Weekly insight: Game industry starts a price war
Commentary by Sandra Sieber, IESE professor: Game consoles: the business is in the software

WEEKLY INSIGHT
Game industry starts a price war
Sony, Microsoft and Nintendo have launched new campaigns in the game console war, with the main weapons this time involving online gaming and price cuts. All the major game consoles--PS2, GameCube and Xbox--now stand at $199 apiece. Will that bring video gaming to a more mainstream audience? (From News.com) [Full Story]

Highlights
- According to IDG Analysis forecasts, the console market will continue to be dominated by Sony’s Playstation 2, with 29% of the market share in US and 34.93% in Europe. Microsoft Xbox will reach 19% of users in US and 12.7% in the Old Continent. In Nintendo’s GameCube case, the console will be used by a modest 5.4% of US users and a more numerous 10.36% of Europeans.
- In order to cope with the price war, the main players in the game market are starting to reduce manufacturing costs. For instance, Microsoft will help pay for the price cut by shifting assembly of the Xbox to China. The company announced it would shut down the Xbox assembly plant in Hungary, run by contract manufacturer Flextronics, late this year and move production to a Flextronics plant in Doumen, China. Sony is exploring the Chinese market to do so too.
- The convergence of videogames and the Internet continues, with 60 percent of gaming households
showing high interest levels in online gaming, according to a report by International Data Corp. (IDC).

- The video game sector is very popular in Spain, with a 22.5% audience, followed by France and the UK (21.2% and 19.3%) in March.

Press Review
From Business Week
"In the game industry, content rules. No matter how technologically advanced a console may be, it's doomed without enticing game titles. For that reason, Sony, Microsoft, and Nintendo are expected to woo top developers to their own platform by giving creators a better deal. Sony has just announced it would reduce by a third--from $2.25 to $1.50--the unit price it charges developers to produce a game disk for the PlayStation. Also, Sony offered to reduce its royalties, what it collects from the sale of each $50 game title, by up to 25%.

(...) Still, the business is wildly unpredictable. Publishers may crank up sales, but games for the new 128-bit consoles that deliver complex 3-D graphics are increasingly expensive to develop. Back in the days of 8-bit and 16-bit machines, in the late 1980s and early '90s, developers spent an average of several months and several hundred thousand dollars to develop a title. Today, it takes two years and costs $10 million."

[Full Story]

From New York Times
"Analysts say Microsoft’s price advantage in Japan could be short-lived as Sony and Nintendo could launch a new cycle of cuts. The next is likely to come from Nintendo, which has so far boasted a competitive price. Lisa Spicer, analyst at ING, expects Nintendo to slash the U.S. price of GameCube to $149 from $199 and the Japanese price to 20,000 yen from the current 25,000 yen.

(...) While hardware makers are at each others' throats, software creators are expected to benefit because of the increased expectations for the size of the hardware market. "This means that people will buy a couple more software titles with the discount they got," said Yuta Sakurai, senior analyst, Nomura Securities. Hit software titles are key elements for game console makers, but even on that front, Microsoft has a lot to do. Kazumi Kitaue, executive corporate officer of software maker Konami Corp, said the price cuts alone would not convince his company to make more exclusives for Microsoft’s game machine."

[Full Story] (A free subscription is required)

From News.com
"Financially, Microsoft has the most to lose from price cuts. The PlayStation 2 has been on the market for almost two years and has sold more than 30 million units worldwide, giving Sony plenty of time to rein in production costs. Sony executives said late last year that they had reached the break-even point on PS2 hardware. Xbox, on the other hand, has been available for less than six months and has been fairly expensive to manufacture from the start, owing to components such as a built-in hard drive."

[Full Story]

Commentary by...
Sandra Sieber, IESE professor

Game consoles: the business is in the software
The game console price battle is basically due to two reasons. Firstly, the video-console is the complementary hardware to what the client really values: games. In these situations companies tend to sacrifice the margins of the lasting good in exchange for safeguarding revenue streams from consumables, in this case, videogames.

However, in consoles, there is a second reason that boosts a still harder price competition: Microsoft’s
interest in finding a place in a market where it has had very little presence up until today. It’s necessary to understand Microsoft’s movement towards the games sector in the context of computing. Traditionally, hardware makers (such as Compaq, HP or IBM) have lived the commoditization of its products thanks to the fact that the differential value of the PC (ready to use) is not perceived for its hardware but for the installed software, which in practice means Windows and Office. Therefore, while hardware vendors’ margins are negligible, Microsoft appropriates the generated value in the sector through its software, which enjoys wide margins.

On the other hand, at present video-consoles have stopped being standalone devices to become online gaming systems. For that reason, they may be considered a new way of connecting to the Internet, which constitutes a serious threat to the dominant player in the computer arena.

With this outlook, Microsoft’s resolute entrance into this already competitive market doesn’t surprise anyone. Although Sony was the first to make a move, it was Microsoft’s Xbox price cut that has toughened the price war in the games marketplace.

For industry vendors, it is an attack strategy planned to propel software sales. For Redmond’s giant, the operation has got clear connotations of defence. Microsoft is trying to occupy an emerging market –that of the videogames- in order to avoid being diluted in a business —software linked to PCs— that could weaken. This price battle is just another one in the great war of Internet revenue streams. The one who controls the access platform will rule over the operating system and the software, and with them, the Net users.

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**EBCENTER ARTICLE**

Companies move from the New Economy to the Now Economy  
Eduard Guiu Research Assistant, ebcenter

IBM, Microsoft and Sun are vesting huge amounts of money in order to take the lead in Web Services, the new environment meant to become the support for all kind of entrepreneurial activities, rebaptised as the Now Economy. [Full Story]

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**REPORTS**

Internet, present in major life moments  
Title: Use of the Internet at Major Life Moments  
Source: Pew Internet & American Life Project  
Date: May 2002  
Abstract: In a survey of 1,415 Internet users in January 2002, Pew Internet & American Life Project asked whether they had used Internet in their major events or decisions in the past two years. Their responses showed that for **14 million American surfers** Internet was crucial in getting more education or training for their career and in **purchasing cars**. For **11 million users**, the Net was very important in **choosing a school or college** for themselves or a child. **Nine million American users** surfed before **making a major financial or investment decision**, while **eight million internauts** did it before **changing their jobs** or **finding new places to live**.

The Internet played a lesser role in romantic relationships. Modest proportions of our respondents reported that the Internet was a vital player when they started relationships (2 million people), ended relationships (2 million people), or got married (1 million people).

To conclude, the Internet is relatively more important in episodes where the abundance of information online is especially helpful, where the activity is focused on learning new material on a complex subject, and where the ability to compare information is especially significant. [Full Story]

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8.8% of Europeans use Internet every day  
Title: Europeans’ participation in cultural activities
Source: European Union
Date: April 2002
Abstract: The European Union has elaborated a special barometer about the cultural activities of European citizens. The survey highlights that a majority of Europeans (53.3%) does not use a computer. This is specially the case in Greece (75.3%) and Portugal (74.7%). On the other hand, more than one fifth (22.5%) use a PC every day. This proportion reaches 36.7% in Sweden, 36.6% in Denmark and 32.2% in the Netherlands. A smaller proportion (14%) use one several times a week.

With regard to the Internet, 34.5% of those interviewed surf the Net: 13.5% several times a week and another 8.8% every day. The Internet is used more by the Swedes (66.5%), the Danes (59.4%), the Dutch (53.8%) and the Finns (51.4%) than other Europeans. On the other hand, the proportion of Internet usage is lowest in Portugal and Greece (14.8% and 15.1% respectively). Europeans use the Internet most frequently for exchanging e-mails with their family, friends or colleagues (57.8%), searching for information on a specific product (41.5%) or work (40.3%). Other uses are searching for educational material and documents (37%) and for information on sports or leisure activities (33.2%) and for preparing or considering a holiday by searching for places to visit, accommodation, etc. (30.8%). [Full Story]

Spain, the most interested in online videogames
Title: Video Games on the Internet
Source: NetValue
Date: May 8, 2002
Abstract: The video game sector is very popular in Spain, with a 22.5% audience, followed by France and the UK (21.2% and 19.3%). This is one of the major findings of a NetValue survey about the video game sector, which includes information and sales sites as well as online gaming. Although it is not the only reason, the success of the video games in Spain is not surprising when we consider the age range of the Internet population: 14/24 year olds account for 34,3% of the Spanish Internet users (compared to 24.5 % in Denmark for example).

With a total of 10.9%, French Internet users are the first to connect to e-commerce sites. The English come second with 8.3% and the Danes third with 4.9%. [Full Story]

One in four users will use Instant Messaging in 2007
Title: Mobile Messaging’s Next Generation
Source: Forrester Research
Date: May 13, 2002
Abstract: SMS still dominates messaging, but instant messaging (IM) has found its niche. On the other hand, EMS (enhanced messaging service) fails. These are the major findings of a Forrester Research survey about e-messaging. The survey highlights that EMS and MMS (Multimedia Messaging) will cannibalise 10% of SMS traffic over the next five years, but 6 billion messages of incremental traffic will raise messaging revenue to 25 billion in 2007, a 42% increase on 2002. Contrary to operator belief that IM has no market, one in six European mobile users use IM on PCs today. In 2007, one in four users will send IM messages regularly. IM users will drive massive traffic, sending 50 messages per month on average in 2002 and IM will contribute 19% of all traffic and 10% of revenues. Only one in five mobile users will use EMS regularly. [Full Story]

COMPANIES
Napster to file for bankruptcy
Napster was poised to file for bankruptcy protection after the company rejected a $15 million (£10.4 million) rescue bid from Bertelsmann, the German media group. Napster’s problems came to a head late after Shawn Fanning, the college drop-out who founded the company three years ago, and Konrad Hilbers,
chief executive, suddenly resigned after Bertelsmann’s offer. The site is still closed, despite the company receiving more than one million hits a month from hopeful users. From *The Times*. [Full Story]

**Microsoft has problems with licenses**
Although companies have until July 31 to sign up for the Microsoft software program, one-third of businesses will not do it, and another one-third of businesses are undecided.
One year ago, Microsoft announced a radical change in the way that businesses buy its software: rather than simply being able to upgrade their software when they wanted to—and when their budgets allowed them—companies would have to commit to buying operating-system and application upgrades ahead of time through an annual fee. Microsoft customers can decline the plan, but they will lose out on discounts. From *News.com*. [Full Story]

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**WE RECOMMEND**

**10 fatal errors in management**
A bad economy and market turbulence are important, but Fortune states that most companies founder for one simple reason: managerial error. The magazine has classified these errors in ten categories from the observation of failures of companies that have appeared in the Fortune 500. *Being softened by success* is the first error. A number of studies show that people are less likely to make optimal decisions after prolonged periods of success. *Seeing no evil* is the second one. *Fearing the boss more than the competition*, *overdosing on risk* and the *acquisition lust* are other errors. It’s not a good decision to *listen to Wall Street more than to employees*, neither is it good to *use a strategy du jour*, or allow a *dangerous corporate culture*. Experts don’t forget the *new-economy death spiral* in which a lot of companies failed. Last, many enterprises fail because of a *dysfunctional board*. From *Fortune*. [Full Story]

**Broadband, an online media lifeboat?**
For Internet media’s true believers, nothing is harder to swallow than the demise of the advertising-based business model. The latest evidence of misplaced optimism is the widespread conviction that broadband will attract enough viewers to Web sites and generate enough page views to make the CPM-based model profitable.
Despite these grim tidings, the deployment of broadband may permit the development of new business models. In the entertainment sector, three in particular could be viable in the near term. The first of them is *selling and delivering non-interactive digital entertainment*. According to the firm, music and video could prove lucrative if companies offered higher quality and greater selection to compete. *Expanding the market for fee-based on-line gaming* and *marketing off-line entertainment* are the other two models. From *McKinsey Quarterly*. [Full Story] (A free subscription is required)

**The historical roots of technofobia**
"The VCR," said Jack Valenti, the chairman of the Motion Picture Association of America in 1984, "is to the American film producer and the American public as the Boston strangler is to a woman home alone." This is one of the most memorable lines in the history of technophobia. Curiously, courts have been reluctant to outlaw the new gizmos, leaving plaintiffs to reach some accommodation with the innovators. More recently, however, the courts have been far more disposed to side with content owners.
Business 2.0 reviews the conflicts produced during the past century, such as the music industry against *player pianos* in 1908 or against *radios* in 1931, or the book publishers claiming against *photocopiers* in 1968. In 1984, it was the movie industry that reported *VCRs*, giving rise to the sentence that heads this abstract. From *Business 2.0*. [Full Story]