

## **Final, 106T, Lec 1: Electronic Arts in Online Gaming (HBS 9-804-140)**

8-11am, Weds, 7<sup>th</sup> December 2011

Name:

ID:

TA:

### **Instructions:**

- You are allowed to bring in 10 single-sided pages of notes, and calculators.
- You can write on both sides of the paper, as needed.
- When answering, suppose you are an economic consultant. Your clients are not economists, so make sure to explain all terminology.
- I advise you to first scan the questions, read the case thoroughly (with notes), and then answer the questions.

### **Shorter Questions (5 points each = 25 points)**

**Question A.** The PS2 is a platform business. Identify the same-side and cross-side network effects.

**Question B.** What effect has the growth of online games had on consumers of the video game industry in terms of network effects, switching costs, and product differentiation?

**Question C.** Why do video game platform providers choose to sell their consoles at breakeven or loss-making prices, profiting instead from royalties charged to game publishers? For example, should a console maker put a \$5 tax on each video game and subsidize the console by \$50?

**Question D.** Currently most games are sold at \$60 with online play bundled for free. Would it be a good idea to unbundle these goods? For example, with a first-person shooter like Modern Warfare, the publisher could sell the single-player campaign for \$30 and the online multiplayer game for \$30.

**Question E:** When someone buys a game they don't immediately know the quality. How does a publisher influence the market's perceptions of quality?

## Longer Questions (75 points)

**Question 1 [20 points].** Microsoft's Xbox unit accrued a cumulative operating loss of \$3.5bn through mid 2004 (see Exhibit 12). Is this investment justified? Please use the data in the case to make your answer as concrete as possible.

**Question 2 [20 points].** Analyze the economics of exclusivity, i.e. an agreement that limits a game's availability to a single console. For the purposes of analysis, assume

(a) A game costs \$6m to produce and \$1m to port to each additional platform.

(b) A publisher sells a game for \$40, the console royalty is \$5, the manufacturing cost is \$2, the IP licensing is \$4 (e.g. EA pays FIFA for the brand name), the studio royalty is \$5 and marketing is \$4.

(c) If the game is not exclusive they sell 500,000 units with 75% share to PS2 and 12.5% share each to Xbox and Gamecube.

(d) If offered exclusively, a console maker's extra marketing push would result in 400,000 sales for PS2, or 100,000 for either Xbox or GameCube.

How much would a publisher demand from each platform provider to be exclusive? Why would Xbox ever purchase an exclusive title? Why doesn't Sony make all titles exclusive?

**Question 3 [20 points].** How do Sony and Microsoft differ in their approaches for managing relationships with third-party providers of online-enabled games? Why are their strategies so different? Is one strategy better?

**Question 4 [15 points].** In the dispute between EA and Microsoft, what were the main points of contention? What were the parties concerns? How important was EA to Microsoft (and vice versa)?