**10.4 CASE STUDY: Zynga: Online Games Get Real**

The world’s fastest growing gaming company does not have top-of-the-line graphics, heart-pounding action, or masterful storytelling. It’s not a boys shoot ’em up or a girl’s dress-up game. It doesn’t make games for the Play-Station or Wii, and the most important tool in its arsenal may be its robust data analytics. The company is Zynga, and if you have a Facebook account, odds are you’re already aware of its most popular games. Zynga is one of many social companies that have brought together online gaming with social platforms. Since 2009, the social gaming industry has grown from nothing to over 70 million players in the United States alone. For marketers, these sizable audiences spell opportunity to sell virtual goods, collect information from players, display ads, and generate sales leads through coupons and special offers. One possibility would be for large consumer goods companies to sponsor contests, or even have branded goods for sale online. How about virtual Tide, or Crest tooth paste?

Zynga’s games on Facebook have over 230 million users, and in 2010, Zynga generated $600 million in revenue selling virtual goods, both “durables” like tractors and skyscrapers, and “non-durables” like clothing, and of course farm animals like chickens and cows. While the goods are virtual, the profits are real, to the tune of $91 million in 2010. Although Zynga is expanding to other social networks such as Google+, it remains heavily dependent on Facebook, where it is one of hundreds of businesses located almost exclusively on Facebook, and where it can directly appeal to Facebook’s estimated 800 million members worldwide.

Founded in 2007 by Mark Pincus and a group of other entrepreneurs, Zynga is the leading developer of social network games, such as CityVille, Texas HoldEm Poker, and FarmVille. These games, along with Zynga’s Empires & Allies game, are the four most frequently used applications on Facebook. Zynga’s games generate 3 terabytes of data every day. Since its inception, Zynga has made data analytics a priority for guiding the management of its games and the business decisions of the company. Zynga is not interested in individual user information, but instead in the trends displayed in the aggregated data it collects. The company relies heavily on its data to improve user retention and to increase collaboration among its gamers. Zynga uses a reporting team and an analytics team to work with the data and create concrete recommendations for increasing sales. Zynga’s analytics system is in reality a very sophisticated customer relationship management system. If a gold halo around a virtual angel’s head causes more purchases of virtual angels, then the change is made. Zynga’s audience demographics are perhaps not what you would think. Like most social games, the audience is slightly more female, older (average age is 46 years), and wealthier than console or other online gamers.

Zynga had planned on going forward with an initial public offering in 2010, but market volatility forced it to put those plans on hold. In June 2011, Zynga filed for its IPO, hoping to raise over $1 billion, with the company valued at about $10 billion. The IPO would have been approximately as large as the market capitalization (stock value) of Activision Blizzard and Electronic Arts, two of the biggest game publishers in the industry, put together. But once again, because of declining stock markets worldwide, the offering was delayed until next year.

Zynga’s business model is to offer free games aimed at a larger, more casual gaming audience, and to make money by selling “virtual goods” in games initially, and later by exploiting the advertising possibilities of the games. The idea of “free games” is a blow to the existing video game business that depends on selling video games. The idea of virtual goods has been around for years, most notably in Second Life and other virtual worlds, where users can buy apparel and accessories for their in-game avatars. But Zynga’s attention to detail and ability to glean important information from countless terabytes of data generated by its users on a daily basis has set it apart. For example, product managers of Zynga’s FishVille Facebook game discovered that players bought a certain type of fish, the “translucent anglerfish,” more frequently than the rest. Zynga began offering fish similar to the anglerfish for about $3 apiece, and FishVille players responded by buying many more fish than usual. Analytics have also shown that Zynga’s gamers tend to buy more in-game goods when they are offered as limited edition items. As a result of fine-tuning the games, Zynga sells about 38,000 virtual goods every second of operation.

Zynga also benefits from using Facebook as its game platform. When users install a Zynga application, they allow Zynga access to all of their profile information, including their names, genders, and lists of friends. Zynga then uses that information to determine what types of users are most likely to behave in certain ways. If Zynga updates its games, it sends messages to all your friends whether they play the game or not. By carefully analyzing the online behavior of its customers, Zynga hopes to determine which types of users are most likely to become “whales,” or big spenders that buy hundreds of dollars of virtual goods each month. Though only a small percentage of its active users contribute to its revenue, that subset of users is so dedicated that they account for nearly all of the company’s earnings.

Zynga’s games also make heavy use of Facebook’s social features. For example, in CityVille, users must find friends to fill fictional posts at their “City Hall” to successfully complete the structure. All of Zynga’s games have features like this, but Facebook hasn’t always fully supported all of Zynga’s efforts. Facebook apps were formerly able to send messages directly to Facebook members, but Facebook disabled the feature after complaints that it was a form of spam. Still, if your friends use Zynga’s Facebook apps, chances are you’ve seen advertisements encouraging you to play as well in your News Feed.

Zynga’s success has caused disruption in the video game industry. Traditional video game companies begin with an idea for a game that they hope players will buy and enjoy, and then make the game. Zynga begins with a game, but then studies data to determine how its players play, what types of players are most active, and what virtual goods players buy. Then, Zynga uses the data to change the game, and to encourage players to play longer, tell more friends, and buy even more goods. It’s a successful business model, and analysts are enamored with Zynga’s prospects to grow even bigger. But not everybody is thrilled with Zynga’s data-driven approach to making games. Many game industry veterans believe Zynga’s games are overly simplistic and have many of the same game elements. The company has also been the target of several lawsuits alleging that Zynga copied their games. And even developers within Zynga have sometimes bristled at the company’s prioritization of data analysis over creativity in game design.

No one knows the long term prospects of Zynga despite all the success it’s had to date. Zynga disclosed in September 2011 that the average life and value of its virtual goods is falling, and that users are churning more. If your primary business is virtual goods that people buy from makers and resellers, it does not look good if they decline in value to zero in a year’s time. What sells on Zynga is fashionable virtual goods, and what comes into fashion often goes quickly out of fashion. Like all games, users get tired of the game and quit. The average life span of a Zynga gamer has declined from 14 months to 9 months in 2011. There are competitors. For instance, Electronic Arts launched a free Facebook version of its classic game “The Sims.” The game now has 40 million active monthly players and was Facebook’s fastest growing app for much of 2011. Perhaps the biggest risk for Zynga is that it is still almost totally reliant on Facebook, to whom it pays 30% of all revenues from its games, including ad revenue, and has agreed to use Facebook credits as the sole means of payment by its users for the next five years. (Facebook credits is Facebook’s internal virtual payment system where users buy Facebook credits to pay vendors on Facebook. The credits are not good anywhere else on the Web.) The customer base is also very narrow, with the virtual goods revenues coming from only 5% of the users. Advertising currently produces less than 10% of Zynga’s revenues. In the last year, Zynga has been working to get its games on other platforms like Google+, Yahoo, and the iPhone and iPad in order to reduce its dependence on Facebook. It has also been working to expand its international presence. It is not clear if a social gaming company will ever achieve network effects where other competitors are unable to break into the market dominated by a single large firm. Instead, Zynga has many competitors with a chance to succeed.

**Case Study Questions**

1.

Do you think Zynga would be a good advertising platform? What kinds of companies would be interested in reaching this audience, and how should the ads be presented to users?

2.

How could firms use the Zynga platform to develop and sell branded virtual goods? Assume you were a manufacturer of sporting goods and wanted to use Zynga as a marketing platform. What concerns would you have about the Zynga platform? How would you use its social character to extend the reach of your campaign?

3.

How would you judge the competitive situation facing Zynga?

4.

What role does Zynga’s customer relationship management system have on its success to date? Why is it effective and what are its limitations?

**SOURCES:** “Testing the Durability of Zynga’s Virtual Business,” by Rolfe Winkler, *Wall Street Journal*, September 28, 2011; “Zynga Filing Shows Slowing Growth,” by Shayndi Raise and Randall Smith, *Wall Street Journal*, September 21, 2011; “Virtual Products, Real Profits,” *Wall Street Journal*, September 9, 2011, Jacquelyn Gavron; “Vertica: The Analytics Behind all the Zynga Games,” ReadWrite Enterprise, July 18, 2011; “Crikey! Zynga’s IPO By the Numbers,” by Mathew Lynley, VentureBeat, July 1, 2011; “Social Gaming,” by Paul Verna, eMarketer, January 2011. January 2011.