

# Case Study: The Dynamic History of Valve. From Game Developer to Console Manufacturer

## 1 Abstract

In this paper I am about to present the evolution of a relatively young company, Valve which has experienced **two adaptive cycles** in its short **17 years** of existence. The paper gives a brief insight of the company's history, highlighting all the major milestones, products and services. The paper mainly focuses on the process that made the company **from an average game development company** to a **digital market leader** and future **gaming console manufacturer**. The paper focuses on the actions that allowed Valve to overcome a serious crisis situation in the past and the most recent strategic move which hopefully will prevent a possible decline in the near future.

## 2 The Beginnings

### 2.1 The Birth of a Titan

Valve was founded in 1996 by two ex-Microsoft employees, Gabe Newell and Mike Harrington. They started out as an average game development company. Their first published game was released in 1998 gaining Valve huge recognition and big sales numbers. The company managed to earn a respectable position among the other PC game developers with different game titles and established a very strong fan base and modding community. [1]

### 2.2 Need for Change

Despite all the success, Valve was still **just one of the many game developer companies** following the same **old business model** that had been used by all the competitors with no differentiating factor. Selling copies of games on physical disks with no additional services or extra content. There were numerous obstacles that had to be overcome:

- The PC gaming market was in a huge competition with the **gaming consoles** (Nintendo, PlayStation and Xbox).
- The phenomena of **digital piracy** foreshadowed the future of the gaming industry.
- The size and complexity of the games, especially with all the fan created content, demanded more frequent and reliable **game updates**.

A new approach was needed to break away from the limitations and dangers of the status quo.

## 3 First step of innovation

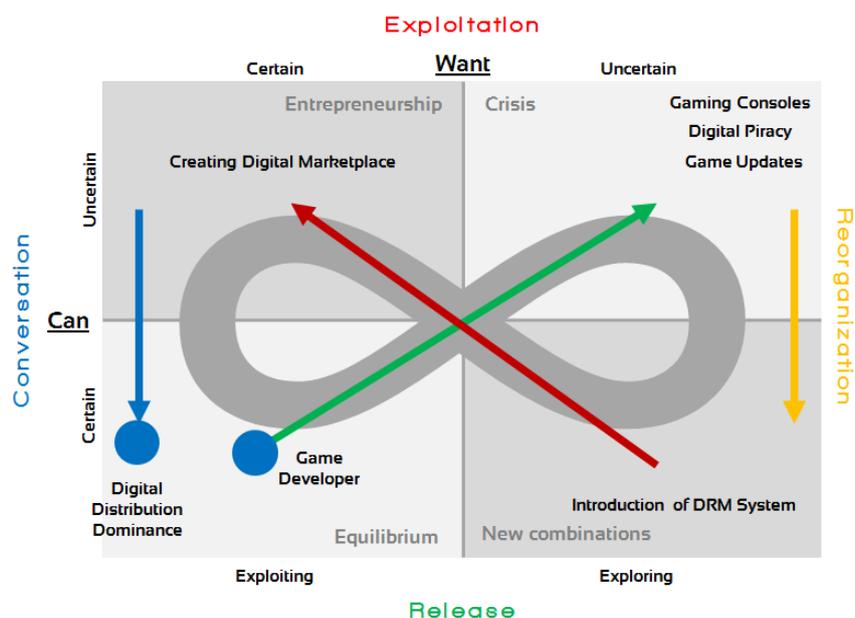
### 3.1 The creation of Steam

As it was mentioned in the previous chapter, the issue of illegal downloads and pirated copies created almost the same reaction in the gaming industry as in the music industry. The companies did not know how to approach the situation. The use of DRM and digital authentication received huge resistance from the users. A serious plan was needed.

Valve's answer to this situation was revolutionary. In 2003, the company launched its **digital distribution platform** called Steam. At the beginning, the purpose of the platform was to create a reliable and easy to use game update interface for all of Valve's online games. Although this was the initial role of Steam, Valve's hidden agenda was to keep the digital piracy to a minimum with an authentication and **DRM (Digital Rights Management) system**. In 2004, Valve announced that all of its games will use the Steam as authentication software from that point on. [1] Of course the customers did not like the idea of locking down the games to one user account only, removing the ability of trading used games. The whole model was too new for most of them. The success of the new approach was not guaranteed at all. The company took a great risk by introducing this system. **The possibility of alienating most of the users** posed a significant threat that Valve had to face. This is the point when the exploration phase of the first adaptive cycle started.

### 3.2 Creating a new equilibrium

The way Valve tackled the situation was to make the use of the highly anticipated sequel to their game, Half-Life only possible via Steam. In time, users accepted the new model and the expansion of Steam begun. From 2005 the evolution of Steam accelerated with the introduction of games from other developers and publishers. [1] A lot of people referred to Steam as the **iTunes of gaming** being the first truly online game marketplace where users could buy digital content fast and with ease. The accomplishment is even more remarkable if we realize that it was years before the appearance of the Apple App Store. The platform introduced new features and services from time to time like, cloud storing, achievement system, gamer profiles, Community Groups etc. Collaborating with more and more publishers and independent developers made **Steam the number one go-to place of PC game purchases**. Soon the platform became available for Mac and Linux operating systems as well making Steam the **dominant player in the digital game distribution market**. Of course new competitors appeared like Origin from Electronic Arts and GOG (although; GOG offers DRM free content) but Steam's position was not endangered.



1. Figure: First Adaptive Cycle

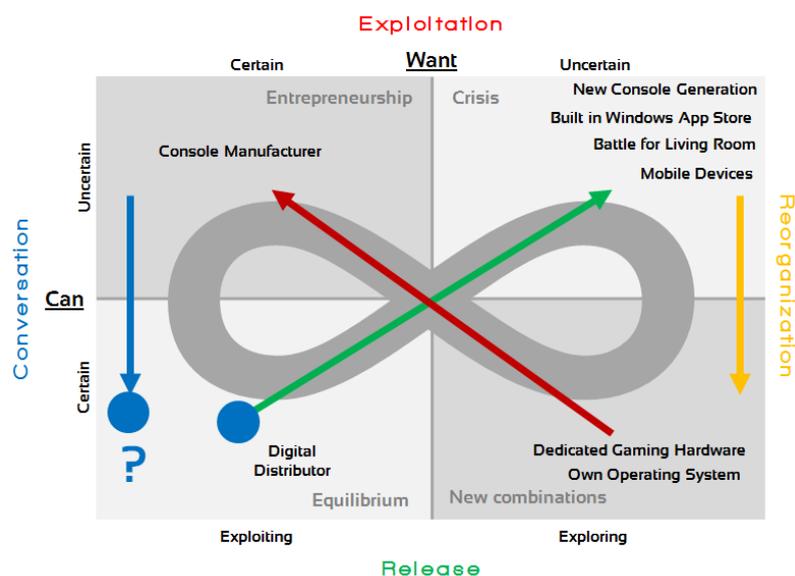
## 4 New challenges appear

### 4.1 Looking into the future

By 2013 Steam and Valve have become the **number one digital game distributor** with more than **2500 game titles** in the catalogue and **65 million accounts** in the desktop PC market. [2] Most of their revenue comes from games on the Windows operating system which makes them quite **dependent on Microsoft's platform**. With the constant decrease in PC sales, Valve needed to find a more stable foundation to its business model. The structure of the gaming marketplace has also changed a lot since the inception of Steam. As the company's CEO, Gabe Newell has stated, Windows 8 is a catastrophe for everyone in the PC market. Of course, we need to handle this statement with caution as it is absolutely biased. The new Windows 8 operating system with its **built in Windows App Store** is a potential threat to Steam's existing business model. Users are able to buy games directly from the operating system without the need of the Steam store. [3] Also more players appeared in the market. **Smartphones and tablets** created a new marketplace and the demand of handheld mobile gaming on smartphones attracts a lot of casual gamers from the "traditional" platforms. Valve realized this situation quite fast and started to work on a strategy that makes the company more independent and diverse in the coming years.

### 4.2 New approach

As the **new console generation emerges**, Valve has decided to make its boldest move since the introduction of Steam. Rather than reacting to a crisis, Valve is taking **preventive measures** to avoid a possible downfall. In 2013, the company announced its new **Steam Machines strategy**. They plan to make their own **dedicated gaming hardware**. Instead of making just one device, the plan is to release multiple machines with different specifications to cover a wider spectrum of the consumer market. The devices will be created by multiple manufacturers and all of them will run **Valve's own Linux based Steam OS**. With this strategy Valve clearly competes with the other gaming consoles in the **battle for the living room gaming**. The details of how exactly Valve plans to make the transition are not known yet but one thing is for sure, a new adaptive cycle has started. [4]



2. Figure: Second Adaptive Cycle

### 4.3 Possible Outcomes

Right now, nobody is sure about if this new strategy is the right path to follow. It has a lot of potential but there are certain aspects that cannot be unmentioned. These are the three most troubling factors that could mostly endanger Valve's new approach:

- Steam's current **catalogue is mostly Windows only** content. Making every game run on a Linux based platform is almost an impossible endeavor
- A significant amount of **people may not want an additional device** in their living room
- The **wide variety of machines** could be **confusing** for customers
- The **price** of the top-tier Steam Machines **could be way too high** [5]

Of course the new strategy also has a good chance to be successful in the long run. According to a survey **more gamers are willing to buy a new Steam Box** than a next generation console in the U. S. [6] This finding and other facts like the well established **brand recognition**, the **free multiplayer** option, the **upgradeable machines**, the large **gaming community**, the **shareable game library** all support the Steam Box's success. Overall, **Steam Box is still a PC** with all its pros and cons. The only difference is that by default it runs the Steam OS and it is in the living room. A good sign for Valve is that by **2013, PC** has become the **number one gaming platform in the U.S.** gaining **51%** of market share. [6]

## 5 Conclusion

Valve's journey shows us that a creatively thinking and agile company can effectively tackle even the direst circumstances. **Realizing the situation in time** and **acting quickly** were the two main reasons why the company managed to reach the place it is now. Although the future of the company is not certain, it has the potential to continue its success story. **Right now**, Valve is at the **reorganization phase** of its second adaptive cycle. There is little information about how the new combinations will be implemented. However, the next couple of years are going to be exciting, not just for Valve but for the whole gaming industry as well.

## 6 References

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