

News Item #3

Matthew Yi, "*X Marks the Box in Parry to Sony, Microsoft Introduces New Game Console*," San Francisco Chronicle, Monday, November 21, 2005.

Discussion:

In its current release of Xbox 360, Microsoft uses versioning to price its new generation of game consoles. There are two versions of Xbox 360 systems Microsoft offers. The high-end version, priced at \$399, includes a wireless game controller, a headset, a DVD remote control, and a 20-GB removable hard drive. The low-end version, which is \$100 less expensive, has only a wired game controller. It does not come with a headset, a DVD remote control and a hard drive, which are included in the high-end version. Without a hard drive, gamers cannot save their places in games. Users can buy a hard drive for \$99.99. A cheaper alternative will be to install a memory card, which costs \$39.99. Price-sensitive consumers may choose the low-end version to save some dollars. Consumers with a higher willingness to pay can buy the high-end version for the additional features.

Microsoft also has a similar pricing strategy for Xbox live, which is a complementary online service to Xbox systems. It allows gamers to download new levels in games, play with other gamers, and voice-chat while playing. Users who value online multiplayer gaming can buy a gold membership for \$8 per month or \$70 per year. A silver membership is also available for those who do not want to pay for the service, but it gives limited access to online content.

Such versioning strategy enables Microsoft to effectively divide the market into different segments and let consumers self-select into the suitable market segment according to their willingness to pay. As a result, Microsoft can attract more customers and earn more profits through price discrimination.

[X marks the box](#)

[In parry to Sony, Microsoft introduces new game console](#)

- [Matthew Yi, Chronicle Staff Writer](#)

Monday, November 21, 2005



The next generation of video game wars kicks off Tuesday when Microsoft unveils its Xbox 360, a powerful new console that the software giant hopes can unseat Sony as the industry's dominant hardware maker.

This might sound familiar, of course. A similar battle was fought about five years ago and will be fought again in the future.

In the last round, Sony was the clear winner. The market research firm IDC predicts that by the end of this year, Sony will have sold 89 million PlayStation 2 units, while Microsoft will move 23.7 million Xbox units and Nintendo 20.6 million GameCubes.

Those numbers also mean that the Xbox business remains drenched in red ink, unable to recoup billions of dollars in investments.

Microsoft is hoping for far different results this time.

Unlike the last round, when Xbox came out nearly two years after PlayStation 2 and months after GameCube, Microsoft is hoping to gain a quick advantage by being the first to market in this round.

Sony has said its PlayStation 3 will be in stores next spring, while Nintendo's Revolution is expected to go on sale in the second half of next year.

Console makers are promising more powerful systems that will lead to more realistic graphics, as well as much-improved artificial intelligence.

Digital battle

While claiming a bigger piece of the more than \$20 billion video game market remains a key goal for the Redmond, Wash., tech giant, its new console also represents a larger battle with Sony and others for the heart of the living room.

With the advent of increasingly consumer-friendly gadgets such as iPods and TiVos, digital entertainment has become a key growth opportunity for technology firms.

Leveraging those gadgets, and combining them with the Internet and television, is the industry's holy grail. In the case of Microsoft and other tech giants, getting into the living room, which is already dominated by consumer electronics giants like Sony, Samsung and Panasonic, hasn't been easy.

Microsoft has "tried the Web TV thing and the MSN TV thing, and they tried the Xbox thing, and it's the Xbox thing that stuck and stuck best," said Jon Peddie, an analyst at Jon Peddie Research in San Rafael.

However, even that assessment is clouded by the fact that Microsoft's first Xbox wasn't able to turn a profit. That will have to change, said David Reed, director of platform marketing for Microsoft's Xbox division.

"We've announced publicly that the Xbox business will get Microsoft-scale profits," Reed said. "We're talking billions. We're not here to break even."

Also, Xbox 360 is aiming to be more than just a video game player, he said.

The console has the ability to connect to a PC to stream music to the living room or display photos stored on the hard drive.

And if the PC has Microsoft's Media Center Edition operating system, the console can also receive video feeds, including live TV, as well as shows that have been recorded on the PC.

"It is part of an overall Microsoft strategy," Reed said. "I would characterize (Xbox) 360 ... as an amplifier for the living room."

Games at its peak

But for now, he said, Microsoft plans to focus its message on gaming.

"We have a knob for (marketing) games and a knob for (marketing) digital entertainment," Reed said. "Right now, the knob for games is almost at the max. ... The knob for (digital entertainment) is turned up, but not at the max. Over time and in different places, those knobs will change."

Analysts believe that strategy does make sense, because consumers, who either preordered their systems through retailers or might wait in line starting tonight to grab the console, will probably be hard-core gamers.

Also, the \$399 and \$299 price tags for the two varieties of Xbox 360 systems may be too expensive to appeal to the mass market, analysts say.

Still, the expectation is that the units will be in short supply. A Microsoft executive recently told Wall Street analysts that the firm expects to ship between 2.75 million to 3 million units by the end of this year, representing roughly \$1.5 billion in retail sales. By the end of its fiscal year, which is June 30, Microsoft expects to ship as many as 5 million units.

The numbers may look sizable, but considering that Microsoft will be selling them in the United States, Europe and Japan this holiday season, some gamers may be disappointed because of short supply, analysts say.

"We've got two plants in China at full capacity, cranking," Reed said. "Of course, we would like to have two to three times more units than what we'll get."

Reed also said he expects that most of the units sold this holiday season will be the \$399 version, which includes a wireless game controller, headset, a DVD remote control and a 20-GB removable hard drive.

The \$299 version, called the Xbox 360 Core System, includes a wired game controller. However, it lacks a headset, a DVD remote control and a hard drive. No hard drive also means gamers can't save their place in games. A hard drive can be purchased for \$99, but a less-expensive option might be memory cards. Microsoft plans to sell 64-MB cards for \$39.99.

Other accessories include a wireless network adapter and a universal media remote control.

Voice-chat option

Microsoft will also expand Xbox Live, the firm's online initiative, which so far has 2 million subscribers who download new levels in games, play with other gamers and can

voice-chat while playing.

Now, Xbox Live will have two levels of service. The silver membership is free to all Xbox 360 owners but gives limited access to online content.

If gamers want to participate in things like multiplayer games, they will have to pay for a gold membership (\$8 per month or \$70 for a year).

But the key to winning the hearts and minds of gamers is software, analysts say.

"I'm still not convinced that the content is there," said Michael Pachter, an analyst at Wedbush Morgan Securities. "I think the (first batch of) content will be eye-opening and beautiful, but I don't think it will be that different in terms of game play. I just don't think game developers had enough time to work with the new console."

There is a steep learning curve for developers designing games for new machines, and it may take a year or two for them to fully take advantage of the power of the hardware, he said.

Still, Microsoft's Reed and some game-publisher executives say it is a huge accomplishment to have 18 titles ready to go on sale at the same time as the console. The list includes titles from familiar franchises such as Madden NFL 06 and Tony Hawk's American Wasteland to new games such as Sega's *Condemned: Criminal Origins*.

Electronic Arts, the world's largest game publisher, looks to lead the pack.

"By our estimation, it's the largest launch that we've supported for any console," said John Schappert, a senior vice president at the Redwood City company. "We started making teams for next-generation games over two years ago."

While Microsoft plans to sell games developed by its studios at the usual \$49.99, many third-party game publishers have said they will sell their titles at \$59.99. That higher price reflects the rising cost of making games, which some estimate will double for the new game consoles to more than \$10 million.

"It's a necessity to see return on our investment now," said Simon Jeffery, president of Sega's U.S. operations.

Xbox 360

CPU: Micro chip with three cores, each running 3.2 GHz

Graphics: Custom ATI chip running 500 MHz

3 USB 2.0 ports

2 memory card slots

DVD/CD: compatible with most DVD and CD formats

Accessories: one wireless controller, headset with microphone, DVD remote control, 20-GB removable hard-disk drive

Price: \$399

Xbox 360 Core System

Same specifications as above

Accessories: One wired controller

Price: \$299

Additional accessories you might think about: wireless controller (\$49.99); wired controller (\$39.99); wireless network adapter (\$99.99); 64-MB memory card (\$39.99); universal media remote control (\$29.99); headset with microphone (\$19.99); face plates (\$19.99)

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