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Microtransactions

Redefining Revenue in the Video Game Industry

Peter Christensen

Although the name microtransactions might sound like something out of the glossary of an economics textbook, microtransactions are a simple system with massive potential to help or hinder video game developers.

Microtransactions refer to in-game purchases of game currencies, items, or game-play boosts. They are a divisive topic among video game players because they often provide a gameplay advantage to *paying* players, leaving *non-paying* players at a severe disadvantage. Players who participate in microtransactions for in-game advantages are often referred to as pay-to-win (P2W) players. The most drastic examples of P2W players are sometimes jokingly referred to as “whales”, because they can squash higher-skilled opponents with the sheer amount of cash

they have spent on a game.

Players who do not participate in microtransactions because of principle or practicality are referred to as free-to-play (F2P) players.

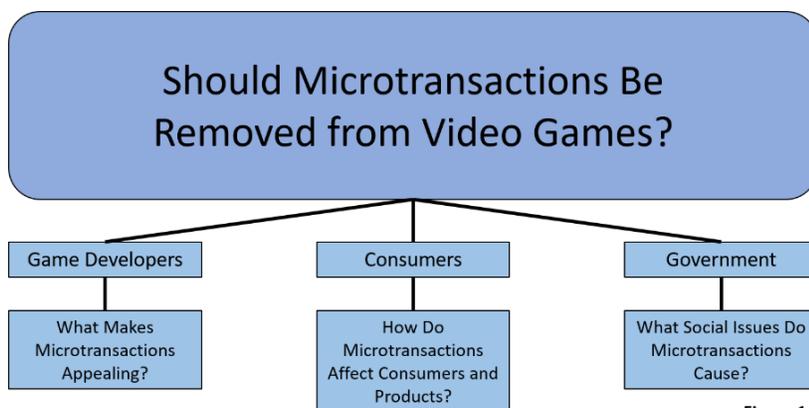


Figure 1

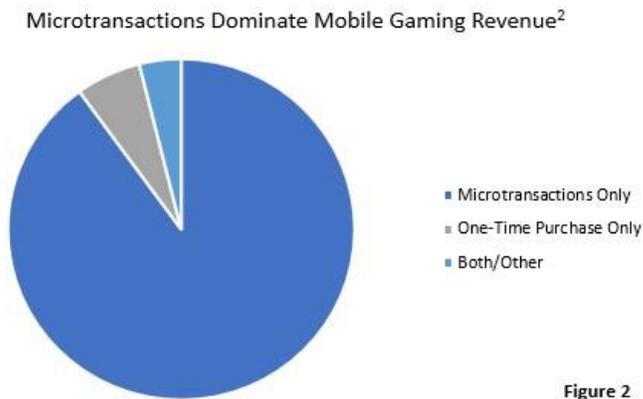
Because game developers, P2W players, F2P players, and outside agencies (such as governments) all have different

perspectives, it is impossible to speak about microtransactions without looking at the concept from each point of view. This article will address the questions seen in Figure 1.

Why Are Microtransactions Appealing to Game Developers?

The basic laws of economics dictate that a supplier of video games will not implement any feature that they do not believe will increase their profits. Especially in the gaming industry, profits rarely come easily. According to Matt McCaffrey, “The market is saturated, gamers have many alternatives, and attention spans (and thus, the shelf-lives of games) are growing shorter.”ⁱ The presence of aggressive competitors and substitutes makes earning a profit in the gaming industry far from certain, because even a great game is soon buried by an avalanche of new offerings pouring into the market.

Microtransactions are one of the solutions that video game developers have implemented to make a profit despite the saturated market. Microtransactions have met with resounding success as an alternative revenue source to game sales; many games are now available for download at no charge, relying exclusively on microtransactions for revenue.



According to data cited by Denis Lescop in his paper entitled “Exploring Mobile Gaming Revenues”, in 2013 developers of mobile games collected 90% of total revenues from “freemium” (free to download but featuring microtransactions) games, compared to a paltry 6.1% from games that required payment to download.

Figure 2

Figure 2 summarizes his findings.ⁱⁱ The same paper also identifies five “drivers of profitability” in the freemium model:

1. Maximize visibility
2. Offer free downloads
3. Use the “stress and release” model to addict players
4. Convert users into paying players
5. Cross-sell and up-sell products

In other words, mobile games make money by using specially-designed gameplay to convert F2P players into repeat customers.

Microtransactions allow game developers to tap into the financial resources of those most invested in a game and generate revenue long after a game’s release. Through microtransactions, developers earn revenue based on the number of customers actively playing a game, as opposed to the traditional system which rewards the quantity of new games sold. In addition to shifting the standard revenue model away from simply selling the most copies of a game, microtransactions have also changed the way that games operate.

In an article published in *Game Developer*, Soren Johnson makes the case that microtransactions are changing what constitutes effective game design. “In single-purchase games, designers rarely build a game mechanic that intentionally tests the player’s patience [in order to encourage the purchase of premium boosts]; in fact, that is a hallmark of bad game design. Thus, free-to-play games upend many of the assumptions that designers bring to the table from traditional single-purchase design.”ⁱⁱⁱ

How do Microtransactions Affect Consumers and Products?

The focus of game developers, however, extends only to the players most likely to participate in microtransactions. Because developers focus on profitable customers, F2P players are left feeling overlooked or marginalized. And their concerns are justified. Game developers simply have **zero** incentive to make a game enjoyable for those who don't pay to download nor pay for microtransactions.

The ability to get more money from those most interested in the game is a powerful incentive for developers to implement microtransactions, as is the long-term revenue stream that they provide. However, some microtransactions, particularly those that grant a competitive edge in the game, have taken flak from many avid video gamers. These dissatisfied customers believe that microtransactions attract P2W players, rewarding those with the deepest pockets over the players with the most skill or time invested.

Game developer Electronic Arts (EA) has become a scapegoat for F2P players dissatisfied with the P2W system. In the last quarter of 2017, EA released a sequel to the much-loved Star Wars Battlefront game. In the weeks leading up to the release, discontent surrounding Battlefront II's release grew, as developers revealed that many of the Star Wars franchise's most iconic characters, including Darth Vader and Luke Skywalker, would be available by microtransaction only. Gamers were outraged: Electronic Arts was charging a standard industry price for only a fraction of the total game content. Resistance to Battlefront II's microtransactions grew so stiff that EA canceled the microtransactions on the day before the release, and during the next month EA's shareholders lost approximately \$3.1 billion because of an 8.5% decrease in stock price, fueled primarily by controversy over Battlefront II.^{iv}

To avoid the stigma associated with catering too much to P2W players, some game developers have designed microtransactions that only change the appearance of the game, leaving gameplay unchanged. A great example of this type of microtransaction is the game League of Legends, which divides its purchases into game-related purchases, made with currency earned in the game, and aesthetic purchases, made with currency that can only be obtained via microtransactions.^v Aesthetic modifications are an excellent compromise between P2W and F2P players, because avid fans of the game are likely to purchase aesthetic content while more casual F2P players do not find themselves at a gameplay disadvantage.

What Social Issues do Microtransactions cause?

Microtransactions in gaming are quickly becoming a social issue as well as a business issue. "Loot box" systems, in which a player can buy randomized packages that contain items of

different rarities, are often singled out for criticism because of their resemblance to gambling. “The ability to use real world currency to pay for randomized content also carries important psychological and regulatory implications, especially relating to addiction and gambling.”^{vi}

In addition, evidence suggests that microtransactions, even for nonrandomized content, may be related to gambling addiction. A study published in the *Journal of Gambling Studies* analyzed the habits of players participating in social casino games. Social casino games are F2P games in which the player is given a starting number of credits with which to gamble. Many also provide additional credits over time, but at a slow rate, so that the player is incentivized to buy more credits through a microtransaction. The study showed that players who engage in microtransactions are more likely to be gamblers than those who did not, and gamblers who engage in microtransactions are more likely to be problem gamblers than those who play F2P.^{vii}

Another study, comprising over 7,000 participants, demonstrated a correlation between amount spent on loot box microtransactions and problem gambling.^{viii} However, whether microtransactions *are* gambling or are just *related* to gambling is still a matter of debate. Belgium classifies any loot box system in which boxes can be bought with real money as gambling. The Netherlands classify any loot box system in which the contents can be redeemed for real money as gambling. France, on the other hand, does not classify any kind of loot box system as gambling.^{ix}

Whether governments should regulate *all* microtransactions as stringently as gambling is dependent on future research. Current science can establish a correlation between some kinds of microtransactions and problem gambling, and more correlations will likely be discovered by future studies. Governments of every country should follow the example of Belgium by restricting all microtransactions to those of legal gambling age, until science discovers exactly which kinds of microtransactions are and are not related to gambling.

Microtransactions: Helpful or Costly?

The entrance of microtransactions into the video game industry has had major consequences for both game developers and game purchasers. To game developers, microtransactions have reshaped the industry’s revenue model, providing a way for developers to profit from a game for months or even years after the game is no longer sold. For consumers, microtransactions change the nature of games that are offered and hide a game’s true cost. Governments too have been affected: as research continues to link microtransactions with gambling, some governments have restricted microtransactions while others continue to deny that microtransactions can be classified as gambling.

Recall Figure 2 above. Microtransactions have become the *foundation* of mobile gaming profits. In an industry where releasing new games is the easiest way to make a profit,

microtransactions encourage developers to create games that not only sell well, but also hold the attention of the player for as long as possible. Indeed, microtransactions allow gamers to interact even more with the games that they love. However, while microtransactions support free-to-download games, they take away any incentive for game developers to listen to F2P players. The debate over microtransactions can be simplified to a debate between avid paying customers and F2P customers.

The best solution to the controversy surrounding microtransactions will leave both kinds of customers satisfied. It will allow game developers to remain profitable while not excluding F2P players from the newest and best options in the market. It will encourage gamers to make in-game purchases without exploiting those sensitive to problem gambling. It will incentivize the creation of even better offerings than what the video game market currently offers. While there is no solution that maximizes benefits for everyone in the market, there are options that have proven themselves better than others.

The current best method of implementing microtransactions is to offer aesthetic purchases only. Avid gamers will still make these purchases because of the pride that they take in their games. F2P players will not have any disadvantages from their choice to play for free. Game developers will still receive microtransaction income, albeit at a diminished level, and will also have an incentive to create even better games that cause more players to become invested and willing to make in-app purchases. They also reduce their risk of negative publicity from dissatisfied customers. Governments will be satisfied because purchasing character outfits is much less likely to turn into a gambling addiction than purchasing game performance.

While it would take a coordinated effort from corporations, gambling experts, professional esports players, and everyday F2P gamers, a law restricting microtransactions to aesthetic purchases only would provide at least some benefit for every member of the market for video games.

Notes

ⁱ Matt McCaffrey, "Microtransactions and Loot Boxes: Can the Video Game Industry Regulate Itself?," Mises, Last modified January 4, 2019, <https://mises.org/wire/microtransactions-and-loot-boxes-can-video-game-industry-regulate-itself>

ⁱⁱ Denis Lescop and Elena Lescop, "Exploring Mobile Gaming Revenues: The Price Tag of Impatience, Stress and Release," *Communications & Strategies* no. 94 (02, 2014), pp. 103-122,15

ⁱⁱⁱ Soren Johnson, "The End of Games?" *Game Developer* 18, no. 5 (05, 2011): 44.

^{iv}Tae Kim, "EA's Day of Reckoning Is Here After 'Star Wars' Game Uproar, \$3 Billion in Stock Value Wiped Out," CNBC, last modified November 29, 2017, <https://www.cnbc.com/2017/11/28/eas-day-of-reckoning-is-here-after-star-wars-game-uproar.html>

^v Lescop, "Exploring."

^MCaffrey, "Microtransactions"

^{vii} Hyoun S. Kim, Samantha Hollingshead, and Michael J. Wohl, "Who Spends Money to Play for Free? Identifying Who Makes Micro-Transactions on Social Casino Games (and Why)," *Journal of Gambling Studies* (Online) 33, no. 2 (06, 2017): 525-538. doi: <http://dx.doi.org.erl.lib.byu.edu/10.1007/s10899-016-9626-6>.

^{viii} David Zendle and Paul Cairns, "Video Game Loot Boxes Are Linked to Problem Gambling: Results of a Large-Scale Surve," *PLOS One* 13 no. 11 (2017): 1. <https://doi.org/10.1371/journal.pone.0206767>.
<https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0206767>

^{ix} Ibid.