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LEADER (U.S.) | OUT OF THE BOX

# Amid Videogame Arms Race, Nintendo Slows Things Down

Simpler Console Invites Adults To Get Off Couch and Play, While Rivals Go for Power

By *Yukari Iwatani Kane and Nick Wingfield*

Updated Nov. 2, 2006 12:01 a.m. ET

Twenty years after Nintendo Co. commanded the videogame hardware business and the afternoons of teenage boys, the company is stuck in third place, outgunned by Sony Corp. and Microsoft Corp.

Now Nintendo is trying to reinvent the market by going after a largely untapped audience -- people over 25 years old. In a new game console to be introduced later this month, the company is aiming for simplicity, rather than the computing power and fast-paced graphics that have pushed Nintendo's rivals past it.

The company will still offer classic shoot-'em-up games and new editions of its cartoony 1980s hits such as Super Mario Bros. But Nintendo will be moving beyond flashing thumbs and joysticks to a new kind of controller that players wave in the air. They can stand in their living rooms and mimic the motion of casting a fishing rod, tossing a bowling ball, or swinging a tennis racket -- and see it happen on their TV screens.



**Shigeru Miyamoto**

It's not your son's videogame. If Nintendo's risky strategy is successful, it could challenge the conventional wisdom in the \$17 billion console videogame industry: that success lies in the fastest, most powerful machines possible, whatever the cost. That's partly how Sony has dominated the industry since 2000 with the PlayStation 2, a machine so powerful that the Japanese government once feared it could be used to develop advanced weapons. Its PlayStation 3, which comes out a week before Nintendo's new console, is even more powerful. Second-place Microsoft is using a similar strategy in its Xbox 360, out since last year.

As more consumers are overwhelmed with increasingly complicated gadgets, some companies are trying to gain a competitive advantage by producing cleaner, simpler designs. In Japan, cellphones are typically loaded with a high-resolution digital camera, music player and Internet capabilities. But this spring, one of the hottest-selling mobile phones for KDDI Corp., a major mobile operator in Japan, was a phone called Neon, which didn't have the most advanced digital camera or the biggest screen but looked like a bar of soap. The elegant design helped it sell out in just three months.

Just as Apple Computer Inc. made a comeback with the innovative and simple iMac computer and iPod music player, Nintendo is hoping that a less complex innovation can have as much market impact as enhanced computer-chip speed -- and at a lower cost.

Nintendo has been recording healthy profits in part because it has relied on products that are simpler and less costly to make. Despite its third-place position, it earned \$841 million on sales of \$4.35 billion last fiscal year. It expects its new system -- dubbed the Wii to sound like "we" or "wheel!" -- and its games to be profitable within a year.

By contrast, Sony and Microsoft are spending billions of dollars developing their machines, with little return so far. Sony's games earned \$75 million on revenue of \$8.19

billion in the fiscal year ended in March 2006. Microsoft has not yet earned a penny from its Xbox business, analysts say.

In Japan, demand for videogame machines is declining. In the past three years, the number of videogame players sold there has declined by more than 8%, while more household members say they are not interested in playing, according to an annual survey by the Japanese industry group Computer Entertainment Supplier's Association. Sales of both hardware and software have fallen about 20% to 496.5 billion yen (\$4.3 billion) in 2005 from 623.2 billion yen (\$5.7 billion) in 2000, according to the group.

"Everyone thought that consumers would continue to buy new consoles as long as you could play more real and more impressive games," Nintendo chief executive Satoru Iwata said in an interview. While fans cheered the new games, he said, "There were also people who would quietly walk away because they got too complex."



Satoru Iwata

In the U.S., the share of households with game consoles hasn't budged past 36% for the past decade, according to San Francisco consumer-research firm Odyssey LP. U.S. console game sales nearly tripled in the same period, with makers selling more games to the same universe of console owners. With an eye on this trend, Microsoft also is turning some of its attention to less high-velocity games to try to bring in new customers, especially women. Sony announced its controller for PlayStation 3 will respond to hand movements by players, though only within a conventional design.

But Nintendo is in a tricky position. The company has always featured a gentler roster of games than its rivals, including long-running hits such as its Zelda game that keep profits rolling in. Its challenge is to hold onto the game geeks who crave the power, speed and intricacies of high-tech games even while forgoing the race for power.

While many game-industry executives and analysts say the new console could well raise Nintendo's approximate 15% market share, some point out it lacks the technological depth of its rivals. Sony argues the Wii's design may have limited appeal. A controller good for swinging a virtual tennis racket "might be a good way to do that and just that," says Kaz Hirai, president and CEO of Sony's U.S. videogame division. Jeff Bell, an Xbox vice president at Microsoft, said Nintendo's innovation could turn out to be a "novelty."

## One Advantage

One potential advantage for Nintendo: price. The simpler Wii will retail for \$250, compared with starting prices of \$499 for the PlayStation 3 and \$299 for the Xbox 360.

Unlike the hardware and software giants it now competes against, Kyoto-based Nintendo's roots are in games. Founded in 1889 as a maker of traditional Japanese playing cards, Nintendo made two difficult transitions to become a toy company in the 1960s and then a videogame maker in the 1970s. Its big break came in the 1980s with its Nintendo Entertainment System, which pioneered sophisticated arcade-style graphics in a home console.

But by 2001, Nintendo faced formidable competition from Sony and Microsoft. Nintendo Chief Executive Hiroshi Yamauchi was disappointed by sales of the Nintendo 64, meant to compete with the first PlayStation, and he wanted to pull out of the expensive race. Mr. Yamauchi, a member of Nintendo's founding family, was looking for a more economical, innovative way to compete.

The GameCube, launched in 2001, was an uncomfortable compromise. Though powerful, the square, toylike console initially came in purple, and Nintendo stayed away from many of the most violent types of games for the console, including the popular Grand Theft Auto. That fed a perception that Nintendo games were primarily for young kids.

The Wii's development was spearheaded by Mr. Iwata, whom Mr. Yamauchi recruited to



Nintendo's new Wii videogame console comes with wireless handheld controllers that mimic hand and body movements on the screen.

the company. He took over the top job in 2002, as company engineers were already looking to affordably differentiate the next-generation console, code-named "Revolution."

Mr. Iwata, a former game developer, knew there often was a gap between his own perception of a game and players' response to it. He had seen test users overlook a feature he was excited about, or become engrossed with one he had thought trivial. The overall message he got from listening to testers: Games were getting too intimidating, and not fun, unless users devoted hours to learn how to play them.

Meanwhile, Sony and Microsoft were competing to develop ever more powerful consoles. Neither company discloses how much it has spent to develop its machines, but Sony spent about \$1.8 billion for the processing chip alone, the company says. Its PlayStation 3 console has a chip that performs 218 billion calculations per second, akin to the speed of a supercomputer. Sony spokesman Satoshi Fukuoka says it is based on the company's "idea of what will come in the future."

Nintendo intentionally limited the capabilities of the processing chip at the heart of the Wii. That way, it was also able to use a quieter, lower-energy processor that could stay on, and ready, all the time. But even game engineers who agreed with the company's need for a different general direction felt anxious.

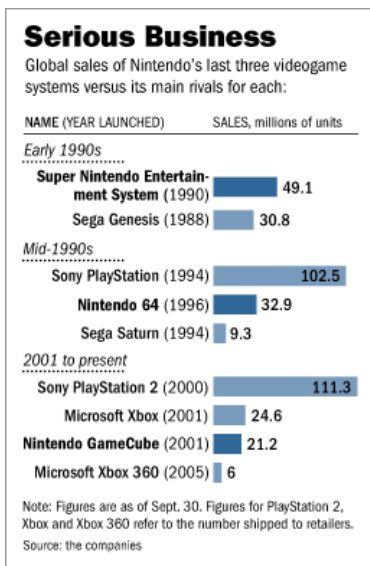
"My brain knew what had to be done, but the rest of me didn't want to follow," says Shigeru Miyamoto, Nintendo's 53-year-old lead game creator, known for developing Mario and the 1981 hit Donkey Kong. Game creators compete to produce graphically detailed games, he says, so it can be a letdown to purposely create simpler games.

The turning point for Mr. Miyamoto and others came in November 2004, when Nintendo launched a portable game machine, the DS. Nintendo considers that relatively simple machine to be a forerunner to the Wii. It opens like a book and has a touch-sensitive screen that players can write on with a stylus.

One DS game, Brain Age, asks players to answer a series of timed drills that test memory and reasoning. In Japan, the game sold big among men and women in their 40s, 50s and older, many of whom had never played videogames. World-wide sales of the DS beat Sony's PlayStation Portable machine, which had a dazzling color screen and graphics nearly as good as the PlayStation 2 machines.

"Nintendo proved with the DS that you didn't need high performance," says Hirokazu Hamamura, president of industry market research firm Enterbrain. Nintendo has sold 26.8 million DS machines, while Sony has sold 22.9 million PSPs in roughly the same period.

Meanwhile, Nintendo engineers led by Mr. Miyamoto, were working on a pivotal feature of the Wii: the controller. To attract new players and encourage families to play together, it had to be simple to use. But it also had to satisfy game fans who wanted to continue playing Nintendo's fast-action games.



For months, engineers sketched more than 100 ideas, including a controller that could be worn on the head. They kept returning to a stick format that resembles a television remote control. The device relays signals to a motion sensor that must be placed near the TV. A second remote can be used for more complicated games, and Mr. Miyamoto suggested that other add-on controllers could be plugged into the device for games that need them.

The first game developed for the Wii controller was tennis. For Mr. Miyamoto, it demonstrated the potential of a wireless controller that could be freely swung. "It's like being able to take off the seatbelt and flying," he says.

In "WarioWare: Smooth Moves," a collection of short, simple games, players make chopping motions to mimic using a knife in a kitchen, or

place the controller at their hips while swaying to mimic hula-dancing. Classic Nintendo games like Zelda come with a twist: Gamers can swing one controller to wield a sword, and press a button on another to activate a shield with their other hand.

## New Moves

To show off its new moves, Nintendo is packaging sports games with the console that include bowling, baseball, tennis and golf. To reach nongamers in an older demographic, the company says about 80% of its U.S. television spending will be aimed at 25- to 39-year-olds, through programs such as ABC's "Dancing with the Stars."

The company has sponsored private Wii-playing parties in volunteers' living rooms. At a recent one in the Kansas City suburb of Tonganoxie, Kan., Karlye Weatherford stood and punched the air with her fists, clutching controllers that translated her hand and body movements to the screen. In front of about 50 friends and family members enjoying a catered barbeque lunch, the 29-year-old mother of three knocked out her husband's character after a series of blows. She says she rarely touches the family's Microsoft Xbox 360.

Nintendo also is seeking urban tastemakers by giving a series of Wii demonstrations at the New York offices of DefJam records, the Phat Farm clothing label and Vice magazine.

Nintendo also has begun to tackle another big challenge -- getting outside game developers on board. Because Nintendo is strong in developing its own games, outside developers were less likely to focus on their hardware -- which ultimately limited its consoles' appeal. So Nintendo made courting them a bigger priority, especially to broaden its appeal in the U.S. and Europe. For example, the French publisher Ubisoft Entertainment SA, known for big hits like the spy game "Splinter Cell," will make a title exclusively for Wii called Red Steel. It will allow players to wield swords by swinging the controller.

A lure for the outside game makers: Games for the Wii can cost as little as half as much to develop as more graphically intense titles for its rivals, where budgets are jumping into the \$20 million range.

GAME QUEST

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