who haven't now are scrambling to do so.

The speed at which video games transitioned from 16-bit graphics and a soundtrack of beeps and bleeps to nuanced images, characters, and storylines is unprecedented. The individuals involved in this development laid the foundation upon which all of our subsequent growth has transpired. Plus, they made video games the preferred medium among a variety of budding artists, from musicians to graphic designers to filmmakers, for expressing their creativity and innovative thinking.

Grand Theft Auto IV is a good example of our evolution. The latest game in a series that historically generated controversy, received widespread acclaim for its artistic value. In describing the game's "action, thrills, imagination, and innovation," *Rolling Stone* wrote, "This is a review of Grand Theft Auto IV the M-O-V-I-E. And I have to say, it's better than anything I've seen at the multiplex.... GTA IV deserves major props for extending the potential of storytelling."

Such reviews caused *Time* Magazine this year to list Sam and Dan Houser, GTA's creators, on the "Time 100," the magazine's annual list of the world's most influential people.

When designing the PlayStation 3 video game *Heavenly Sword*, developer Ninja Theory could have synced the game's narrative with easily accessible stock music. Instead, the game's creators hired award-winning composer Nitin Sawhney to produce a soundtrack with help from orchestras in London and Prague.

Into the Pixel, an art exhibit on display in the Concourse Pavilion here at E3 and sponsored by the ESA, the Academy of Interactive Arts & Sciences and the Los Angeles County Museum of Art, earned considerable praise when it was recently displayed at the popular South by Southwest Music, Film, and Interactive Festival in Austin, Texas. The festival, long a mainstay in the music and film worlds, expanded in 2007 to include the ScreenBurn Arcade, a public space designed to "explore the newest innovations in video games." The *Into the Pixel* exhibit's presence in the Arcade helped to further promote our industry's artistic talent.

It is the computer and video games' artistry that has helped build and expand a strong consumer base that includes both loyal, hardcore gamers as well as newer, more casual gamers. The *2009 Essential Facts about Computer and Video Games* booklet, which the ESA proudly released today, effectively captures just how large a percentage of the U.S. population has come to appreciate the pioneering work that the video game industry has produced. For example:

- 68% of American households now play video games;
- 42% of American homes have a video game console; and
- 82% of parents report that one of the top reasons they play video games with their children is that it's fun for the entire family.

The Entertainment Software Rating Board deserves much credit for bringing together families and the video game industry's unique products. The gold standard among rating systems, the ESRB has created the trust necessary for parents to appropriately pick video games for their children. This, combined with our industry's other parental tools, brings us to the forefront in the entertainment world. As new technologies emerge, we will remain vigilant in continuing to provide parents the resources they need to ensure safe, secure gaming experiences for their children.

As a result, families have the potential to propel exceptional new growth for video games in the years to come. We have seen in recent months, that as families look to limit spending, video games present an attractive option for fun, affordable entertainment. Our superior entertainment value compared to cinema, sporting events, or amusement parks stems from video games' interactivity and high replay value, which can entertain a family with new content for many hours over a prolonged period of time. Games also have an advantage in that they bring fast, up-to-date, and customized interaction directly to the consumer.

This feature is becoming increasingly important to all types of gamers. Unlike movies, music, and books, computer and video games allow the user to interact with the rich unfolding story. Moreover, online play enables gamers to connect to others and share virtual experiences. Like many other myths about our industry, the assertion that gamers are isolated is upended by the facts. Games are a social activity. The *2009 Essential Facts* reports that 62% of gamers play games with others in person, up from 56% in 2007.

In this age of social networking, video games are superbly positioned to maintain the ultimate competitive advantage – a close connection to the consumer. Social networking is not just a hobby for our industry – it's a 21st-century business built on a close, collaborative relationship between passionate consumers and innovative video game creators.

A staggering number of people, for instance, currently subscribe to online multiplayer gaming and digital media delivery services. Combined, a total of 40 million people subscribe to Xbox Live and Sony's PlayStation Network.

This lucrative, high-growth-potential business model has become so competitive that our companies are regularly devising new methods to utilize online capabilities to attract new subscribers and expand entertainment options. In early 2008, Sony announced that the PlayStation Network soon would stream full-length movies and television shows from, among others, Paramount Pictures, MGM, Disney, and Warner Brothers. As unveiled at last year's E3, Microsoft has partnered with online DVD and Blu-ray Disc rental service Netflix to stream video to the Xbox 360 console. Within the first three months of Netflix becoming available on Xbox Live, users watched 25 million hours of movies and TV programs.

The interplay between video games and Hollywood continues to grow stronger. Just last month, film and television producer Jerry Bruckheimer announced plans to create Jerry Bruckheimer Games because of the unique narrative opportunities video games offer. And Steven Spielberg

released, through Electronic Arts, his second video game title, *Boom Blox Bash Party*. Spielberg's idea for the game grew out of a desire that his seven children have an entertainment option that "got them up and moved their bodies around."

The music industry also has sought to make the link between video games and consumers. Young bands such as Gym Class Heroes and The All American Rejects helped pioneer the practice of using video games to introduce their music to a broader audience. Both groups took advantage of Electronic Arts' call for popular new music for its *Madden NFL* series; they since have been joined by the likes of Busta Rhymes and Linkin Park.

Similarly, well-established bands such as The Beatles, Aerosmith, Boston, and KISS turned to wildly popular music-based video games to replace lost revenue from declining CD sales. Gamers have downloaded more than 40 million songs on *Rock Band* since the title first became available in November 2007. As Aerosmith bassist Tom Hamilton told the Associated Press, "Far more of this audience will hear our music via this game than if we had strenuously attempted to talk them into buying all of our CDs."

Each such innovation or partnership further blurs the line that divides the entertainment mediums. No longer merely a packaged-goods business, video games serve as the central hub for this integration. Accordingly, our industry must use this unique position as a springboard to the next phase in video games' evolution in the entertainment world.

The drive among gamers for a strong sense of community – and the industry's subsequent search for technological solutions to deliver it – is creating opportunities that could dramatically change the way we do business.

Not long ago, built-in network adapters served little or no purpose on video game consoles, due to narrowband connections and poor console integration. Today, nearly all video games come equipped with such capabilities. In fact, widespread broadband access, popular MMOs, and mainstream downloadable content have converged to create an unmistakably interconnected relationship between video games and the Internet, further establishing our pre-eminence in the entertainment industry.

Grand Theft Auto creator Rockstar Games, for example, released the series' first downloadable content, entitled, *The Lost and the Damned*, to tremendous excitement and publicity this past February. Industry analyst Michael Pachter estimated that the add-on will receive two million downloads by the end of the year, representing sales over \$40 million. As other publishers make other blockbuster content available online, downloadable content will become a common term in even the most casual gamer's household.

Of course, this progress toward digital content raises concerns about theft, especially in a struggling economy. As a result, some individuals within the computer and video game industry are actively beginning to test what online distribution models would look like and mean for our business. Such a willingness to explore and take risks will not only protect our intellectual property rights for the future, but also reshape the interactive experience that video games offer the consumer. Among other changes, the new model would establish a direct link between consumers and the ideas and products that both large, established publishers and relatively small start-up companies have created.

For the ESA's part, we have recalibrated our dues categories and broadened our membership ranks to reflect and support the trend. Ideally, the changes we have made will bolster our industry's reputation as an entrepreneurial business where even small game publishers can

flourish and all can benefit from our efforts to serve our industry's business and public affairs needs.

Trion World Network, one of our newest members, publishes server-based games and original entertainment for online gamers. Under the leadership of Dr. Lars Buttler – who is here today and whom I congratulate for his company's innovative work – Trion has shown the capabilities and vision that likely will come to define a key segment of the modern video game marketplace.

Mobile gaming and in-game advertising, two simultaneously emerging trends, also stand to blossom from this seismic shift. With capabilities that allow for both game play and a variety of other functions, smartphones have positioned mobile devices as a legitimate fourth platform. With a low barrier to entry for application development, the increase in aspiring game developers should move the growth process along at a rapid pace. In fact, according to comScore, 8.5 million people downloaded a mobile game during the month of November 2008.

In-game advertising, meanwhile, has soared in popularity as organizations recognize the potential of a live, customizable channel that can target niche audiences. Keep in mind that an increasingly large number of the people who purchase our products no longer watch television programs on the network's schedule. Perhaps that's why in-game advertising has proven more effective than traditional TV ads; new technology has forced advertisers to identify new methods for reaching potential consumers – and voters.

Then-presidential candidate Barack Obama purchased advertising space within video games during his presidential campaign. Eighteen video games, including *Madden '09* and *Burnout Paradise*, featured Obama ads that reminded players about early voting dates and encouraged them to visit a campaign website to facilitate voter registration. In doing so, Obama became the first presidential candidate to use video games to engage voters and court their support. Others will inevitably follow.

Nielsen Media Research revealed that companies spent \$75 million in 2006 trying to reach customers through video games. Media analyst Screen Digest predicted in a report last month that, within five years time, in-game advertising will soar to a value of more than \$1 billion.

Yet, in order to maximize the potential that downloadable content, mobile gaming, in-game advertising, and other new opportunities afford, we will need continued support from two of our most powerful allies: the government and academia.

You may recall that Texas Governor Rick Perry delivered our keynote address last year, encouraging video game companies to relocate to the Lone Star State. A true advocate for the industry, he backed up his words over the past year. He proclaimed February 3 "Entertainment Software Day" in Texas. Then, in April, he supported State Senator Bob Deuell and Representative Dawwna Dukes in tripling the economic incentive programs in Texas for digital interactive media production.

And he is not alone in appreciating the value of our industry. A growing number of elected officials increasingly view incentives for video game companies as an essential component in any plan designed to revive a local economy. From Connecticut to Arizona, from Louisiana to Wisconsin, numerous states have witnessed our success and committed to helping us grow within their borders. This year, 18 states have actively considered legislation to create or significantly expand existing incentive programs for digital interactive media development and production. The states that are not being as proactive, risk falling behind their peers and missing out on the benefits the video game industry can provide.

Of course, there remain some in government who still seek to lay society's ills at our doorstep. We are vigilant in defending the interests of the video game ecosystem and we are expanding the Video Game Voters Network to play an increasingly vital role in cultivating advocates among elected officials and standing up for our Constitutional rights. I would encourage and challenge everyone in this room, and at the E3 Expo, to visit the lobby of the West Hall, where you can swipe your card to immediately join VGVN. You may also join at any time at www.videogamevoters.org.

Since 2006, VGVN members have sent nearly 74,000 letters, including 31,000 in the last fiscal year, to legislators in Congress and state capitols across the country. As a result, we have seen demonstrable proof that VGVN's powerful activism can stop a bad legislative proposal from becoming an even worse law. In Utah, for example, gamers stepped up, encouraging Governor Jon Huntsman to reject a piece of flawed legislation. The governor heeded their call and, in March, vetoed the bill.

This decision represented a great win for both gamers and the industry at large. For the first time, a governor vetoed legislation that would have profoundly affected video games, consumers and the industry. I felt enormously proud that day, and I believe that the VGVN will wield even more influence if we can continue to tap into the passionate video game base that dominates college campuses across the country.

After all, more than 200 U.S. colleges, universities, and technical schools, including Carnegie Mellon University, Massachusetts Institute of Technology, the University of Southern California, and Southern Methodist University now offer video game courses and degree programs.

The ESA Foundation has worked hard to encourage this trend, selecting 15 promising game development students to receive \$45,000 in scholarships. The students, from academic institutions across the country, are studying subjects that range from electronic game design to digital audio technology.

I hope that computer and video game companies of all types will follow the ESA Foundation's lead on this front, by making available additional scholarships, internships, and training programs that will support future jobs in our industry.

Last month, I had the privilege of delivering the commencement address at The Guildhall at SMU, to an entire class of graduates who eagerly await the opportunity to contribute to our industry. I can tell you first-hand that, even in a down economy, our industry will be in great shape if we can rely on such a smart, passionate group of young men and women.

While the marketplace "rules" present our industry with real challenges, the solid foundation that we have built over the last decade and the artistic and technical advances that are coming in the next decade leave absolutely no doubt about the future of this industry. We will proceed with tremendous passion and excitement – the entertainment industry leader that has consumers eagerly awaiting what will come next.

So, as you go to the show floor to learn about our industry's next line of creative and innovative products, I encourage you to be confident about our future. In these products, you will see why video games are on every screen in our society, from the PC to plasma, and stimulate every interest, from SAT preparation to sports to science fiction. You will see the bold experimentation and innovation that has empowered video games to transform entertainment around the world.

And you will be reminded that, as spectacular as our rise as an industry has been, our best, brightest, and boldest days still lie ahead.

Thank you.