

## CHAPTER ONE: MARKETING IN THE MODERN FIRM

Microsoft Xbox: Does it have the "X factor" to beat Sony & Nintendo?

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Microsoft launched its much vaunted games console, the Xbox to much fanfare with the catchphrase of "Play More", last March in the UK. The Xbox is the most powerful games console ever. Built to the highest of technological specifications. Microsoft is taking the might of Nintendo and Sony with a \$500 million dollar global marketing campaign to muscle into this industry. It wants a slice of the video games industry, worth an estimated \$26.5 billion dollars according to Goldman Sachs, which is comparable to worldwide cinema box office earnings and music sales. Console and hardware sales alone, nearly account for 33% (8.7 billion) of the market in 2002. In addition, blockbuster games like "Tomraider" can bring in sales of between \$200m to \$300m, showing the industry's lucrative nature.

Games have been transformed over the past last two decades; visuals have come along way from Atari's Pong and Pac-Man. Now games possesses photo-realism, astonishing 3D graphics, accompanied by Dolby Digital bombastic surround sound. The gaming industry is characterised by a five-year cycles, where a games consoles has roughly a five year lifecycle before being replaced with a new and improved technological hardware. Many industry giants have come and gone in this very competitive area. The pioneering Atari had enormous financial difficulties in the mid eighties, and went out of business. Sega with their all-conquering "Sonic the Hedgehog" and Sega Megadrive have retrenched from the games console market concentrating on being only a games developer. In 1999, they launched their Sega Dreamcast machine, the most powerful console of its time and with an online capability, spending a huge marketing budget, even sponsoring the Arsenal football team. However, they failed to displace the marketing dominance of Sony, as games addicts held off on hardware purchases until the launch of Sony's Playstation 2. So why has Microsoft entered an arena when so many others have failed?

The industry is characterised by a five-year cycle, where hardware would be developed and then surpassed by a technological development five years later, making the hardware obsolescent. Hardware is usually launched with a handful of games titles, as it takes games developers roughly between one or two years to launch titles, therefore a glut of games usually are launched during this period. After this five year cycle ends the next generation of consoles are launched, with advanced technological features, usually faster processing speeds or larger memory, similar to the PC industry. Figure 1 illustrates past video games consoles and their product lifecycle.

**Figure 1: A Brief History of Games Consoles**

<u>Launched</u>	<u>Game Console</u>
1977	Atari Video Computer System (VCS)
1982	Sinclair Spectrum
1984	Commodore 64
1985	Nintendo Entertainment System (NES)
1986	Commodore Amiga
1989	Nintendo Gameboy
1989	Sega Megadrive
1995	Sony Playstation
1995	Sega Saturn
1996	Nintendo 64
1999	Sega Dreamcast
2000	Sony Playstation 2 (PS2)
2002	Nintendo Gamecube

Traditionally the games industry has been seen as a focused towards children. However many games are targeted towards adults. Games developers are even launching titles with 18 certificates, banning under age children and teenagers from buying these titles. For example the infamous 18 cert game "Grand Theft Auto 3", where players take the role of a violent criminal and are rewarded for robbing, shooting and killing people, was one of the biggest ever sellers for the Playstation 2 platform. Game developers are increasingly using movie licensing deals, to bolster sales, with movies tie ins such as James Bond, Harry Potter, & Lord of the Rings. Further licensing deals include sports organisations such as NFL, F I F A and third parties such as author Tom Clancy.

**Figure 2 - Some interesting facts on the gaming industry**

60% of Americans play video games
61% of those gamers are adults
43% are women
28 is the average age of gamers

Microsoft dominants in its core markets of operating systems and desktop application software, with near monopoly status and power. Its revenues and profits have been healthy and steady. However PC software is not going to grow continually like it has over the past decade. Microsoft now has to look for new avenues of future growth for the company. They decided that the video gaming industry was this avenue for future growth. The company poured millions of money into the development of their Xbox. A games console, the most sophisticated ever released, that could play DVD's and the piece de resistance possessed broadband gaming capability. Broadband is a high-speed network connection that allows for real time Internet gaming and the ultra quick downloading of software, games and films through a broadband connection. This is the real reason why Microsoft entered the games console industry. It hopes to use the Xbox and its future incarnations as a platform for other Microsoft products to be distributed through and gain subscription fees from subscribers to this broadband gaming network. The company sells its game console at a loss, hoping to build a large customer base of future potential subscribers and make money from licensing arrangements with games developers. The manufacturers really make their money through the amount of games sold, not the hardware. For every Xbox game developed, Microsoft receives a licensing fee from the games developer.

However Microsoft is facing one of the strongest challenges it has ever faced, strong competitors. Two hardened veterans of past game console wars: Sony and Nintendo.

Launched in March 2002, Microsoft has been faced with sluggish sales and extra competition with the launch of Nintendo's Gamecube. Microsoft slashed prices of the Xbox to boost sales, dropping its price from £299 to £199. Only 3.5 million of the Xbox games consoles were sold, compared to Sony's PS2 30 million units (11.3 million sold in the US, 9.9 million sold in Japan/Asia & 8.8 million sold in Europe). Sony launched their Playstation 2 (PS2) in Nov. 2000 in Europe, getting a good head start on their competitors' next generation of consoles. Sony launched their console with a relative poor suite of opening games, however the consoles backward compatibility (ie. its ability to play old Playstation 1 games) proved a major draw. Microsoft launched their console in March 2002, with small of selection of blockbuster games, such as Halo. However less than three months after launch, Microsoft is embroiled in a bitter price war, with industry stalwart Sony reducing its price of its consoles, controllers, memory cards and some of its games titles. This price cut showed the Japanese company's clear intention of fighting ferociously for the market dominance it has achieved. This is due to the fact that 60% of Sony's total profits are dependent on Playstation business. It repeated the same tactic when launching the Playstation 1 in 1995, when it competed against Nintendo and Sega. Furthermore, Nintendo cut the price of its machine from £170 to £129, before it was even launched in the UK, five days after Xbox announced their console's price was being reduced from £299 to £199. Microsoft has a very tough fight on its hands.

Table 1 Comparison of the Key Players

	Microsoft Xbox	Sony Playstation 2	Nintendo Gamecube
Specification	An Intel 733MHz processor, the most powerful CPU of any console	128-bit console with Emotion Engine processor 295 MHz processor	485MHz custom CPU with 162MHz custom graphics processor
DVD Playback	Yes (Playback kit required)	Yes	No
Broadband Capability	Yes	Capacity for future modem/broadband connection	Capacity for future modem/broadband connection
Key Features	An internal hard drive, for massive storage of game information	Backwards-compatible with Playstation 1 games	Compatibility with Game Boy Advance
Key Games Titles	Halo, Oddworld Munch's Oddysee Project Gotham Racing Dead or Alive 3	Metal Solid Gear 2 Medal of Honour Grand Theft Auto 3 Gran Turismo	Star Wars Rogue Leader, Resident Evil, Super Mario Sunshine Zelda
Available Since	March 2002	Nov 2000	May 2002
Price	£ 199	£ 199	£ 129

The New York Times has reported that Microsoft Xbox consoles have slipped into third place behind Nintendo's Gamecube. Playstation 2 has sold more than 30m units, Nintendo Gamecube has sold around 4m, with Microsoft's Xbox 3.5m. In addition, Microsoft is said to be performing very badly in the key Japanese market. Datamonitor forecasts that revenue from games will grow by 22% above last year. Sony has upped the pressure on Microsoft by recently announcing a strategic alliance with AOL, the Internet service provider. The companies are jointly trying to exploit the PS2 interactive features, enabling gamers to browse the net, play games online and email through their games console. Microsoft has similarly set up alliances with other companies, such as telecoms companies and even veterans of past games wars, Sega. Sega dropped production of the ailing Dreamcast games console in 2001, plans to publish titles for Xbox. Microsoft claim that they will have launched nearly 200 Xbox games in the US by the end 2002 and 10 online games will be available, with more to come.

All of the games consoles are sold at a loss. Manufacturers hope to make profits from licensing and royalties from game software titles in the future. Microsoft is pinning much of its hopes on "Xbox Live", where it intends to invest \$2 billion dollars into online gaming. Microsoft believes this capability will provide the killer application, which will entice customers towards the Xbox. Users of the "Xbox Live" will be able to go online and play their games online against people from around the world. Microsoft has publicised the fact that its machine is broadband ready, where gamers can link online, play against one another and compete in online tournaments etc. However analysts have questioned their rationale, as the majority of European households are not broadband ready, with only 4% ready and with broadband penetration rising slowly over the next five years. Microsoft has planned to spend over USD\$2 billion over the next five years to develop Xbox Live, as an online gaming platform. Cynics have questioned the viability of this initiative as to why have Microsoft placed so much resources into this area. They argue that there is lack of broadband infrastructure and that there are question marks over future revenue streams. Will gamers pay for this service?

The system will allow all gamers to talk to each other while competing online. Users obtain a unique login, a password and then access to Xbox Live compatible games and buddy lists, where they can interact with friends online. It will be first launched in the United States where Xbox live set will cost \$49.95. Users will pay a monthly subscription fee of \$10, on top of the monthly fees they already pay for broadband access. This price covers a year's subscription and an Xbox communicator that allows gamers to interact with other gamers. Microsoft views this as a long-term investment in the future, trying to build a subscriber base for the next generation of console.

When Bill Gates approved the Xbox in the autumn of 1999, he was told that the console could lose between \$900 million to \$3.3 billion dependent if Sony undertake a price war. To another company, this investment would seem lunacy, however Microsoft has deep pockets with an estimated \$42 billion in cash reserves and making \$10 billion profits annually. Microsoft is estimated to be currently losing at least \$150 on every box, which is probably more when shipping, advertising, development overhead costs are factored in. Much in the same way razors are sold below cost and their costs are hopefully recouped in the future purchase of replacement blades. The industry sells their consoles at below cost, hoping to gain their money back on the sale of games for the consoles, which typically sell for £40. For every game sold the console makers make roughly £8 in the form of licensing fees. Microsoft are trying to reduce costs aggressively, moving production and assembly of the box from low cost Hungary to even lower cost China and negotiating with suppliers to reduce costs for component parts. Microsoft is learning about the harsh realities of hardware production, the videogames industry and the costs associated, it is primarily a software company after all.

## QUESTIONS

1. How can Microsoft create customer value with Xbox?

2. Discuss what you believe to be the key success factors of launching a games console, using the marketing mix 4P framework?
3. Identify what you believe to be the key weaknesses of the Microsoft Xbox business model, if any?

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