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What's Happening Out There

Everyone is chasing living-room nirvana. Microsoft has a strategy for connecting its Xbox to computer-based media—all you have to do is install a home network. Sony has a strategy for connecting its PS2 to all sorts of media—all you have to do is buy a PSX. And now the consumer-electronics industry is seeing handheld makers offer devices that pack PDA, phone, and BlackBerry functionality in one tiny unit, and as one game-console exec tells us, “If you own the single device at the center of everything, you wind up owning everything. Sorry if that makes me sound like the guy in *The Matrix*.” With hopes of ruling this new world where one remote delivers Internet, television, and games, consumer-electronics companies and their gaming compatriots are rushing to deliver all-in-one devices. They’re interim devices, though, in part because of the many competing standards—the idea of resolving all format incompatibilities with one unit resides somewhere between wishful thinking and willful ignorance. Early sacrifices in this area are likely to be the Phantom (assuming it exists) and Apexreme, both of which received a good deal of attention at the recent Consumer Electronics Show. According to our man at Sony, which is betting on the success of the PSX, “This space won’t hit the mainstream for years,” perhaps not until the next version of Windows emerges. If even relatively entrenched companies like Gateway are having trouble inching toward convergence from the PC side, the executives we’ve talked to insist there’s no room for the upstarts. With console prices continuing to drop, it’s likely that a large percentage of gamers just want a device that lets them play games.

As a result of convergence mania and tighter margins, the console war is getting nastier. According to Nintendo, its dramatic GameCube price cut helped the company take first place this holiday season. According to Microsoft, its outstanding Xbox Live service led a “great” holiday sea-

son that saw the company hold off Nintendo. According to Sony, while PS2 sales dipped, the company maintained its lead position during the holiday season and shipped its 70 millionth PS2. Even the objective analysts we’ve talked to can’t agree on who’s up and who’s down. This reflects a console cycle that has entered its second half, a time when the battle for market share is fiercer and meaner than ever. Every executive we asked predicted Xbox and PS2 price cuts this year, most likely in the first half. “They’d be wise to couple the price cut with the release of a long-awaited new game and put out an irresistible package,” one developer CEO says. “As the prices go down, the whole image thing isn’t a differentiator anymore. It’s all about what games people want to play.” This jockeying for position in the market is already spilling over into the jockeying for position that’s taking place inside console-maker boardrooms. The recent high-profile departure of the Xbox team’s Vice President of Games Publishing Ed Fries, a situation our sources at Microsoft and elsewhere tell us is the result of a fierce power struggle, is only the beginning. Indeed, in next month’s issue, we’ll catch up with the members of the original Xbox team.

EA, EA, EA. Which mountains are left for Electronic Arts to climb? In North America this past December, the company sold four of the top 10 PS2 titles. In the United Kingdom, according to Chart-Track, it sold five of the top six titles on all platforms. Its biggest franchises are spawning new sequels this year. Activision and THQ have earned competitors’ respect, but as one THQ exec tells us, “EA is the only publisher that actually spawns fear. They’re unstoppable.” However, when you hear executives talk about EA—which they do all the time—they rarely talk about nonfranchise titles, which brings us to...

Too many sequels. We asked buyers from a consumer-electronics chain and a gaming-

specialty chain to tell us which new titles at CES excited them the most. Every single one was a sequel. With game-production costs through the roof and game-console margins about to be sliced by discounting, everybody wants a sure thing, now more than ever. So when a striking new game like *Beyond Good & Evil* appears, publisher Ubisoft won’t put much muscle behind it because there are truckloads of *Rainbow Sixes* to move. This can’t go on. Nine of the top 10 best-selling PS2 titles in December were sequels, but among the top 10 highest-grossing films in December, only two were sequels or remakes. An industry that continues to feed on itself will one day devour everything and will then somehow have to start over from scratch. Hopeful observers maintain that the new Nintendo DS and Sony PSP handheld platforms, due late this year, will force more innovation in console games. Is this the beginning of a new console cycle or something much, much bigger? In our next issue, we’ll explore why we think the latter is far more likely. ■

NINTENDO SEES DOUBLE

As this newsletter went to press, Nintendo revealed the first skeletal details of its next device, a “Nintendo DS” handheld that will include dual 3-inch color screens, giving players multiple views of the same game. More details are promised for E3 in May. Apparently geared for older players than the GameBoy, the DS will battle the Sony PSP for more upscale players. Don’t compare the two, said one developer CEO: “The PSP is do-everything, a handheld PSX. **The DS is for gamers and only gamers.**” Added a biz-dev exec: “Great. Another platform that only Nintendo will write for.” Those are only the earliest, most knee-jerk comments. Is this what Nintendo’s legions want? Sixteen hours after the announcement, enthusiast boards offered more chatter about Linux-based GameCubes than the DS. We’ll have in-depth coverage in our next issue, mailing February 20. At the very least, E3 just got more interesting.

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All the Wood Behind One Microsoft Gaming Arrow?

Dean Lester has big plans for Windows gaming. First, he's working to make the Xbox team play nice with the Windows one **By Mary Jo Foley**

Our sister newsletter Microsoft Watch covers the Redmond Giant with unparalleled rigor. We're delighted to have Microsoft Watch editor Mary Jo Foley share what she learned at CES. You can find out more about her publication at www.microsoft-watch.com. —Ed.

Interteam rivalries are a way of life at Microsoft. For years—maybe even since Microsoft was born—the company brass has pitted one team against another, with the intention that the best team's products would triumph.

Gaming has been no exception: The Xbox team has been no friend of the Windows team. But Dean Lester, general manager of Microsoft's Windows Graphics and Gaming Technologies, claims the tide is turning on that front.

We chatted with Lester in his well-hidden suite at the Hilton during the Consumer Electronics Show. Lester has been with Microsoft since 1996 and was responsible for all of Microsoft's simulation titles. Before that, Lester worked at a number of gaming-related companies, including Disney and Sega. But Lester hasn't been all about gaming at Microsoft—he also did a stint with the Office team.

These days, Lester is touting Windows—both the current Windows XP release and the future Longhorn one—as a gaming platform as palatable as Xbox. “We have two gaming platforms, Windows and the Xbox, and they are equally important to the company,” Lester claims. “Windows is an \$11 billion a year business for the company, and games show off what Windows can do more than anything else.”

ONCE A MONTH

To improve cross-divisional coordination, Lester says he meets every month with J Allard, the corporate vice president in charge of Xbox. Lester also touches base every other week with Rick Thompson, the corporate VP heading up Microsoft's

Windows Client Extended Platforms division. That unit is composed of the Windows eHome division and the Windows Tablet PC and Windows Hardware Experiences groups—basically all the Microsoft businesses that are extending the Windows core.

Lester admits Microsoft has done little to extol the virtues of Windows XP as a strong gaming platform. But he says the company won't make the same mistake when Longhorn ships two years from now. In Longhorn, he promises, gaming will be treated as an experience on par with sharing photos, shopping, and other key groups of tasks.

While Longhorn will feature its own presentation/graphics subsystem, code-named Avalon, DirectX 9—not Avalon or even the next version of DirectX—will power Longhorn's graphics. But don't think that DirectX 9 won't be up to the task, Lester says. “DirectX 9 has two generations of graphics support built into it,” he explains. “There's hardware it can support that people haven't seen yet.”

Lester's team is also working to guarantee that existing games will run on Longhorn. Just as they did with DOS games for Windows 95, the graphics and gaming developers are building configuration files for each and every Windows XP game so they will run on Longhorn, he says. While Microsoft cannot ensure that every single game will work, its goal is to enable the vast majority to do so from the get-go.

Watch for Microsoft to tout its Windows XP Extras website, Lester adds, to provide gamers with more incentives to upgrade to XP in order to take advantage of new downloadable features. Parental controls for Windows games are in the hopper, although it's not yet clear how the controls will be delivered. And don't be surprised to see a new Gaming Update site for patches and fixes in the not-too-distant future. ■

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Everything You Know About Online Gaming Is Wrong

A new report is alternately optimistic and provocative

Worldwide online-gaming revenues will reach \$1.4 billion this year, double what they were in 2002. Virtual property sales, the next trend in online gaming, will generate \$20 million in genuine money this year. And mass-market subscription games are making some enormous mistakes.

These are some of the alternately optimistic and provocative findings of a report from The Themis Group, an online-videogame consulting firm. While some of the report is silly—the blue-sky projections of online gaming out to 2014 are unintentionally hilarious—the core provides as rigorous and surprising an evaluation of the business as we've seen. We spoke to Alex Macris, a founder and chief executive of The Themis Group, about the report, which he edited.

Q: How is the North American online-game market different from that in Asia? The Korean market is more mature than the U.S. market. It's much harder to launch a new game there. Already, there are so many fighting for attention. The U.S. market is more culturally fragmented because the U.S. is so much more diverse than Korea. The games in Korea are all about hierarchical behavior; U.S. games tend to

be more about individual achievement.

Q: What has the industry learned from *Star Wars Galaxies*?

Launching a licensed property is risky. It has to include what gamers think are the properties of the license. *Galaxies* opened with a very rich environment, but it didn't launch with spaceships. Contrast that with *Final Fantasy Online*, which felt more traditional and chose to do only a handful of things very well. It captured the feel and ambience of the franchise. And they're claiming 500,000 players.

Q: What's the future of online gaming on consoles?

Sports. Rotisserie leagues: That's a big business, with hundreds of millions of dollars being spent. Mix that with a console experience, and it's going to be absolutely huge. We see a lot of growth in the future of consoles. Right now, anyone who has a PC and wants to be playing online is doing so already. New games and licenses drive whatever growth there is. But online gaming is much newer on consoles, where penetration is only 3 percent. It's a much bigger growth area.

Q: Where is mass-market subscription gaming going wrong?

There has got to be an appropriate balance between game and chat room. Chat is free. Why should anyone pay for that? We need a type of gameplay that appeals to the mass market. Right now, all these virtual worlds are catering to people with one type of asset: time. That's a limited market. What about those who want status, recognition, and fun but can't put in the time? These games then would need to differentiate themselves from other games by [focusing on] skill, money, or some combination of the two. *Magic: The Gathering* is somewhat successful in that you can use skill, money, or time to move ahead. But the proper balance of game and chat? No one is offering that. *There* is trying, but if you look closely, you'll see there's no *There* there. ■

A NEW BUSINESS MODEL FOR ONLINE GAMES?

THE NEXT VIRTUAL WORLDS LOOK MORE LIKE EBAY AND LESS LIKE *THE SIMS*

Linden Lab's *Second Life* is one of the most intriguing virtual worlds, but like all but a few entries in the category it hasn't immediately been a massive success. So rather than change the product, the company has just released version 1.2, which tweaks *Second Life's* business model more than anything else.

The new version offers many payment plans. To get in the door, there's a one-time-only charge of \$9.95. And that's all some players will pay—ever. "We've seen a lot of different usage patterns," says Linden Lab founder and CEO Philip Rosedale. "Most people don't know what they're going to get out of an online game. When a recurrent fixed price is required, you miss a lot of customers. That's why so many of these games have crushing turnover. Online games force a projection mentality. You have to figure out how much time you will spend in the game to decide whether a monthly fee is worth it. We wanted to get around that."

The \$9.95 cover charge gets you in the door and gives you a small weekly grant. But those who like what they see in the game can pay another \$9.95 per month for more goods and services. Once inside the game, players can pay in-game currency or real money for various fees and improvements. Those who sell items in *Second Life*, (these are some of the virtual world's heaviest players) can take in genuine cash for their wares, thus encouraging them to stay longer and contribute more. "This lets our most aggressive content developers make money," Rosedale says. It's an example that should inspire happy buyers to become sellers.

THE TOP NEW ONLINE GAMES

In its report, Themis estimates which "new persistent worlds" will be the biggest hits a year after they launch.

■ **World of Warcraft**
(Vivendi/Blizzard)

■ **EverQuest II**
(Sony Online Entertainment)

■ **Middle-Earth Online**
(Vivendi/Turbine)

■ **The Matrix Online**
(Ubisoft/Monolith)

■ **Ultima X: Odyssey**
(Electronic Arts/Origin)

Game VC: Alive but Picky

Capital Entertainment fails to find funding, but Turbine lands \$18 million **By Dean Takahashi**

In October, Capital Entertainment Group closed its doors after a fruitless 18-month search to raise \$20 million to \$30 million in venture capital for its game-production start-up. In December, role-playing-game developer Turbine Entertainment Software managed to raise \$18 million to develop its *Dungeons & Dragons Online* game and buy back its *Asheron's Call* massively multiplayer online game franchise from Microsoft.

The contrast between the two companies' experiences raising money is straightforward but perhaps hard to fathom for game executives who don't peer into the minds of venture capitalists. VCs have been notoriously shy about investing in game-content companies because doing so is akin to gambling on Hollywood films—it's too hard to pick the hits, and no one wants to risk funding the duds. CEG's failure can be attributed at least in part to this shyness.

"We pitched about 1,000 visitors and held meetings with 50 or 60 before we shut down," says Kevin Bachus, who was vice president of publishing at CEG. "They looked at the industry but didn't know how to evaluate the opportunities."

Sri Jagannathan, vice president at venture investor Global Asset Capital in Menlo Park, CA, agrees with Bachus. His company has invested in wireless-gaming companies that have created gaming technology, but he has steadfastly avoided investing in content companies.

THINK TECH, NOT GAMES

Even though they proceed cautiously when looking at game-content companies, VCs are comfortable assessing the risks for technology ventures. Online-game development requires technological prowess, including expertise in software programming, server management, customer support, and game maintenance. The entry barriers are high since development can be so costly, but companies can distinguish themselves based on the quality of the technology they use for game security, communication, graphics, and technical support for hardcore

online gamers. The VCs can consider these factors in their due-diligence investigations, which give them the confidence to part with their money.

Turbine's deal fits into this category, and that's why it managed to raise such a large sum of money, says Bob Davis, a partner at Highland Capital in Lexington, MA, which is one of the venture firms that funded Turbine.

"We're talking about the opportunity in massively multiplayer online games to get customers to pay a sustainable subscription fee," he says. "That's far different from the classical developer, who is at the mercy of either a publisher or a hit game at any given point in time."

While CEG's founders were aware of the venture-capital community's leanings, they tried to win it over anyway. Founded by game-industry attorney Eugene Mauro, veteran production manager J. Mark Hood, and Xbox co-creators Seamus Blackley and Kevin Bachus, CEG wanted to insert itself as a new middleman in game production by utilizing seasoned producers who could foster risky but original titles.

Game publishers fund roughly nine out of 10 games, which still leaves plenty of opportunities for a smaller company to move into the development chain. This is important because relations between smaller developers and large publishers have become frosty. Publishers have shied away from original titles and tend to focus on proven teams and sequels to big hits, while developers want to focus on making games rather than negotiating deals and learning the finer points of the production process. CEG would essentially outsource production, freeing publishers to focus on sales, marketing, and distribution.

In hindsight, Bachus saw the flaws in CEG's approach—it was a prerevenue company. In the post-dot-com era, VCs are avoiding such investments. In this case, it would have been at least two years before the VCs saw any kind of return on their

investment. CEG needed plenty of cash to spread out its risk among four to six titles. But because it sought \$20 million to \$30 million, the VCs needed CEG's exit valuation to hit \$200 million or more in order to justify tying up their funds for a long time. Bachus says CEG hoped to improve the process for developing games and that was where its experienced team could make a difference, much like Joe Roth's Revolution Studios produces successful movies on a more or less consistent basis.

"It turned out what we were doing was just riskier," Bachus says.

A STILL-GROWING INDUSTRY

While CEG's experience illustrates how things can go wrong, Turbine's shows what can happen when they go right. VCs realize that investment returns aren't what they used to be for many technology companies. With the games industry still growing in any given year by 10 to 30 percent, they wanted to jump into the market. So far, other companies that have reaped investments include online-game companies with a technology focus, such as Butterfly.net, Ultimate Arena, and Mythic Entertainment.

Davis studied the games market for six months before making his first investment in Turbine, which has almost a decade of experience in online-game development and a proprietary graphics engine that generates outstanding graphics for online games.

Still, raising money wasn't easy. Turbine CEO Jeff Anderson says the company talked to dozens of VCs since January 2003, with most of them saying they weren't prepared to pick the hits. "It was a challenge to penetrate minds with those three worst words in the wake of the downturn: online entertainment technology," he says. "People saw it as an antiquated pitch from a few years earlier."

Anderson argued that the company could mitigate its risks because it used the subscription business model that generates recurring monthly payments for its online games and because it had an experienced

Into the New Year

The industry girds itself for an uncertain 2004

ENEMY OF THE MONTH

Christopher Byron, a financial reporter best known for his recent attack biography of Martha Stewart, recently went after *Grand Theft Auto* in the *New York Post*, using hyperbolic language to suggest that the Rockstar line was worse than child molestation. Nothing like absurd exaggeration to undermine an argument. We wonder what will happen when someone shows him *Manhunt*.

team and its own graphics engine. Besides, Turbine has been profitable for a couple of years due to *Asheron's Call*. Anderson also says the move to purchase *Asheron's Call* was an attempt to transition the company into a publisher, which could open more opportunities beyond being acquired as an exit strategy. That is, game publishers are far more likely to go public than developers. As a result, Turbine stood out and received several term-sheet offers.

The upshot? Content is risky; infrastructure and technology are good. That leaves many independent developers who want to get their money from a source other than a publisher with empty pockets. Bachus says CEG could have tried to get money from rich individuals, but angels are known for investing small amounts in seed-stage companies. They are not likely to pony up tens of millions of dollars to fund a large number of games.

Another money source could be investment firms set up to take advantage of German tax shelters. In Germany, rich investors have long sought to avoid Germany's 50 percent income taxes by investing in sheltered investments in intellectual property, regardless of whether the companies are in Germany. So far, movies have fit that bill, and as a result, German investors have financed dozens of films. Those same shelters could be used to fund game development, and one firm, Attraction GmbH in Munich, is trying that approach. It may be hard for game companies to score VC money, but it's far from impossible. ■

"I'm glad that's over," a Best Buy manager says to us during the first shopping day of 2004. "That," of course, is the holiday shopping season. "We did OK," he says. "But there were no gotta-have brand-new titles to bring people in. Assuming the new *Halo*, *Half-Life*, and *Doom* actually come out when they're supposed to, we'll get some good traffic. I don't want to make it sound like we blew it for Christmas—we got past expectations, even if we didn't blow 'em away—but we could have done better if the publishers had delivered what they'd promised."

Nonetheless, frequent press reports of a bust this holiday season, blaming everything from the weather to our current position in the console cycle, turned out to be overblown. The Electronics Boutique chain announced that total sales for the nine-week holiday period that ended January 3 grew 24.4 percent and that same-store sales were up 2.5 percent, more than the company had forecast.

Retail didn't experience as much growth as online, but it did grow (not counting KB). This happened, and will continue to happen, in part because the major players are desperate for market share, seemingly at any cost. Nintendo, it appears, will all but give away its GameCubes if that's what it takes to expand console market share, and Nokia is giving away 70,000 copies of the N-Gage version of *Tomb Raider* to spur

LAS VEGAS? SAN ANDREAS? BAYONNE, NEW JERSEY?

CES didn't offer much manna to game-industry attendees. As our Ziff Davis Media colleague Jim Louderback put it, "CES is trying to supplant E3 as a gathering of computer and console game vendors, but there was pitifully little to talk about in this area." But more information on upcoming high-profile games did become available last week—some of it contradictory, most of it because CES presenters needed something to talk about. *Doom 3* will ship in April; Microsoft has given up guessing when *Halo 2* will appear. And last week's rumor that the next *Grand Theft Auto*, due in November, will be set in Las Vegas was replaced by this week's rumor that San Andreas will be the new home of the next game to antagonize various self-appointed protectors of our nation's youth. What didn't come out of CES, though, was enthusiasm about the many new games without numbers in their titles.

interest, having sold barely 3,000 units so far. That's not a good sign for a title that has been the subject of two big-budget films already.

While we're considering the Hollywood angle, let's note that Atari, currently suffering the ramifications of lousy *Matrix* and *Terminator* games, has signed Ridley Scott Associates to produce a series of commercials promoting its upcoming *DRIV3R* game, which is due to ship in March. Atari dressed up the press release with terms such as "short films" and "vignettes" that are "inspired by" the game, although this is just another example of how important Hollywood convergence is to the success of many big-budget videogames. We'd be shocked to learn that Atari wasn't hoping to expand these short films into a genuine feature. Which leads to our best bet for what the major players want most of all in 2004: IP that's available in all media all the time. ■

UP/DOWN

Up: Videogames on TV

The same licensing frenzy that hit feature films is moving to cable and even broadcast television. Look for UPN's *Game Over* to make a big noise.



Down: Plots of videogames on TV

The premise of *Game Over*: "Race car drivers and archeologists come home after a long day's work and deal with life in the suburbs."



Gaming on Demand

Publishers can use the new model. Will players demand to use it? **By John Gaudiosi**

Unlike Hollywood movies, which are able to recoup poor theatrical performances with DVD sales and pay-per-view windows, most videogames have just one shot—often as little as eight weeks at retail—to make it or break it. While some franchises, including Electronic Arts' *Madden* and Rockstar's *Grand Theft Auto* titles, sell throughout the year, most games face a short retail life. The sheer number of games—more than 1,200 shipped in 2003—leads to the problem of a lack of retail shelf space. It's no wonder that the top games during the past few years have been big Hollywood licenses such as *Spider-Man* and *The Lord of the Rings* and established franchises such as *Metal Gear Solid* and *Final Fantasy*. The familiar games get the shelf space—for everything else, a new distribution method is needed. Some

WE NEEDED DIGITAL DISTRIBUTION. WE FOUND NO ONE HAD ANYTHING IN DEVELOPMENT, SO WE DID IT OURSELVES.

are betting that digital distribution of games on demand is the answer.

"Games on demand are a win-win situation: Publishers get an additional channel to extend product life cycles, game portals get additional revenue, and gamers get the chance to try, rent, or buy games at a bargain," says Billy Pidgeon, analyst for the Zelos Group. "In the long run, the only losers may be traditional publishers and retailers who resist digital distribution of games."

Valve Software, maker of the best-selling *Half-Life* videogame franchise, has its proprietary digital distribution network, Steam, up and running. The developer will expand Steam dramatically this year, releasing its two next games, *Counter-Strike: Condition Zero* and *Half-Life 2*, as online downloads, in addition to the traditional retail model. Gamers will also be able to buy monthly subscription packages. The service currently provides gamers the ability to download patches and updates for existing Valve games, and *Condition Zero*

According to Infinium Labs CFO Tom Wong, 400,000 *Phantoms* will be sold in the U.S. during its first 12 months of release. By 2008, he forecasts annual sales of 1.3 million. And within the first five years of business, he expects more than 2 million subscribers will be paying the monthly subscription fees. We'll see.

will be available on the service on March 25. Doug Lombardi, Valve's director of marketing, says no prices have been established yet, but he expects some of the costs saved by bypassing retail (packaging, inventory, distribution, etc.) will be passed on to the consumer.

"We began creating Steam two years ago when we discovered that there was a huge

gap for game developers interested in using the Internet for business," Lombardi notes. "After speaking to the companies we thought would be working on something that would allow digital distribution of games, we found none had anything in development, so we created our own."

Steam is available for any developer, publisher, or retailer to use. The service comes free to anyone who purchases the *Half-Life 2* engine, and Valve is offering the engine at a discount to any developer interested in self-publishing a title through Steam's digital distribution. The business model: Valve takes a 5 percent licensing fee on revenue.

"We're the Independent Film Channel of gaming," Lombardi says. "We're giving game developers and mod makers the opportunity to take their risky and creative ideas and sell them to a huge gaming audience. I expect a lot of developers to work on big Hollywood games or franchise titles by day and moonlight at night for more risky, self-funded fare for Steam."

Right now, Steam only works for PCs. The technology is said to be non-operating-system-specific, which means it conceivably could work with consoles, but Lombardi acknowledges that there would be many obstacles to overcome for that to happen.

INFINIUM: IFFY PRODUCT, INTRIGUING MODEL

Another company, startup Infinium Labs, is jumping into the PC-game digital distribution channel with *Phantom*, which is currently slated to launch this summer. The iffy nature of *Phantom* demos (no working unit to demonstrate a mere six months ahead of release, except in a private suite) at CES this month is a good example of why Infinium attracts skepticism like lint. Nonetheless, its model is worth evaluating. *Phantom* is a new customizable videogame console that will have several configurations available for less than \$500, bypassing retail and discs completely. The box won't even have a DVD tray—instead, it will serve as a digital download device for videogames on demand. Consumers will be able to play free game demos, rent games, or buy titles outright through the *Phantom* Game Network, which will charge gamers between \$7.95 and \$9.95 per month for access to the network.

Infinium Labs says it has secured licensing agreements with about 3,000 PC titles

WHAT, NO GTA: TWIN PEAKS?

Last month, we reported on how the games industry might not be making full use of patents. It is, however, using trademarks, as evidenced by a story that broke on the computerandvideogames.com website. On December 17, Take-Two Interactive, which owns Rockstar Games, listed three *Grand Theft Auto* trademarks: *GTA: San Andreas*, *GTA5*, and *GTA6*. It appears that this is one franchise that will be running over pedestrians and mistreating lowlifes of all creeds and colors for some time.

Microsoft Moves FUD to a New Platform

Game execs are learning what tech execs know too well

WHAT'S WRONG WITH THE GAMING BUSINESS?

"Most gamers cite lack of time second only to social pressure as their reason for leaving gaming. Yet we make games that require 10, 20, 30, or more hours for the gamer to fully enjoy."

—Seamus Blackley, formerly of Microsoft and Capital Entertainment Group

for launch, many of which came through sublicensing agreements with Trimedia. Activision, Encore, and River Deep have agreed to distribute their PC titles through the service. The machine will ship with 30 games installed on the hard drive, and gamers can purchase and store additional games either on the drive or on a Phantom server.

While Phantom accounts for a minute blip in the overall videogame market space, it does give PC game publishers, as well as developers of all sizes, an opportunity to reach a new audience. Phantom will plug into living-room TV sets, which will extend the reach of these games beyond the PC. PC shelf space has been especially quashed by big franchises and a glut of console titles that command prime placement at retail due to higher sales volumes.

Valve's Lombardi adds that there will always be people who want to buy games at retail, especially gift buyers and collectors who want to own the physical package. He believes that over the next three to six years, we'll see slow but steady growth of digital distribution.

Moving forward, PlayStation 3 and Xbox Next are likely to employ some type of games on demand, at least on a rental basis. Microsoft is already getting console users accustomed to downloading extra content through Xbox Live. Five years ago, Amazon.com showed shoppers the ease of online purchasing. Valve and Infinium are betting they can do the same with digital distribution. ■

The Consumer Electronics Show, held earlier this month in Las Vegas, is different from many other technology conferences. For one thing, it's one of the few such events that Microsoft doesn't dominate (at least not yet). Macworld, held in San Francisco at roughly the same time, is usually an opportunity for True Believers to demonize the Redmond Giant and all it allegedly stands for, but for business customers, some of the biggest news out of that event was Microsoft's updates to the Macintosh version of Office. Bill Gates and co. loom large, even at conclaves where they serve as official villains.

Microsoft made a plethora of announcements at CES, but many of them were overshadowed by news from its competitors. Who cares about incremental

improvements in the "media" versions of Windows and Xbox when Apple is hyping new mini-iPods and Hewlett-Packard, perhaps Microsoft's most important hardware partner, announces a deal to sell private-label iPods (even if early rumors about HP sneaking Microsoft's music format onto Apple devices were too delicious to be true)? Bill Gates' CES keynote address was low on detail, even for CES keynotes. All he acknowledged about the next Xbox was that Microsoft was developing it.

Thanks for the breaking news, Bill.

But those looking for what Microsoft is trying to do in the game arena need look no further than a widely circulated Reuters piece that hit the wires on January 14. In it, Microsoft Chief Xbox Officer Robbie Bach boasts that holiday Xbox console sales were "very good" and "solid," and then goes on to claim that Xbox outsold Nintendo's heavily discounted GameCube in the last two weeks of December.

UP/DOWN

Halo 2 anticipation

Demand for the sequel appears to be enormous.



Halo 2 release date

Now Microsoft says: "We're going to ship it when it's ready. It might be the first half of 2004. It might not."



What's astonishing is not that the Reuters reporter sent along these claims without checking them or challenging Bach (the outselling-GameCube assertion is particularly dubious, if you ask around)—wire-service reporters have to file quickly and often deliver incomplete copy. This

THIS IS AN INDUSTRY WHERE HUBRIS AND OBFUSCATION ARE ESSENTIAL PARTS OF ALMOST ALL PUBLIC STATEMENTS.

happens all the time, even if it doesn't yield optimal journalism.

What is astonishing is Microsoft's apparent decision to take the "fear, uncertainty, and doubt" marketing method it employs in the areas it dominates (you should hear what it says about the competing Linux operating system) to a market in which it just went through a holiday season most likely in third place—far behind the leader, Sony, in the United States and even further behind in Asian nations such as Japan and Korea.

We should carefully parse the words of all videogame-industry executives: This is an industry where hubris and obfuscation are essential parts of almost all public statements. But when Microsoft executives feel they can make big, unverifiable boasts without any demand for evidence, you know the gaming industry is being visited by a FUD machine that makes John Romero look modest. ■

More Than Just Catchphrases

Star actors provide yet another sign that Hollywood and the videogame industry are getting more comfortable together **By John Gaudiosi**

As videogame publishers have increased their presence in Hollywood, professional voice acting has undergone quite a change. Fueled by the success of franchises such as Square-Enix's *Kingdom Hearts* and Rockstar Games' *Grand Theft Auto*, which employed well-known actors Haley Joel Osment and Dennis Hopper, respectively, more big Hollywood voices are being heard in videogames.

In addition to deals that incorporate actors into the game versions of their films (you can hear Arnold Schwarzenegger in the latest *Terminator* game), more Hollywood voice talent is being used beyond the scope of licensed movie and TV properties these days. Videogames are being cast like Hollywood features. Activision attracted a noteworthy cast for its entry in the *Grand Theft Auto*-clone sweepstakes,

their likeness in most cases that we're using. For some games, such as *The Lord of the Rings*, we've used motion-capture data as well to capture the unique walks and actions of actors or stuntmen just as we would in a sports game. Going forward, we'll see an increase in graphical realism and special effects, but more importantly, an increase in the emotional depth and impact of gameplay."

"Actors are getting embedded more deeply into games," says Steve Allison, former vice president of marketing at Atari, which pulled in Michael Madsen, Michelle Rodriguez, Mickey Rourke, and Ving Rhames for *DRIV3R (Driver 3)*. "Gamers expect certain production values," he says, "including licensed music and Hollywood voice talent."

"WITH CELEBRITY TALENT, WE'RE NOW DEALING WITH SIX-FIGURE PAYDAYS AND POINTS ON THE BACK END."

True Crime: Streets of L.A.—Christopher Walken, Gary Oldman, Michael Madsen, Russell Wong, Michelle Rodriguez, Ron Perlman, CCH Pounder, James Hong, Mako, and Keone Young voice the game.

CYBERSCANNING THE ACTORS

Electronic Arts began incorporating Hollywood talent into videogames 10 years ago and is now at the point at which next month's *James Bond 007: Everything or Nothing* will feature the voices and likenesses of film stars Pierce Brosnan, Judi Dench, John Cleese, Shannon Elizabeth, Willem Dafoe, and Heidi Klum. Rounding out the Hollywood experience, EA hired *Bond* movie scribe Bruce Feirstein to write the story and dialogue and 24 composer Sean Callery to score the game.

"We 'cybercan' our actors," says Nick Earl, vice president and general manager of Electronic Arts' Redwood Shores studio. "It's a process that scans their faces and bodies so that it's not just their voice but

Higher production values do have a drawback: bigger salaries.

"Until recently, there was not much negotiation for videogame voice acting because game companies would hire voice actors and pay them scale (roughly \$500 for four hours of work), but with celebrity talent, we're now dealing with six-figure paydays and points on the back end. It's similar to a movie deal," says Larry Hummel, co-head of the animation voiceover department at talent agency International Creative Management.

Tommy Tallarico, president of Tommy Tallarico Studios, has watched the audio budgets of videogames double from an average of \$75,000 to an average of \$150,000 over the past three years. He's been working with voiceover talent and game audio for 13 years and says that nowadays, a videogame budgeted at \$10 million could have an audio budget of \$500,000 or more. "A star could make anywhere from \$5,000

HEADLINE OF THE MONTH

"Miami Vice Game Signals the End of Original Content"

-GameSpy, January 13, 2004

to \$100,000 for voice acting in a game, depending on the role and the current popularity of the star," he says.

Lev Chapelsky, president of Los Angeles-based Blindlight Media, which matches game companies with Hollywood talent, says that big actors don't make anywhere near as much in games as they would in television or movies, simply because of the technology cost of games. Plus, it's the gameplay that drives sales, not known actors, which is the opposite of star-driven Hollywood productions. But games can increase awareness of an actor within the lucrative 18-to-34 year-old male demographic, and any type of back-end deal on a huge game franchise could result in a nice return for a celebrity.

IT'S THE GAME, NOT THE NAMES

Not everyone is going for big-name stars these days. Majesco's new trilogy of games, *Advent Rising*, built around the work of sci-fi writer Orson Scott Card, held an open casting call for its characters. More than 500 actors showed up.

"I had an idea in my head of what each

UP/DOWN

Yahoo

Its online parlor games garner a large audience of mostly older players who want to play sedate Web-based games at work without getting caught.



KB Toys

Four hundred of its 1,300 stores won't sell videogames anymore, evidence of tough times for the bankrupt chain.



Executive Pulse

What are you thinking? Let us tell you

character's personality and voice would be in the game, and that's what I based my decisions on," says the game's lead designer and director, Donald Mustard, who did end up hiring actors Malcolm Jamal Warner and Dwight Schultz for parts. The script for the first game alone spans 400 pages.

The sheer volume of videogames in development, and the large number of game companies in the Los Angeles area, has been a boon for union-scale and double-scale voice actors. The work is steady and the money good. Schultz (you may remember him as Murdoch from *The A-Team*), who has been very active in videogames, including recent titles such as *Battlestar Galactica* and *Riddick*, says that interactive entertainment is really the only place left for a character actor like himself these days.

The influx of Hollywood talent may be resulting in deeper stories. Tallarico says 400-page scripts with as many as 20,000 lines of dialogue are commonplace today. That's a far cry from the early days of videogame voice acting, which allowed a few catchphrases to be squeezed on to a cartridge.

According to Tallarico, it's been only in the past few years, following *GTA*'s lead, that publishers and developers have allotted more time and money for the audio aspect of games. Game makers now actively seek professional writers to spruce up a game's dialogue, giving additional depth to the professionally read lines. So the increased attention on voices is helping the scripters, too.

Gamers remain a fickle but devoted audience. Solid games will be rewarded with millions of units of sales. Increasingly, Hollywood voice talent is seen as a necessary component of such a hit. Every blockbuster game needs to keep up with the EAs and Take-Twos of the world. ■

Our goal is for Gaming Industry News to be a must-read among senior gaming executives, and one way to live up to that promise is to fill this newsletter with the voices of those executives. This month, we present our first poll of senior executives. We'll conduct these surveys at least quarterly so that we can be sure of what the top pros are thinking—and make sure you're aware, too.

Q: Which company are you most bullish about for the next console cycle?

Sony: 29

Microsoft: 22

Nintendo: 1

Sony advocates maintained, "Their lead is unbeatable any time soon," while one Microsoft fan said, "The Xbox 2 will be at least a year ahead of the PS3. Can you imagine what Bill and Robbie can do with a lead like that?"

WE HEARD VARIATIONS ON "SONY IS UNSTOPPABLE." WE WERE ALSO TOLD, "EVERY DAY, MICROSOFT KNOWS MORE AND MORE ABOUT THE INDUSTRY. NO ONE IS SMARTER."

This month, we sent our questionnaires to 75 executives at the VP level or higher, divided more or less equally among publishers, hardware makers, and developers. Of those 75, 52 answered all of our questions. (Four respondents returned partial questionnaires, so we didn't include them.) Here's what we learned, along with some relevant quotes. As promised, we are not revealing who said what.

Q: Has the current console cycle peaked?

Yes: 41

No: 11

Some of the "yes" comments included "Sure it has. Let's get the discounts out of the way, make this whole thing mass market, and move on to the next one" and "Yes, but more for the console makers than the software guys." The most vocal "no" voter said, "This is a classic double-peak cycle. Just wait."

Q: Which company are you most bullish about for the remainder of the current cycle?

Sony: 37

Microsoft: 14

Nintendo: 1

We heard variations on "Sony is unstoppable." We were also told, "Every day, Microsoft knows more and more about the industry. No one is smarter."

Q: Is gaming on mobile phones here to stay or just a fad?

Here to stay: 28

Fad: 24

This was one of our tightest results, and it might have been even tighter if three of the respondents weren't from companies that have made big bets on mobile gaming.

Q: Is the Phantom real?

Yes: 32

No: 20

"Well, I hope it is. It was announced last April 1, though, so you never know."

Q: Did the holiday season meet your expectations?

Yes: 25

No: 27

Let's let a VP for a large publisher have the last word: "Depends on what you mean by expectations. For instance, expectations from when? Our November 1, November 15, December 1, and December 15 expectations were all over the place. So, yes, we did somewhat better than I was afraid we'd be doing around Thanksgiving. But back around Labor Day, I thought we'd kill this Christmas."

If you would like to be considered for participation in a future survey, please write to Jimmy_Guterman@ziffdavis.com. ■

gaming|industry|news

Four Big Questions

Ultimate Arena top dog Mike Cassidy submits to the ultimate test

Ultimate Arena's chief executive officer, Mike Cassidy, comes to the online gaming business with an interesting pedigree. He was, most recently, CEO of Direct Hit, an Internet search engine he helped found in 1995 and sold in 2000 to Ask Jeeves.

For years, there have been sites (like EA's Pogo) that let people play social games for money. Now these sites have expanded their businesses and begun offering brokerage services for multiplayer games. Ultimate Arena, which hosts competitions for *America's Army*, *Counter-Strike*, and *Unreal Tournament*, boasts tens of thousands of active players.

Ultimate Arena knows the mind of the competitive gamer well: Its chief gaming officer is Dennis Fong, who in his free time has been known to be a world-champion *Doom* and *Quake* player.

Ultimate Arena charges entry fees and takes 15 percent of the pool for its games. The company also shares with the makers

spoke to Cassidy about what he sees ahead.

Q: What's the biggest difference between the Internet business and the gaming business?

In one crucial way, they're the same: Success comes down to deal making with the powerhouses. In the Internet space, they were Microsoft, AOL, and Lycos. We did deals with all three. In the game space, for us, the powerhouses are Valve, EA, and Epic. From day one, we've been working on deals with those guys. There's a great similarity in how concentrated the power is and how key it is to get deals with those players.

The big difference is pace. Direct Hit did a deal with Microsoft in 10 days and one with AOL in four weeks. We recently had our one-year anniversary at Ultimate Arena, and there are deals we've been working on for 10 months that haven't closed yet. Some of our biggest deals have taken five or six months to close.

CONSOLE MULTIPLAYER GAMING WILL EVENTUALLY OVERTAKE PC-BASED ONLINE GAMING.

of the games. "We share revenue based on the amount of support and integration a company gives us," Cassidy says. "If someone just gives us permission to do it and wishes us good luck, they get a relatively small share. If they build Ultimate Arena into the game, what they get is substantially higher."

As part of our ongoing series of interviews with gaming industry CEOs, we

Q: What's the future of massive multiplayer on consoles?

Console is a bigger gaming market overall, but right now, the PC is bigger for multiplayer. Console multiplayer will grow very rapidly because the installed base is larger and will eventually overtake PC-based online gaming. We've seen some interesting console/PC integration stuff lately, where you can play a game on a console and see

UP/DOWN

Take-Two stock

On January 8, Southwest Securities raised the company's rating from neutral to strong buy. Must have been a good holiday season.



Take-Two stock

Only weeks earlier, Southwest had downgraded Take-Two from strong to neutral, anticipating a lousy holiday season.



your results on the Web. Xbox Live has a system for seeing where your buddies are, communicating in real time. It has a unified interface for playing all games.

Q: What's the future of massive multiplayer on handhelds?

My board of advisors and board of directors keep saying that handheld is going to be huge and that we need to get in there. For me, I'm just perplexed. People are playing graphically rich games online and playing them quickly. Anything with more than a 40ms ping time is unacceptable. Handheld could be a cool platform for other kinds of games—social interaction games, social network games—that are not latency dependent or graphics intensive.

Q: You've said what you offer is not gambling because you host games of skill and not chance. And you've built in some protections, like limiting players to adding only \$50 at a time to their accounts. But what about the line between videogaming and gambling? Isn't it getting more blurred?

If it is, I haven't seen it. Most of the companies in the skill-games space are very careful. They don't even want to take ads from something that might blur the line, such as online casinos and the like. Most of the CEOs I know in the skill-games space want to maintain a clear distinction between skill games and gambling. Our business success is dependent on that. ■

MOBILE GAMING REVENUES: PICK YOUR FAVORITE ESTIMATE

	2001	2002	2003	2006	2007	2008
Frost & Sullivan (July 2002)	\$0.44	-	-	-	-	\$9.34
Informa Media Group (Aug 2003)	\$0.24	\$0.59	-	-	\$3.78	-
The Research Room (July 2003)	-	\$0.60	\$1.50	\$2.19	\$4.13	-
Wireless World Forum (2003)	-	-	\$0.54	\$0.54	-	-

Source: www.emarketer.com

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.

Are massively multiplayer online social games—i.e., those that don't involve shooting or pretending you're Lord of the Realm—heading for a shakeout? The failure of *The Sims Online* to capture a *Sims*-size audience (despite front-page coverage everywhere from *Wired* to *The New York Times*) seems to be having a ripple effect. If you believe the rumors, the virtual environment *There* has laid off between one-third and one-half of its staff.

Eager to put the online mess behind it, EA is pushing *The Sims 2* “harder than any new game in their history,” according to a buyer for a large electronics-store chain. “My guy there told me they have more riding on this than anything else in 2004, and they're going to be ruthless about getting shelf space, even if it means some of their other games get short shrift.” We're sure the product manager for the new *Def Jam Vendetta* won't want to hear that.

When it comes to *The Sims Online*, aside from the financial disaster associated with it, EA execs would probably most like to forget player Peter Ludlow, whose *Alphaville Herald* online newspaper, a tabloid about the world of *The Sims Online*, got him kicked off the game and has led to a PR mess. But we've heard some more about what's really happening inside the virtual world (from a CEO who should really spend his time in other pursuits): As any *Sims* player knows, if you don't let your Sim relieve himself in an appropriate place, at some point he will do so in an inappropriate one. In the online game, there are at least two groups of players who “save it up,” go as a group to an unsuspecting player's property, and—boom!

One multiplayer online game enjoying a different kind of explosion is *WarCraft*.

We've heard that Blizzard has signed a deal with a major manga publisher to develop comic books based on the game. Games and comics have a long shared history, but according to our source, “This is different. Most of the time, it's been comics that have been turned into games. Now that manga is so huge among teens, we're going to see a trend going in the other direction. Turning games into comics is going to be a very successful business.”

WarCraft is quite successful, but the online games dominating the U.S. market might want to eschew too much success. A Korean mental-health professional tells us he and his colleagues are “fighting an epidemic” of online-game addiction that “tech companies here are trying to keep quiet.” Americans may joke that *EverQuest* is “Evercrack,” but when you move a popular online game to a country that has much higher broadband penetration, it's not so funny anymore.

Also not funny is the trend in American universities of women shying away from computer-science classes and, hence, com-

IS ELECTRONIC ARTS “PUSHING THE SIMS 2 HARDER THAN ANY NEW GAME IN THEIR HISTORY?”

puter-science careers. We've heard from two professors at two well-known universities—one in California, one in Massachusetts—that are developing programs in game development. Says one professor, “It's a mix of art and science, and it's the only way we can think of to get more women back into computer-science departments.”

Finally, what's a rumor column without a reference to Microsoft?

One correspondent writes: “Man, you should have been at Microsoft's secret suite at CES. The Xbox 2 rocks! It has a 3.2GHz processor, 160GB hard drive, writable DVD, broadband accelerator, full Nvidia emulation, awesome design. We're looking at *Knights of the Old Republic 3* and *Half-*

UP/DOWN

Sony's PSP

It's the better part of a year away (expect a November launch), but everyone's talking about the upcoming handheld.



Tapwave's Zodiac

It's out now and it's great, but no one's talking about it. At least it's not being made fun of, like Nokia's N-Gage.



Life 3 as the two big launch titles, unless the EA/Xbox Live deal goes through. This console will blow your mind!” It went on like that for three more paragraphs. We were intrigued and about to contact Microsoft to get a confirmation or (more likely) a denial when we looked at the lovely forged e-mail address: edfriesnolonger@microsoft.com.

Speaking of Ed, the departed Xbox executive has been the subject of some hilarious rumors and conspiracy theories since his

abrupt departure from the Redmond Giant. Although the more sedate buzz has him going to Nintendo or starting up something new, our favorite piece of gossip came in an e-mail (with an unforged microsoft.com address) that claimed, “This is just a negotiating tactic. He doesn't want to go. He wants Robbie Bach's job. He'll be back shortly. Just wait and see.” Robbie Bach? Why stop there? Maybe Ed is angling for Steve Ballmer's job. No, not high enough. Bill Gates' job? Yeah, that must be it.

Do you have specs for the new Nintendo device that you'd like to share? Are you the real Ed Fries? Do what your colleagues are doing: Sign up for an anonymous e-mail account and write to me at Jimmy_Guterman@ziffdavis.com. We can't do it without you. ■

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