

# gaming | industry | news

## STATE OF THE INDUSTRY

Last holiday season, the videogame industry was filled with hubris. It was as if the people selling videogames were taking their cues from characters in the *Grand Theft Auto* series. A year later, the pendulum has swung hard to the other side. "Everything is fine in the game business except for one thing," a regional buyer for one of the country's largest electronics chains said during Columbus Day weekend. What's that one thing? "We're all gonna die," he said.

Then he laughed. "I don't really mean that," he went on, "but this is going to be tough when you compare it to last year." Indeed, analysts have come to a consensus that 2002 was the peak of the current hardware cycle. Buyers and analysts tell us that PlayStation 2 console sales are down more than one-third off 2002's torrid pace. Xbox sales are also down, though less so, and the only reason GameCube sales are looking up, at least in the short term, is because Nintendo just cut its price by one-third. There isn't much buzz about holiday games (with the revitalized *Prince of Persia* one of a handful of huge exceptions). Retailers and analysts predict good things for the usual suspects—such as the *Grand Theft Auto* combo packs for PS2 and Xbox, the latest *Lord of the Rings* game from Electronic Arts, and *SOCOM II*—but some of the season's most highly anticipated games, like *Half-Life 2*, have seen their ship dates slip to next year.

It's bad, analysts agree, but it's only "we're all gonna die" bad if you compare it to last year. Those who appreciated that last year's holiday season was a once-in-a-cycle event knew this was coming. As this holiday buying season hits high gear, you don't see many gaming executives dressing as Santa Claus. As Electronic Arts CFO Warren Jenson puts it, "There's going to be some road kill. There are going to be people who are not going to make it." Hardware and software sales trends are troubling, and

it's extremely unlikely that the holiday season will meet high early-in-the-year expectations, which analysts are now lowering—again. Early-year expectations of modest growth have been replaced by sobering sales figures: NPD Funworld reports that, despite being the leader in console sales, PS2 sales last month were down 37.6 percent from the year before. Total hardware sales are down 16 percent from one year ago. Software sales are somewhat more encouraging, in part because September was packed with new releases. Leading that charge is, of course, EA, which just announced that net revenue is up 17 percent compared to the same quarter last year.

The industry is entering a period of consolidation. Vivendi Universal Games, left out of its parent company's NBC deal, needs a new owner if it's going to thrive even in more modest form. VU's plight is symptomatic of many software houses: It had to cancel a long-promised Tolkien-estate-licensed *Lord of the Rings* game in part because it would have been up against a movie-licensed omniplatform *Return of the King* juggernaut to which EA has the luxury of devoting more than 100 people. Competing against EA in videogames is becoming like competing against Microsoft in PC software.

VU is far from alone. Eidos is abandoning development for the moribund GameCube, but it has problems of its own, changing in-house development groups in hopes of saving its sagging Lara Croft franchise, a once-great brand smacked down by lousy games and lousy movies. Nintendo's GameCube problems have been offset by its Game Boy monopoly, but the handheld-gaming business is about to get much more competitive thanks to Nokia, Sony, and others. There are still some sure things in the business—*Enter the Matrix* shows there are some brands so strong that even ragged gameplay and a host of high-profile bugs can't hold them back. But, for the most

part, this is an industry at a crossroads, just beginning to confront such enormous challenges as generating successful online business models and getting the most out of the remainder of the current console cycle.

An industry at a crossroads is an industry that needs an authoritative source of information and analysis. Ziff Davis Media's *Gaming Industry News* aims to be that source. This monthly newsletter, complemented by weekly e-mail updates, will look closely at the crucial issues facing the industry and both their long- and short-term ramifications. *Gaming Industry News* is intended to give readers the tools you need to succeed in a business that is full of more trash-talking, surprise, and opportunity every day. Thank you for joining us. ■

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# Who Should Buy Vivendi Games?

We look at the possibilities and suggest the best new owner

Earlier this month, Vivendi Universal announced that its VU Games unit was no longer for sale. Don't believe it. The former utility company sold Houghton Mifflin late last year to a consortium of private investment funds after company officials publicly indicated it was not for sale. And unlike the Vivendi music division, also said to be withdrawn from possible sale, the games business, although consolidating, is experiencing nothing similar to the free fall afflicting the music business.

We spoke to analysts, competitors, and Vivendi executives current and departed. All but one agreed that VU Games is still very much on the market, although the current offers for the division, reportedly ranging from \$700 million to \$900 million, are less than the \$1 billion the French newspaper *Les Echos* reports the current management is asking for.

Two executives familiar with the negotiations confirmed that VU Games' suitors have included strategic investors, other game companies, and at least one combination of the two. These potential acquirers have been brought in by different Vivendi entities—some by the North American division, some by its international headquarters—and one executive tells us, “North America and international are each desperate to bring in their own team because each side thinks that if they bring in the buyer, they will be in control.”

Those at VU's corporate office in France say not to compare VU Games to Houghton Mifflin. “We had to sell assets very quickly then,” one source says. “We were struggling for life. There's no liquidity crunch now, so we're in no rush.”

Nonetheless, it's a tough season for most game makers, and Vivendi corporate has given every indication of wanting to reduce its remaining debt by shedding the media properties associated with the era of former chief executive Jean-Marie Messier. A sale even at a reduced price would put a dent in the company's debt, which current chief executive Jean-Rene Fourtou has estimated

will be in excess of \$5 billion next year—even after the transfer of many of its entertainment assets to General Electric is complete.

So, who would want VU Games? Here are the predictions we're hearing:

■ **It won't happen right away.** Rumors run rampant that large job cuts are coming, and it's unclear whether those layoffs will bring with them a shift in internal structure. If current costs are high, why not wait for the current owners to deal with them first, as is inevitable?

■ **VU Games may follow the lead of VU corporate.** Just as Vivendi is selling sundry assets to different buyers in the hope that doing so will generate more cash, VU Games will look for its strongest properties to perform best separately. Blizzard, home of *WarCraft* and *Diablo*, was frequently mentioned as a division that “would be the subject of a bidding war,” as was Sierra Entertainment. Both EA and Microsoft are reported to have indicated their interest, so that bidding war may be underway already. Perhaps this is what Fourtou means when he hedges that VU Games isn't for sale, but he is still pursuing “strategic maneuvers.”

■ **If it does go as a unit, don't assume a game company will be the buyer.** If Vivendi wants to quickly get out of the videogame business altogether, it will sell to an investment group that will sell off the bits and pieces itself. The presence of Blizzard and a handful of other key assets raises the valuation of the whole unit.

■ **One way or another, Electronic Arts wins.** The powerhouse knows how to maintain franchises (see related story, page 5). As one VU Games exec puts it, “We got the reputation of releasing a lot of buggy, mediocre games because nothing was allowed to bake.” Although EA looks at each quarter as obsessively as any other game company, with a \$15 billion market cap, it has more freedom than any other major player (except Microsoft) to digest

## WHY VIVENDI KILLED BILL

The biggest action movie this month, in terms of both buzz and box office, is the first installment of Quentin Tarantino's *Kill Bill*. Most big-budget action films nowadays arrive hand in hand with big-budget videogames, but not *Kill Bill*, despite Black Label Games, a division of VU Games, having signed a deal last year to make and market one. Tarantino's core fans—young adult males with a love for violent entertainment and junk culture—are exactly the sort of people who pay \$50 for videogames. Why is there no game for them?

According to two sources at VU Games, the decision to build the game was vetoed by a “new corporate green-light system.” Despite the demographic match, the execs up top “simply did not believe that a *Kill Bill* game made sense for the company. It's just another example of the new centralized structure making it difficult for the individual studios to go about their business without getting micromanaged. You want to know why there's no *Kill Bill* game? It's because corporate wants everything at the company to be top-down. They want control.” If so, they'd better extend that control to the *vugames.com* website, where *Kill Bill* is still listed as a Q2 2004 release. A company spokesperson was terse on the topic, saying nothing beyond, “I can confirm that our company does not have a game in development at this time.”

and make sense out of Vivendi's many brands—either one division or a whole, either directly from VU Games or via an investment group—and then not let a game out of the oven until it's done. ■

# Not a Sure Thing

Bundling games with hardware can help both sides, but choose your partner carefully **By Dean Takahashi**

You'd expect THQ Chief Executive Officer Brian Farrell to like bundling. His company, after all, has scored deals with both Sony and Microsoft in which his games will be distributed with every PlayStation 2 (Combo Pack version) and Xbox sold this holiday season. (Sony is bundling *ATV Offroad Fury 2*, while Microsoft is distributing *Tetris Worlds*.) You'd expect consumers to like bundles, too: It gives them a free game without increasing the price of the hardware.

Indeed, bundles can be a good deal for publishers. James Lin, an analyst at the Simba Group, says publishers accept anywhere from \$1 to \$5 per bundled unit to include their games with consoles. With new games, the fee can reach \$20 per unit. THQ's Farrell says that bundles are attractive to publishers because they generate close to the net proceeds that the publisher would have received selling the game at retail. After factoring in retailer's profit, console royalties, cost of manufacturing, marketing, and shipping, perhaps \$5 profit remains on a \$20 game. Plus, there is no risk of returns, which typically accounts for 2 percent of retail product.

Farrell declined to say how much THQ will receive in the Sony and Microsoft deals, although he countered Lin's assertion that \$5 per unit was the top of the usual bundling range, saying it was more like \$7.

For the console makers, the right bundle can open new markets. Mitch Koch, vice president of retail sales and marketing for Xbox, says Microsoft wants to expand the reach of its Xbox console to casual gamers. So, for its bundle, it chose titles that appealed to broader audiences.

## NINTENDO BUNDLE LOSES SALES

Nintendo didn't benefit when it bundled a free game with its GameCube console during the spring and summer. Retailers felt that including *The Legend of Zelda: The Wind Waker* in the bundle hurt sales of *Zelda* because the game was a hit that would have sold well without bundling.

Meanwhile, GameCube console sales stagnated and Nintendo had to call an embarrassing halt to GameCube production in August. Only when Nintendo cut the price of the console to \$99 did console sales pick up again—although even that didn't stop Nintendo from having to reinstitute the *Zelda* bundle.

Why did Nintendo go forward with a bundle that hurt *Zelda* sales? George Harrison, senior vice president of marketing at Nintendo of America, says the company needed a promotion to lift console sales, so it introduced the first bundle of a free game in February. In May, it added a free *Zelda* game, and in June it added a Game Boy Player option. Those promotions, he said, let Nintendo postpone the foreseeable console price cut until the fall. It was a defensive move, intended not to lift console sales but to hold off for a season an inevitable price cut for the third-place console.

When it comes to bundles, hardware makers can suffer at the hands of software makers. Graphics-chip maker ATI thought it had scored big when it announced it had paid \$6 million to bundle Valve's *Half-Life 2* with its new DirectX 9.0-compliant graphics chips.

Shortly after ATI announced the deal, Valve admitted that the game would be late, and, even worse, hackers had broken into Valve's computers and stolen the code for the game, which soon appeared on the Web. (The game still would have been late without the theft.)

ATI said it would offer a coupon in the box that buyers could use to get the game at a later date. Valve, however, indicated that the game would be delayed as long as seven months. To make the wait easier for consumers, ATI is making a number of other Valve games available, including several iterations of the original *Half-Life*. The lesson of this bundle for ATI: You may think you're hitching yourself to a rocket, but you don't have control over when—or if—your product will take off. ■

## SIX BIG QUESTIONS

SIMON JEFFERY, LUCASARTS

Each month in *Gaming Industry News*, we'll ask an industry insider six big questions about where the business is going. This month, we turn to Simon Jeffery, who just stepped down as president of LucasArts.

### Q: WHAT IS THE HOTTEST TREND COMING UP IN GAMES RIGHT NOW?

Quality finally being introduced into IP gaming. EA and Activision are rewriting the rules here, and it's no bad thing. To really hit mass market, the industry needs every "game of the movie" to be as good as the movie property itself.

### Q: What trend has peaked, but people don't really know it yet?

Wireless gaming.

### Q: What will it take for online and wireless games to go mainstream?

A few more games like *Star Wars Galaxies* are about to be what takes MMOs to the masses. But why people are so excited about wireless gaming is simply beyond me. Today's gamer is sophisticated and demanding. Wireless gaming is neither.

### Q: How should game companies behave differently in the latter part of a console cycle than they did early on and at the peak?

They won't. Just sit back and watch. Many will make the same mistakes, and there will be blood on the walls. We will, however, see reduced risk: less creativity, more licensed product, and near-100-percent reuse of existing engines.

### Q: How can companies keep costs down on game development without shifting all the work to Belarus?

Games are beginning to cost too much to build, and one day, the business model will stop making sense for all but a small minority. The economics of game development and publishing have to be re-evaluated at pretty much every level.

### Q: You've had the opportunity to shepherd one of the great brands of our generation.

What would you recommend to game developers trying to maintain a strong long-term brand – and what would you tell those starting with a new wanna-be brand?

Focus on quality and the right genre. We learned a lot at LucasArts over the last few years about what does and doesn't work in IP gaming. We learned that even though the industry thought *Star Wars* gaming was dead, if you build the right product in the right genre, gamers will buy in huge numbers.

# Will the U.S. Game Industry Be Fried by the French?

In the first of a series on how various governments are helping or hurting their local game industries, we visit Marseille **By John Gaudiosi**

Traditionally, Paris has been the center of the French gaming business, much as California has been the U.S. gaming headquarters. But things are changing, thanks in large part to the provincial government of Marseille. With more than \$3.5 billion (3 billion euros) invested, redevelopment of Marseille's port began five years ago, turning run-down warehouses into state-of-the-art modern office buildings in a 766-acre section of town. It's the biggest economic development project in France. The Belle de Mai Media Center opened this fall, offering 300,000 square feet of office space, half of which is dedicated to videogame, Internet, and multimedia companies.

"So many media companies today are using the same technologies for film and TV as they use in videogames that it makes strategic sense to bring all of these industries under one roof," said Philippe Stefanini, director of the Euromediterranean Project, the entity overseeing the revamping of the port district. "Videogames are a good, strong link between TV and film production and multimedia talent."

The Marseille government is making the area attractive by offering a variety of tax incentives and monetary assistance. A regional development grant offers a company \$12,635 (11,000 euros) per job created. SME Development Fund investment grants, which apply to any company with fewer

than 250 employees, support one-third of the costs of start-up investment. A training subsidy covers 50 percent of the training costs for employees for up to three months. Each company is also assigned, at no charge, a project manager, who will help with all the necessary arrangements from local networking to moving.

Companies are already taking advantage of these incentives. European videogame publisher LSP (Light and Shadow Productions), which makes licensed games based on Vivendi's *Sitting Ducks* and the animated *Mummy* series, as well as the PC version of Namco's *Dead to Rights*, recently moved its headquarters from Paris to

## SWEET EXPORT

France accounts for only 5 percent of the world's videogame consumers, but the country's game publishers (such as Vivendi Universal, Ubisoft, Atari, Titus, and LSP) sell 20 percent of the world's games.

the subsidies, French game companies continue to build studios outside of France. Ubisoft recently used a studio in China to do a low-cost porting of *Splinter Cell* (from Xbox to PS2), and we have seen a rise in studios from former Soviet Union countries, where costs can be significantly lower than France and other western countries."

## A REGIONAL DEVELOPMENT GRANT OFFERS A COMPANY \$12,635 PER JOB CREATED.

Marseille. The provincial grants and investor incentives helped the company raise \$5 million while lowering its operating costs by two-thirds by moving its operation to Marseille.

### COST IS THE ENEMY

"Anything that helps publishers lower the cost of game development through subsidy or use of studios in low-labor-cost regions is a good thing for the game industry, not just in the U.S., but worldwide—provided that the quality of the games is high enough," said Simon Price, analyst for International Development Group. "The key problem in game development for current- and future-generation platforms is the rapidly increasing cost of content creation. As long as truly talented developers with the ability to create games for global markets can be encouraged to thrive in Marseille, the game industry will welcome the opportunity to take advantage of the talent pool."

UBS videogame analyst Mike Wallace isn't so optimistic. He notes, "Even with

French game makers still face cultural hurdles separating them from the U.S. and U.K. markets. Aside from Ubisoft's *Rayman* franchise, few French-developed games have succeeded outside of Europe. "What you've seen in the U.S. from French game developers is a small fraction of the games made here, because the gameplay wasn't good enough for the U.S. and U.K. markets," said Stephane Baudet, head of Lyon-based (and Atari-owned) Eden Studios.

France won't be another Japan quite yet. Japanese developers have been successful in the U.S. and U.K., despite the linguistic barrier, because they have been able to prosper in a large domestic market, with the most exportable Japanese titles migrating to the West. France doesn't have that built-in market. But the influx of money and new talent into Marseille could start to bridge the cultural gap that has kept French developers from breaking into the North American marketplace. At the very least, Marseille's experiment is a model other local governments may wish to consider. ■

## BLIZZARD TOSSES CHEATERS

- Number of *WarCraft III* accounts closed for cheating: 12,000
- Number of *Diablo II* accounts closed for cheating: 13,000
- Number of CD keys banned from Battle.net for one month: 7,000
- Number of CD keys banned from Battle.net permanently: 1,000

Source: Blizzard

# What's in a License?

EA makes licensed franchises last **By John Gaudiosi**

When the latest installment in a game franchise moves 2 million units and grosses \$100 million during the first three weeks of its release, you know the company behind it knows how to sustain a brand. Electronic Arts did just that with *Madden NFL 2004*. A look at what EA is doing with Hollywood licenses for *Harry Potter* and *The Lord of the Rings* shows that the company makes franchises last by developing each one in a unique manner.

"Electronic Arts looks at every movie deal they make as a multi-title license that it can exploit as a game franchise," says P.J. McNealy, an analyst at the American Technology Research. "This November's *Harry Potter: Quidditch World Cup* is an interesting example of how to use an element of a movie license to grow the franchise in a year when no movie is hitting theaters."

By signing the multiyear licensing agreement for both the *Harry Potter* books and movies, EA has been able to develop games without relying on the films' actors or assets. The company has sold nearly 5 million units of *Harry Potter and the Sorcerer's Stone* and *Harry Potter and the Chamber of Secrets* in the United States alone since fall 2001, according to the NPD Group. This approach is particularly appropriate, since the child actors in the films are getting older and will be replaced midseries.

## WHEN TO USE THE ACTORS

Taking a different approach with *The Lord of the Rings* movie license, EA utilized the actors' likenesses and voices, as well as the soundtrack and digital assets from the films to completely obliterate Vivendi Universal's *The Lord of the Rings* games, which were based on J.R.R. Tolkien's literary works. EA's *The Two Towers* outsold Vivendi's *The Fellowship of the Ring* 1.8 million to 750,000 across all platforms in the United States. (This may have played a role in Vivendi's recent decision to remove one of its Tolkien titles from its fall lineup.) And EA is readying a movie-related title for release next year, even though there's no new movie coming out.

"There's more art than science in mixing the right blend of gameplay, game design, and a Hollywood license," says John Taylor, an analyst at Arcadia Research. "But when you find the right combination of license, audience, and gameplay, you can create an upside boost."

A strong Hollywood license, like *The Matrix*, can propel even a roundly slammed game, like *Enter the Matrix*, into the stratosphere. Despite nasty reviews, the game has sold more than 1.5 million units in the United States and another million copies worldwide. By the end of the year, analysts expect Atari to sell all of the 4 million units it has shipped. Although, some predict it will take discounting to get there, and one can argue that a *Matrix*-licensed game should sell far better—and it would have, had it been a better game. By the time *Madden NFL 2005* hits stores next August, EA is likely to have sold 4 million units of this year's installment at \$50 a game. Once a licensed game proves it has staying power, it's hard to knock it from its perch—unless, as with *Lara Croft*, it has been subjected to a series of increasingly lame sequels. Ask Sega, whose ESPN-branded football game has scored more enthusiastic reviews than EA's *Madden* but has sold far less. Perhaps only *Madden*'s death could hurt this franchise—and one suspects EA is working on a plan to deal with that, too.

## EA REVEALS ITS SECRETS

How can EA do all this? "With a huge team," says Neil Young, vice president and executive in charge of production at EA, whose main responsibility over the past few years has been managing the *Lord of the Rings* business. "The team I managed for *Return of the King* was 30 to 40 percent larger than the *Two Towers* team, which was itself twice as large as any other project team I worked with. Once we understand the center of a game, we deploy resources to maintain quality and hit a release window. Other companies think license is all that matters and then underinvest on development. We overinvest. In the long term, deploying all those resources will mean customers will associ-

ate *Lord of the Rings* and EA with quality, and that's the way to keep the game franchise alive even after the movies are over."

Young maintains, "You have to think of every game as a potential franchise. The only reason to move on after one game is if it wasn't successful enough to want to make a sequel." ■

### EDITOR-IN-CHIEF

Jimmy Guterman

Jimmy\_Guterman@ziffdavis.com

### ZIFF DAVIS MEDIA

500 UNICORN PARK DRIVE

WOBURN, MA 01801

781-938-2639

**ART DIRECTOR:** Jason Babler

**COPY DESK:** Tom Edwards, Greg Ford,  
Maritza Refuerzo

**PRODUCTION:** Carlos Lugo, Michele  
Manousos, Anne Marie Miguel

**CIRCULATION DIRECTOR:** Chris Wilkes  
Chris\_Wilkes@ziffdavis.com

### ZIFF DAVIS GAME GROUP

**SENIOR VICE PRESIDENT:** Dale Strang

**PUBLISHER:** Lee Uniacke

**EDITORIAL DIRECTOR:** John Davison

**BUSINESS DIRECTOR:** Cathy Bendoff

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# Does PSX Matter?

It's not a gaming device, but it does pit the two leading console makers against one another in another arena

All Sony wants to do next year is kill Microsoft.

Last month's unveiling of Sony's PSX prototype—a digital video recorder plus gaming machine—shows that the company is running hard against Microsoft, which in September released another version of its media PC. Neither device is primarily a gaming box, but PSX in particular gives the gaming industry a hint of what the next generation of converged devices, if not the next generation of consoles, will look like.

For the gaming business, PSX is a curious piece of hardware. It's too expensive to be marketed as a game console, but if you add up the value of its various components (recordable DVD, television tuner, large internal hard disk, PS2, and TiVo functionality), it's quite a bargain for those high-end consumers who would have bought the components separately (see accompanying box).

That's a relatively small market, though, and analysts fell over themselves the day of the PSX announcement to say it's too expensive for the masses. There was also a chorus stating PSX would create confusion because it does not fall into any existing home-entertainment category.

All this would be problematic if Sony were intent on world domination through the first-generation PSX.

But this Swiss Army knife of a home-entertainment device is clearly intended to educate those looking for the next big thing

in consumer electronics. In time, Sony will make sure consumers learn what it does. As a northeastern Best Buy buyer put it, "Right now, it's the same old stuff on our shelves: last year's components at a lower price. The PSX has a shot at opening new lines for us. Anything that creates excitement is really welcome. And if you follow Sony's history of hardware introductions, I doubt the PSX will stay a high-end-only item for more than a season or two." But a buyer for a rival chain warned, "The PSX looks like it might be another TiVo. The people who have it say it's the best component they own. But not that many people own it. I wonder whether the PSX, which is sort of a TiVo on steroids, might be like a TiVo. It's unbelievably useful for those who need it, but it doesn't look like that many people really need it."

PSX isn't party to the next generation of console wars since it plays only current-generation games, but it does provide some tantalizing hints regarding what sort of functionality consumers may expect from the next-generation of game consoles, whenever that may be. Where will a gaming device end and a broader entertainment device begin?

If Sony indeed wants to edge Microsoft out of the living room, the best way is to ensure that convergence in the living room comes with consumer electronics, not computers running Windows, as the center. The last thing a consumer wants to see when turning on the television is a Windows error box. Microsoft will have to work hard to match Sony's legendary usability. ■

## CHEAPER IN ONE BOX

PSX may seem pricey, but compared with components purchased separately, it's a bargain.

■ **TiVo:** A unit costs \$199 to \$299, plus a \$12.95 monthly subscription fee. The company is currently offering a \$50 rebate on both models.

■ **PS2:** \$179

■ **DVD player/recorder:** Prices vary. Sony's RDR-GX7 DVD recorder costs \$649 on Amazon.com; other brands, like Panasonic, are as much as \$200 less.

■ **250GB hard drive:** A popular model, the Maxtor S01J250, is available for \$299 on Amazon.com.

### TOTAL COST OF COMPONENTS SOLD SEPARATELY = \$1,076

(assuming purchase of a less-expensive-than-Sony recordable DVD and a low-end TiVo, including \$50 TiVo rebate and not counting monthly TiVo fee)

The high-end Japanese PSX, the DESR-700, will retail for the equivalent of \$907. A lower-end device, with a 160GB hard drive rather than a 250GB one, will sell for the equivalent of \$750.

## THE MATRIX RELICENSED

It was widely reported that Atari needed to sell 4 million copies of *Enter the Matrix* to break even.

There were huge development and marketing costs, of course, and it's been assumed that Andy and Larry Wachowski, the brothers

behind the *Matrix* franchise, were well paid. Thanks to court documents passed on to [www.thesmokinggun.com](http://www.thesmokinggun.com), we know how well: \$2.75 million guaranteed, against 50 percent of the advances and royalties paid to Warner Bros. under the license. (They won't

get all of that, though. According to the court document, which is associated with Larry's divorce agreement, more than 25 percent of those fees will go to agents, partners, and so on.) And that's just for one game. For their involvement in the

multiplayer online *Matrix* game, still under development, they are due to receive another \$2.5 million guaranteed against royalties. It's more proof of one of the oldest axioms in entertainment: Make sure you get paid before the reviews come in.

# Grand Theft Auto Crashes Onto Xbox

This may look like a big win for Microsoft in the short run, but the surprise beneficiary of the move may be...Sony?

Last month, Take-Two released *Grand Theft Auto Double Pack*, a twofer package for Sony PlayStation 2 that includes the two PS2 smashes *Grand Theft Auto III* and *Grand Theft Auto: Vice City*. If Sony is looking to sell more consoles this tough holiday season, bundling the two most popular PS2 games of the past two years (with more than 25 million units served) at half-price isn't a bad idea.

But it's what happened earlier this month that's more important. On November 4, the same bundle was released for Xbox. Take-Two CEO Jeffrey Lapin says that the company's exclusivity deal with Sony had been amended to allow the porting to the Microsoft console platform.

Now, wait a minute. Why would Sony allow this? *Grand Theft Auto* has been one of the most popular brands in the videogame industry over the past two years—and it has been available exclusively on the PS2 console. There have been ports of the games to PC, but permitting them to show up on Xbox, PS2's most competitive console rival, is a bold move.

It's so bold, in fact, that some are incredu-

lous: A knowledgeable colleague jokes that only hypnosis could have led to such a deal. While no one at Sony, Take-Two, or Microsoft would talk on the record, both Our Man at Sony and a slew of observers maintain that the deal had to be a good one for Sony, both in terms of short-term financial incentives for letting this happen (they were speedy ports to accomplish, since the hard work of moving the games to Windows had been done already) and continued lengthy exclusivity periods for forthcoming *GTA* games. Sony, after all, was the only console maker that had a chance to sell each of the two now-bundled game separately at premium price. That's the crucial deal point and nothing has changed there.

Conventional wisdom maintains that this port is a huge gain for Microsoft at Sony's expense. With Nintendo's GameCube fading (the recent price drop will only get the platform through the holiday season), the reasoning goes, Xbox is the only challenger to Sony's console hegemony. As companies as diverse as Lotus, Netscape, and Stacker know all too well, Microsoft has a long history of moving from distant competitor to unchallenged leader in new markets with great speed. Microsoft may be a remote sec-

## UP/DOWN

### RPGs on Xbox

BioWare's *Knights of the Old Republic* and upcoming *Jade Empire* revitalize the form. Expect an onslaught of such games next year.



### Star Wars Galaxies

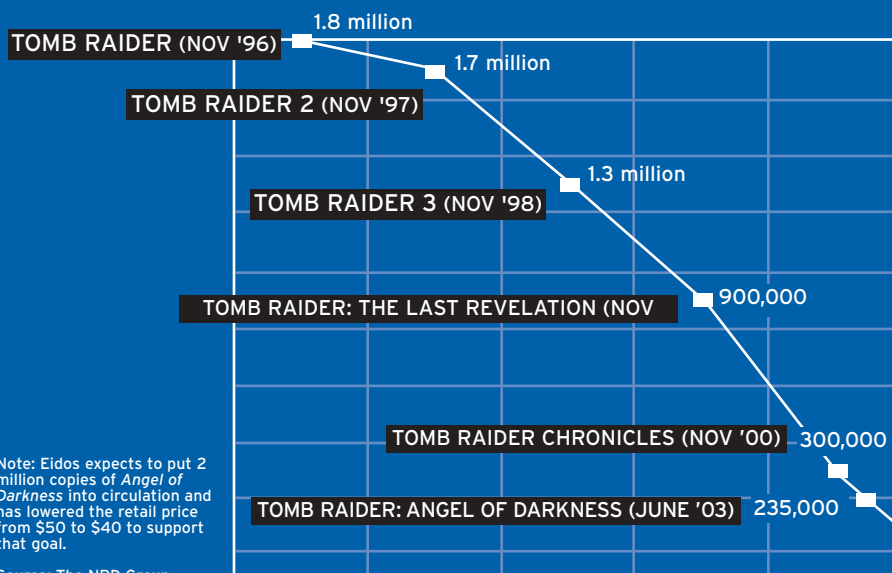
Sure, it's a huge hit out of the box, and it'll find a place under many Christmas trees. But we'll see how long players stick around after finding out about the six months it takes to become a Jedi. No one wants to bus tables at Mos Eisley.



ond now, but two years ago, the Redmond-based company had a zero-percent share of the console market. Imagine what can happen in two more years. Those who have seen the new *GTA* pack on Xbox report significant graphical improvements over the Sony version, which will please hardcore gamers.

But conventional wisdom is wrong. The only loser here is Nintendo, which is left out of the *GTA* race entirely. Microsoft will continue to be a more and more formidable competitor, especially in the next console cycle, but Sony isn't losing much here. It sold many millions of copies of *GTA* for its platform at full price before the PC version came out, let alone the Xbox release. There is a huge conceptual upside for Sony as a result of the series' move to Xbox. Most of all, this is good for Sony because the very existence of a highly promoted *GTA* pack for Xbox extends the current generation of games and platforms. Take-Two didn't develop new games for Microsoft or even exclusive new games in existing franchises. Take-Two merely ported two popular games to another console, albeit with more impressive screens and effects. The new *GTAs* give Microsoft delayed parity in another area, not a lead. More than anything else, it makes the status quo of the current console cycle last longer. The longer the current console cycle lasts—a cycle it dominates—the happier Sony will be. ■

## TOMB RAIDER U.S. SALES



# The Coming Console Price War

There can't be one until all the players join in. We won't have to wait much longer

All the signs that we're in the latter stages of a console cycle are upon us. Hardware sales are down, software prices are down (the *Grand Theft Auto* bundle cuts the price of the two smash-hit games in half), and—most tellingly—console prices are dropping.

Nintendo has made the most noise with its \$50 cut in the retail price of its GameCube, and Microsoft is bundling two games with its Xbox console in the United States without raising the unit's price. But where's Sony? PlayStation 2, the sales leader among the three consoles, costs the same in the United States as it did last year.

In Japan, though, the price war has begun. (Note: I'm using rough U.S. dollar equivalents here, rather than yen.) This month, Sony reduced the price of its PS2 in Japan from \$230 to \$182, which led Microsoft to cut Xbox's price from \$230 to \$154. Xbox trails PS2 in Japan by a far greater margin than it does in other territories (a mere half-million consoles shipped versus Sony's 14 million), so it needs a more dramatic price drop to cut into Sony's market share.

## FIGHT FOR SECOND PLACE, THEN FOR FIRST

The price war, starting in Japan and no doubt coming to a country near you soon, suggests that the first battle is not between Microsoft and the dominant Sony, but between Microsoft and Nintendo. What we're seeing in the console marketplace is a fierce battle for second place that Microsoft will win, in large part because Xbox's third-party developer market is healthier than GameCube's. The price cut may be intended to lure third-party developers to the platform, but it's too late in the cycle to kick-start such development (although THQ must be pleased). Kids (by which I mean parents) buy GameCubes for titles

like *Mario* and *Zelda*, which are published by Nintendo, not outside developers. Even in the unlikely scenario that the short-term sales gains caused by the price cut remain, the vast majority of the development community has already moved on to other platforms. Eidos was only the most high-profile third party to drop out of the GameCube market this year.

Even with its large price drop, Nintendo only pulls closer to Microsoft. According to NPD Funworld, in September there were still 5,000 fewer GameCubes sold than Xboxes. As word gets out that GameCube is much less expensive and the holiday season heats up, it's reasonable to believe that GameCubes will pass Xboxes in sales, at least in the short term. But neither console is within shouting distance of PlayStation 2. First place in the current console cycle remains sewn up, with Sony selling nearly as many consoles last month as Nintendo and Microsoft combined. The battle for second place may get hotter, but there's no all-out price war unless Number One becomes part of it.

That will come, and although conventional wisdom might state that it's getting late in the U.S. holiday season for Sony to make a move, Sony has to do something. Since its consumer electronics brands are fading (Trinitron is over) and replacement brands such as PSP and PSX aren't coming until next year (at the earliest), the company can ill afford to have a game business that isn't minting money. PS2 is still the leading platform, but it's in an industry that has seen a 16 percent decrease in hardware sales so far this year. A price drop won't help margins, but, as Our Man at Sony tells us, "We have to do something to get consoles out the door. Now that they've done it in Japan, I expect we'll get the green light. I hope we get it soon." ■

## UP/DOWN

### Licensed games

All but the most savvy game buyers are attracted to familiar brands.



### Quality in licensed games

*Enter the Matrix* shows some franchises are so strong that even buggy, ragged games under a banner can sell millions.



### Bringing old brands back to life

It's 2003, and the game everybody is talking about is...*Prince of Persia*?



### Cranking out new versions of familiar brands because you have to meet your numbers

Something tells us Lara Croft is going to take a long vacation.



### Moral outrage over *Manhunt*

At least one could argue that *Grand Theft Auto* was art. Rockstar's new *Manhunt* makes *GTA* feel like *Mr. Rogers' Neighborhood*.



### Moral outrage over *Doom*

What Activision has to contend with now isn't the fan outrage over *Doom 3*'s violence, but its recent delay.



### Major League Gaming

So many good gamers with too much leisure time want to turn pro; now there's an agency dedicated to skimming off the lucrative cream.



### Capital Entertainment Group

The new game agency, founded by the guys who came up with Xbox, folds when funding fails to materialize.





# The Government Game

Intervention, legislation, and litigation you can't ignore

By Jennifer Buckendorff

## GOVERNMENT GRANTS FOR GAMES

**WHERE IT'S HAPPENING:** France

**TWO-SECOND SUMMARY:** In late July, France's Minister of Culture announced a €4 million (about \$4.3 million) program to reward well-designed games from French developers. (See related story, page 4.)

**WHERE IT STANDS:** The French government wants to see its game corporations enjoy the success of their American counterparts. Who's most likely to benefit? Infogrames, for one, the French game outfit that's also Atari's parent company. The BBC reports the French government is also hoping for increased interest in gaming in France. Perhaps Paris could subsidize arcades, too?

### WHY THE OUTCOME MATTERS FOR THE GAME

**INDUSTRY:** More European countries may follow France's lead, spurring on a trend of state-subsidized games. French game producers had until this week to submit proposals to the Minister of Culture. Perhaps the game industry will find itself in the same trans-Atlantic mess as the agriculture business.

## SENATE BILL S. 161

**WHERE IT'S HAPPENING:** United States

**TWO-SECOND SUMMARY:** A bill to amend a 1934 communications act, S. 161 would require "violent video programming" not be broadcast until after kids are likely in bed unless it can be blocked electronically by parents. Primarily geared toward curbing television programming, S. 161 would make it "unlawful for any person to distribute to the public any violent video programming not blockable by electronic means specifically on the basis of its violent content." The FCC is the regulator.

**WHERE IT STANDS:** Introduced in January 2003 by South Carolina Senator Ernest Hollings, S. 161 is still in debate in the Senate Commerce, Science, and Transportation subcommittee.

### WHY THE OUTCOME MATTERS FOR THE GAME

**INDUSTRY:** The bill specifically mentions the game industry, stating it would require the FCC "to study and report to specified committees on the marketing to children of violent content by the motion picture, music recording, and computer and video game industries." Senator Hollings isn't seeking re-election in 2004, but even if this specific measure isn't passed during his remaining time in office, the issue is likely to remain a topic of debate in the Senate.

## HOUSE OF REPRESENTATIVES BILL H.R. 669

**WHERE IT'S HAPPENING:** United States

**TWO-SECOND SUMMARY:** Introduced in March by Rep. Joe Baca of California, H.R. 669—"Protect Children from Video Game Sex and Violence Act of 2003"—is founded on statements made by six public health organizations indicating that "viewing entertainment violence can lead to increases in aggressive attitudes, behaviors, and values, particularly in children." The bill seeks to restrict both the sale and use of videogames. It would hold individual retail outlets accountable for imposing those restrictions, primarily by levying fines against the retailers.

**WHERE IT STANDS:** Still in subcommittee, the bill's 42 cosponsors boast a wide range of partisan affiliations. Liberals and conservatives alike are on board.

### WHY THE OUTCOME MATTERS FOR THE GAME

**INDUSTRY:** According to H.R. 669's current phrasing, it will affect the sale of any game that violates "prevailing standards in the adult community as a whole with respect to what is suitable material for minors, and lacks serious literary, artistic, political, or scientific value for minors." Call it the *Grand Theft Auto* effect—and expect First Amendment backers to take it seriously if it gains ground.

## VIDEO VIOLENCE LAW

**WHERE IT'S HAPPENING:** Washington state

**TWO-SECOND SUMMARY:** A federal judge temporarily halted a Washington state law that would prohibit the sale or rental of videogames depicting cop-killing.

**WHERE IT STANDS:** In the case of *State Representative Mary Lou Dickerson v. Video Software Dealers Association*, the VSDA currently has the upper hand. A federal judge temporarily halted a law that would slap a \$500 fine on anyone who sells or rents to a minor any game that shows violence against police officers. A full trial will determine the law's constitutionality. Said Representative Dickerson to the *Seattle Times*, "I strongly believe the courts will decide the sickening level of violence, brutality, and racism being peddled for profit to children cannot be wrapped in our precious First Amendment."

### WHY THE OUTCOME MATTERS FOR THE GAME

**INDUSTRY:** The VSDA issued a prepared statement that said, "We are pleased that the court agrees that the solution devised by the state of Washington is arbitrary and too broad and likely infringes the constitutional rights of video retailers and the customers." But the injunction is only temporary.

## OK, It's a Bomb. Now What?

The gaping yawn that has met the release of the N-Gage won't matter. Nokia has good reason to be in the mobile-game market for the long haul

It seems like everyone in the game business is enjoying N-Gage. They're not having fun playing with Nokia's new combo mobile phone/game device, though: They're having fun making fun of N-Gage's anemic introduction. Despite a high-profile marketing campaign designed to amuse teenage boys of all ages, initial sales figures suggest, at the very least, that there is no pent-up demand for a \$299 mobile smartphone that plays games. Arcadia Research reports the N-Gage's first week on shelves resulted in fewer than 5,000 sales. Chart-Track says that 6,000 game stores in the U.K. were able to move fewer than 500 units during the same time period, or less than one sale per 12 specialty shops. Unofficial price cuts are happening already. At least two U.S. chains are selling N-Gages for \$199. One European carrier is selling the device for a penny to get the service contract. The lead headline on the enthusiast website [www.allaboutngame.com](http://www.allaboutngame.com) is "What a Disaster."

Reviewers have been quick to skewer the device for its shortcomings as a game machine (few strong games at launch, battery removal for game switching, etc.). Two sources close to Nokia told us that the company loaded the N-Gage design team with telecom designers, not experienced game designers. A recent weekend afternoon spent at a GameStop in downtown Boston revealed a lack of interest in N-Gage, despite two demo units being placed in a prominent position next to the front door, where they could clearly be seen through the front window. Not a single one of the dozens of adults who entered the store during a 90-minute period more than glanced at the display, and the handful of preteens who tried out the test devices moved on to the Game Boys and other demo areas within five minutes.

At whom is N-Gage aimed? The suggestive marketing campaign (sample text: "Are you ready to have a threesome in the back of a cab?") seems directed at a younger crowd, but the \$299 price rules them out. And N-Gage's design—more like the Sidekick and the original Game Boy

Advance than a mobile phone or PDA—makes it awkward for older consumers who are used to maneuvering around conventional mobile phones.

"Nokia has not made a firm decision [about] who N-Gage's competitor is," says Eric Goldberg, president of developer Unplugged Games. "Nokia has to define who this competitor is. The competitor can't be Game Boy, because N-Gage is not for kids. You have to pay hundreds of dollars for this phone, and phones are not

### ONE EUROPEAN CARRIER IS SELLING THE DEVICE FOR A PENNY TO GET THE SERVICE CONTRACT.

bought for 8-year-olds to play games on. You can't say the competitor is [Sony's upcoming] PSP, because that's a Game Boy killer, not a phone. Currently, there isn't a competitor." And a lack of competition makes it difficult to show the N-Gage is superior to anything.

#### NO RUSH FOR NOKIA

Goldberg maintains that Nokia has time to get N-Gage right before competitors show up. "Nokia can afford to do a new N-Gage every couple of years, put a \$100 million marketing budget behind it, and it's barely a material event in its annual report," he says. That's an overstatement for a company that has just gone through another uneven quarter—net sales down from the year before, mobile phone sales flat—but at the same time, Nokia is seeing its dominant market share grow. More than other phone companies, it has the time and resources to get phone games right.

With N-Gage, Nokia finds itself in murky water, trying to define a new type of consumer electronics product that offers elegance and value, compared to multiple single-use devices. (Look for Sony to face a similar challenge when it releases its PSX; see related story, page 6.) Unlike Nintendo, Nokia has other businesses that support its gaming ambitions.

The second version of N-Gage is said to be in development. Anyone who's followed the progression of Nokia's phone designs, increasingly functional and clever with each generation, has precedent for believing that five years down the road, N-Gage 1 may be little more than a self-effacing joke Nokia executives make during presentations. Over time, it may go the way of Microsoft Windows version 1: a forgotten misstep early in the life of an industry juggernaut. It wasn't until Windows version 3 that Microsoft was able to secure an acceptable

level of third-party developer support and sweep away any serious competition. The critics are chortling now, but look for Nokia to have the last laugh over competitors current and future: None of the sources for this article mentioned Tapwave Zodiac without being prodded. This market is still very young.

Nokia is not focused on the games business, but committing to a gaming-phone platform does contribute to Nokia's long-term goal of disintermediating the carriers. As Goldberg notes, "Games contribute less than one-tenth of 1 percent of all telecoms' revenue last year, so the carriers and Nokia are paying an extraordinary amount of attention to games relative to the immediate revenue prospects—and this from an industry not noted for its willingness to take on long-term risky projects." ■

### WANT BETTER ONLINE GAMES? HIRE MORE GEEKS!

"The game industry doesn't have enough network engineers or database engineers, people who know how to build a massively connected secure environment. Hey, we know how to do that."

—Chris Melissinos, chief gaming officer, Sun Microsystems

# Editor's Note

Even those who say story in games isn't important rely on it

"Story in a game," says John Carmack of Id Software, "is like story in a porn movie. It's expected to be there, but it's not that important."

There are many arguments consuming the business: How bad will the downturn be? Where are we in the console cycle? Will EA ever slip up? But those are squabbles of the moment that will be replaced, in time, by other squabbles of the moment. Carmack's provocative volley strikes at the heart of the videogame industry, recalling some seminal issues. What's the point of a story in a game? While the genius writers at Infocom were roundly praised for their devious, hilarious story lines in games such as *Zork* and *Deadline* a generation ago, the most popular games of that era were those that were all play and no story, such as *Pong* and *Space Invaders*.

The case against weighing down games with stories has centered on the idea that

stories are linear things—with a beginning, middle, and end—while games only work with looser narratives. If people want stories, they watch a movie or read a book. Games are about escape, release, imagining you're someone else. You don't need a story to enjoy a racing game, sports game, or shoot-em-up. All you need to know is which button to push to make your car go faster, sneak past a defender, or exterminate an opponent.

A look at today's most popular games blows that particular case to smithereens. *The Sims* and *EverQuest* are all about the story created by the people who play the open-ended games, and games such as *Battlefield 1942* and *Castle Wolfenstein* succeed in large part because players want to reenact historical tales—or make up some new story that changes history to their liking.

And what of Carmack? He made his

millions on *Doom* and *Quake*. He'd tell you they're just shooting games, enormously successful due to their great technology and design. But talk to those who play these games in their homes and at high-profile public events like QuakeCon, and they'll talk with equal enthusiasm about the story underlying those games and the extra charge they get from destroying a wraith because they know where it came from and how that character got into the game. They care about the story lurking behind the shooting. *Quake* and *Doom* players imagine themselves as characters in a story that Carmack and his inspired colleagues created—even if the creators think it's cool to say that the weapons and the kills are all that matter. He's working in an industry with an audience that pays close attention to a game's story, even if the game maker pretends there is no story. When Carmack says story doesn't matter, he's just doing what he does in his games: telling a story. ■

## Too Soon to Verify

The hottest industry tips, unfiltered

*Editor's note: Throughout Gaming Industry News, we endeavor to stick close to the facts and make assertions based only on the evidence. But not here. Every month in this space, we'll report the juiciest of stories—those we're pretty sure won't get us sued...or you fired.*

Do you remember Sony's bullish PS2 forecasts early this year, the ones that saw sales increasing? We hope you've committed them to memory, because they're no longer on the company's website.

Speaking of Sony, a few weeks ago, the company released the first concept model of its upcoming PSP handheld gaming device. It doesn't seem to include a phone, although Sony's Ken Kutaragi has toyed publicly with a phone upgrade. "Forget an upgrade," says a source in Sony's New York office. "We'll have a phone in it. That way, we can kill Nintendo and Nokia at the same time."

Look for Disney to announce a new phase of *Toontown*, its kiddie MMORPG. It's called Cog Headquarters, and the folks working for The Mouse promise us it will be "much edgier" than the current environment.

Some executives inside Ubisoft think the company's stockings this holiday season are a bit too full, thanks to French headquarters overruling U.S. recommendations. *Beyond Good & Evil* has been a good performer, but it's fighting for shelf space and sales attention with two other hotter, better-known Ubisoft titles: the latest *Rainbow Six* and the revitalized *Prince of Persia*, the latter of which is generating deafening buzz. "Michael Ancel is a god here," says our source regarding the creator of *Beyond Good & Evil* (and the *Rayman* franchise). "The top dogs in Paris wanted it out for Christmas because it's great, but everyone in the U.S. thinks we should have waited until after the first of the

year, when *Good & Evil* would have had the field to itself. Can't the people in the field decide when something will sell best?"

That field doesn't extend far beyond Ubisoft, though, with so many highly anticipated games coming next year, such as *Half-Life 2* and *Gran Turismo 4*. Microsoft will debut *Halo 2* next year, and the company is banking on it to kick-start its Xbox Live service. "We recognize that most of our current Xbox Live subscriptions aren't real," admits a source deep within the Redmond giant. "*Halo* is our first shot at an Xbox Live version of a game that people really do want an Xbox Live version of."

*Do you have a tip worth sharing? Have you actually seen a working Phantom console? If so, do what your colleagues have done: Sign up for an anonymous e-mail account and write to me at [Jimmy\\_Guterman@ziffdavis.com](mailto:Jimmy_Guterman@ziffdavis.com).* ■

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