GameStop & Pre-Owned Software: An Analysis of the Used Video Game Market

Anthony Rogers
Matt Stuckey
04/24/07
EEP 142
GameStop Information

- 4,400 stores located throughout the US (and 15 other countries)
- Franchise employs 22,000 managers
- www.gamestop.com
- “Offers expansive selection of new products, knowledgeable associates, and value-added pre-owned products”
Fiscal 2006 full-year sales: $5.3 billion

“2006 was a remarkable year for GameStop. Total sales increased 72 percent, operating earnings grew by 73 percent, net earnings were up 57 percent, and comparable store sales increased 12 percent; by any retail measurement, a remarkable year. In addition, we finished the year with a strong balance sheet and a year end cash balance of over $650 million.”

--R. Richard Fontaine,
GameStop chairman and CEO
Used products made up almost 32 percent of the company's total retail sales and almost 44 percent of gross profit.

Gross profit margin on new software less than 25 percent, while profit margin 45 percent in used segment.
Horizontal Integration
GameStop Background

- 1983: Babbage’s (mall software retailer in Dallas, TX)
- 1994: Babbage’s merges with Software Etc. to become Babbage’s Etc.
- Fall 1996: Babbage’s Etc., facing bankruptcy, is acquired by Barnes & Noble
- 2000: Funco, Inc. (operator of FuncoLand stores) acquired by Barnes & Noble; all three restructured and named GameStop, Inc.
GameStop Background

- Fall 2004: GameStop becomes independent from Barnes & Noble
- Fall 2005: GameStop merges with EB Games; all stores to be renamed GameStop
- Winter 2007: GameStop Corp. officially purchases Rhino Video Games from Blockbuster
Horizontal Integration

- After EB merger, GameStop controls around 25 percent of the gaming market.
- This market also includes sale of new games, with competitors such as Wal-Mart and Best Buy (neither of which sell pre-owned games).
“...the used games business does not sound exciting until you look at the numbers. GameStop, which recently acquired Electronics Boutique to become the No. 2 video game retailer behind Wal-Mart, has made used games one of its pillars and that is a big reason its shares are up 89 percent since the beginning of last year; Electronic Arts shares are down 11 percent over the period.”

--Seth Schiesel, New York Times
Price Discrimination
Industry Price Discrimination

- Games industry as a whole utilizes a form of 3rd degree price discrimination
- Manufacturers charge full price to those insisting on being the first to try new games
- The price is then lowered over time to capture the consumers that value the product less
- Additionally, GameStop’s practices match the criteria for price discrimination
GameStop’s Price Discrimination

- GameStop’s prices for new games are set by MSRP; they have no market power.
- They do, however, have market power when it comes to used games.
- Their market power is unique, as it operates with a price ceiling in place (the price of used games cannot exceed new ones).
- This explains why there’s often a negligible ($5) difference between new and used games.
Gamestop’s Price Discrimination

- Resales are prevented via high transaction costs
- Lack of a unified place to find people to resell to and relatively low profit to be had
- Price discrimination practiced is 3rd degree, not 1st, as they’re unable to charge each person’s WTP
- Instead, consumers separated into 2 groups: those that pay full price, and those that buy the cheaper used games
Gamestop's total profit, therefore, is made up of the following equation:

$$\pi = [p_1(Q_1) - m_1]Q_1 + [p_2(Q_2) - m_2]Q_2$$

where

- $p_1 =$ price of new games
- $Q_1 =$ quantity of new games bought
- $m_1 =$ marginal + fixed costs of acquiring new games
- $p_2 =$ price of used games
- $Q_2 =$ quantity of used games bought
- $m_2 =$ marginal + fixed costs of acquiring used games
Field Research

- Super Paper Mario was released April 9th, 2007, at an MSRP of $49.99 (plus tax)
- GameStop buys new games with MSRP of $49.99 for $44.99 from developers
- The used price of that same game in a GameStop store is $44.99 (plus tax)
- As of April 23rd, GameStop buys used game for $30.00 in-store credit, or $24.00 (20% less) in cash
Final Fantasy XII was released October 31st, 2006, at an MSRP of $49.99, plus tax.

The used price of the game in a GameStop store is $44.99, plus tax.

Currently, GameStop offers a $15 in-store credit for the game, and $12 cash.

While eBay prices vary greatly, the average used price is ~ $25.00.
Other examples of P.D.

- Regular new/used prices offered online, while those that value time less and go into stores offered better deals
GameStop EB GAMES

IN-STORE SPECIALS

OFFERS VALID 4/20/07 THROUGH 4/26/07 WHILE SUPPLIES LAST

FREE ZUNE GEAR BAG!
WITH ZUNE PURCHASE
$39.99 VALUE

$249.99

BUY ZUNE HARDWARE (BLACK, WHITE, OR BROWN)
AND RECEIVE ZUNE GEAR BAG FREE!
OFFER EXPIRES 5/6 WHILE SUPPLIES LAST.

$29.99

SAVE $20!

HAPPY FEET

$19.99

SAVE $20!

CHICKEN LITTLE

SAVING $5!

$9.99

$14.99

$19.99

EXTRA 25%
TRADE-IN CREDIT

TRADE IN ANY 2 XBOX 360, PS2, DS, Wii, OR PS3 GAMES, GET AN EXTRA 25% TRADE-IN CREDIT

COUPON CODE: EBC3002003

25% OFF
ANY 2 USED GAMES

GET 25% OFF 2 USED GAMES WHEN YOU PURCHASE ANY USED OR REFURBISHED HARDWARE.

COUPON CODE: EBC3002011

ASSOCIATE INSTRUCTIONS
1. Customer must present coupons for discount.
2. Use coupon code provided.
3. Enter the coupon code in the SKU field when ringing a transaction.
4. Attach coupon to store receipt copy.
Other examples of P.D.

- “Edge Card” is a once a year fee that gives 10% off the price of used games
- This simultaneously rewards long-term loyalty and increases sales of used games
Gamestop’s Price Discrimination

- As with all price discrimination, the group with the higher elasticity of demand is charged the lower price (used games)
- GameStop is an unique example, however, in that they actually prefer getting people to pay that lower price
Future Trends

- Direct distribution options
  - CD keys
  - Online downloads
  - System recognition
- Others entering the market
  - Best Buy experimenting with used games in certain locations
Sources