

# How the XBOX went 360

An Overview of Xbox's International Markets and Transnational Production

Robert J. Schmuck  
Mark Wilber  
Cuong Nguyen  
Bradley King  
Aaron Smith  
Candice Joy Worden  
Sam Hong

## **Introduction to Microsoft's Xbox 360**

The Microsoft Xbox 360 is a stunning example of globalization and Globalization; the processes of both global interconnections (through production and access to the video game console) and also through the use of Globalization as a political buzz word (to generate an image of the Xbox 360 as the brand connecting users worldwide) (Sparke 2005a, 3). These two definitions of globalization; as a physical process of interconnections and as a political buzz word, can aid in understanding the systems at work when examining how Xbox is attempting to go 360. Microsoft's Xbox as a technology can be seen as a computer with access to very specific content; all that is needed is the video game console and a connection to broadband Internet. When considering the qualifications to gain access to the Xbox 360 'experience,' one must consider how to get an Internet connection and to the Xbox 360 console. While most citizens in the Xbox 360's major markets, US, EU and Japan, may not consider these systems hard to obtain, many millions of people globally do not have the luxury of high-speed access to the Internet and the Xbox 360 console. Through understanding the impacts of creating a virtual community based on access to technology, which Microsoft states it hopes to do with the new Xbox 360 console, the inequality of the situation starts to be clarified.

## **Introduction to Microsoft as a Global Company**

Microsoft is a well-known company in the computer software industry. It continues to expand to new markets with such assets as the Xbox and other offshoots of its original products. In the last two decades the company's large profits and dominance in general use computer software have propelled the company to an industry leader, if not the controller of a large monopoly with its Windows operating system and Office application products. The history of Microsoft is a short but productive one; founded in 1975 by Bill Gates and Paul Allen the company took a large role in the early 1980's when microcomputer technology started to advance rapidly; Microsoft's MS-DOS programming language was used as a base for programming multiple third party programs being developed by many companies. (Budd 2005, 1) Microsoft globalized early; incorporating in the United Kingdom in 1982 and expanding to many countries via foreign direct investment. (Ruby 2005, 3) The company started the firm GameBank Corp. in joint venture with Japanese firm SoftBank

Corp. in 1995 and the joint project was intended to market the Windows 95 operating system as a computer game platform. (Budd 2005, 1) In 1999 rumors emerged that Microsoft was developing a video game system but it was not till May of 2000 that an official statement was made confirming that the “Xbox Project” was indeed in production.

In 2000 Microsoft acquired the game developer Digital Anvil and folded the company into the Microsoft Game Studios division and continued to develop its new Xbox video game console (BizJournals, 2000). Microsoft continued to acquire many companies as it started to prepare to be a major force in the video game industry. This included Bungie Software in 2001, a computer game company who would later develop the “Halo” video game franchise, which became one of the highest grossing video game franchises in history. Microsoft also bought Rare, Ltd a British video game developer that previously developed games for Nintendo since the early 1980’s in 2002 (Answers 2006). This acquisition marked a new stage in the validity of Microsoft as a console game creator and first-party developer, many industry analysts claimed this as a sign that Microsoft was committed to take a loss to stay in the forefront of the video game industry.

In November 2001 Microsoft launched its first video game console, the “Xbox” and immediately started work on its successor later named the “Xbox 360”. In November 2002, a year after the launch of its Xbox console, Microsoft announced and released an Internet system based on its Xbox console entitled “Xbox Live” (Wikipedia 2006). The system connected users around the globe by using the Internet as a proxy for users to create a custom ‘gamertag’ to be identified by other users, and facilitate online multiplayer games via the Internet. Microsoft’s first console, the Xbox, had many of the same problems that more recently have affected the Xbox 360, as publicized in the American media and around the globe. In early 2003, Microsoft officially lowered its sales expectations of the Xbox for the 2002 fiscal year, which ended in June, from a forecast of 4.5-6 million to a more realistic 3.5 to 4 million units sold (Carless 2006). The lack of sales was based on a lack of appeal to gamers in the European Union and Japan, and competition from Sony’s Playstation 2, which launched in 2001 with the Xbox. Coinciding with the announcement of lower sales, Microsoft slashed its manufacturer suggested retail price almost forty percent in the European Union in hopes

to raise sales in that market.

In late 2005 the success of Microsoft's Xbox 360 was in direct correlation with the rise of the video game industry. Last year the industry in America alone reached 10.5 billion, a 6 percent increase from the year before according to leading marketing information provider, The NPD Group (Schneider 2006, 1). Leading the American market, video game specialty store Gamestop grossed an astounding 1.3 billion in the 9-week holiday season alone as reported on earlier this year, proving that the video game industry is becoming a viable force in America and on a global scale with industry analysts estimating 28.5 billion in gross sales for 2005 (Wire 2006, 1) (Cole 2005, 2). Microsoft launched an impressive marketing effort that gathered a 23 percent recall among a poll of 1000 American consumers for new products last year according to Insight Express, a leading information provider (Schneider 2006, 2). Due to the recent marketing hype surrounding the Xbox 360, many consumers were unable to snag one of the limited 1.5 million consoles shipped worldwide before the end of 2005. The bulk of that amount went to America with 900,000 units, which launch first on 22 November 2005, Europe with 500,000 units, which launched on 2 December 2005 and Japan with 100,000 units, which launched on 10 December 2005 (Berardini 2006). Microsoft stated that it hopes to sell 3.5 to 4 million units by the end of its fiscal year in June garnering it can raise production to fill that amount. Goldman Sachs, a global investment banking and securities firm, estimates Microsoft has sold 1.3 million since launch in November, well short of the 1.8 million originally predicted; indicating possible production problems from any of the three firms charged with manufacturing the Xbox 360 hardware. Sales within North America would have soared much higher if they were not restricted by the inadequate supply of the Xbox 360 (Carless 2006). Microsoft was planning on releasing the Xbox 360 to the markets of New Zealand and Australia on 2 March of this year, but due to, what the company called, "a short term manufacturing challenge" the release has been pushed back to the 23 March release date. (Jenkins 2006).

### **Manufacturing the Xbox 360**

The original Xbox was manufactured in Guadalajara, Mexico in a factory owned by Flextronics, one the three firms that is currently manufacturing the Xbox 360. The production of the Xbox 360, while under the

control of the same company, was relocated to China to take advantage of the electronic manufacturing services already incorporated there by Flextronics, Wistron and Celestica (Carbone 2002). In Southern China, the two main factories manufacturing the Xbox 360 are run independent of each other by two of Microsoft's outsourced EMS companies, Flextronics Corp. and Wistron Corp (Guth 2005). Recently, a low quality bootlegged video was leaked from the assembly line of the Xbox 360 in China, and in response to this, Microsoft released its own higher quality version of the production video which shows Chinese workers in rather sterile conditions checking the quality and putting together different parts of the new system. Aaron McKenna, a reporter, says that "at least it does our hearts good to see that Microsoft's Chinese workers don't have to earn their pennies in overly arduous conditions" (McKenna 2005). It is hard not to identify the sarcastic overtone in what the reporter is illustrating, but nevertheless it seems that Microsoft is not promoting the abusing and underpaying of its Chinese workers, which arguably go hand in hand.

Outsourcing is a simple way for transnational corporations to increase their profits and improve their sourcing efficiency because it creates cheaper inputs and hopefully does not reduce the quality and in some cases, expands their markets. While outsourcing has been a productive process for Microsoft and the Xbox division by providing more profitable commodities, outsourcing for Microsoft employees has its downside. As a result of the new connections with India Microsoft has made through its process of globalization, a document has surfaced regarding the contracts of outsourcing companies. After years of claiming that high level positions in Microsoft were not vulnerable to outsourcing, a document, obtained by WashTech, a Seattle-based union specifically for high-tech workers, now shows that Microsoft is has looked to outsource high-level software positions to India (WashTech 2004). "The terms call for Microsoft to pay the outsourcing companies as much as \$90 per hour for supplying a software architect in the United States, or \$187,000 annually" and as low as \$23 per hour for the software testing engineers in India which translates to about \$47,000 annually (SeattlePI 2004). Compare this to the average salary in Seattle, Washington for software testing engineers which is over \$57,000, over \$10,000 more than Microsoft would pay the outsourcing companies. According to the article," the top annual salaries paid by Indian outsourcing companies to Indian software experts

working in the United States are about \$40,000” which is significantly less than what the company receives to supply these workers. (SeattlePI 2004).

Microsoft incorporates outsourcing in many ways in the manufacturing of the Xbox 360 and its seventeen hundred components. (Guth 2005) The Xbox 360 console is in no way generating profits for Microsoft, it loses approximately \$128 per console sold from money spent on marketing and researching/development (Blake 2005). The corporation intends to make its' profits through the commissions on the sales of games and online subscriptions to Xbox Live (Samuelson 2002 p. 1619). In order to reduce the financial losses the console is already causing the company, Microsoft moved the consoles production components from Mexico to countries such as China, Taiwan, and Korea to take advantage of the EMS production facilities already located there and the specialized labor in electronic manufacturing. (Luhnnow 2004)

Within the country of Taiwan numerous parts of the Xbox 360 are being manufactured, the south bridge found within the gaming system is manufactured as well as the CPU (Kubicki 2005). However, Microsoft outsourced the manufacturing of the CPU, central processing unit, to IBM (Freund 2005). Microsoft, together with NVIDIA, a leader in programmable graphic processors, invested \$15 million dollars into the production of chip simulation software and servers for the original Xbox. The majority of this money went to the Taiwan Semiconductor Manufacturing Co., which produces some of the micro processing chips found within the original Xbox console (Balijko 2002).

Flextronics Corporation had no previous experience in the making of gaming systems, and one of the primary reasons Microsoft chose to outsource their production to the corporation was because they already had factories set up in the global south including China, Hungary and Mexico (Carbone 2002). Infineon Technologies, who manufactures a few of the components including the memory unit within the console, an advanced security chip and other internal cables for the device's operation in China as well (Anonymous 2005). With these two Chinese factories in place, components from all around the world are shipped in for the manufacturing of the console. Japan and Korea supply the hard drives and are shipped to the factory for final assembly. ATI, a Canadian based company hired by Microsoft in order to design the GPU, distributes the graphics chips from Taiwan. The buttons for the console's controllers are shipped from Lacrosse, Wisconsin

and the finished product travels from Hong Kong to Chiba, Japan; Rotterdam, the Netherlands; or Long Beach, Calif. Some of the consoles arrive in the United States in either Chicago or Toledo Ohio by airfreight. Regardless of where or how the consoles arrive in the U.S., they all end up traveling to Memphis, Tennessee at the central distribution center and from there are loaded into trucks and delivered to stores or distribution centers nationwide (Guth 2005).

### **Going 360<sup>o</sup>**

Microsoft globalizes their activities through both foreign direct investment and outsourcing. Foreign direct investment is the direct investment of a TNC in a foreign country via a merger or by employing a company in said country. This can be accomplished in several ways, including TNC's using this type of investment to build a new factory in another country (offshoring) or through the purchase of a foreign company (Mergers and Acquisitions) (Sparke 2005a, 33). An example of Microsoft using foreign direct investment to pursue transnational development is through the production of one of the components for the Xbox 360 known as the South Bridge Bus, which is manufactured by Microsoft in Taiwan. Microsoft had to build and buy new production facilities in Taiwan to supply part of the Xbox 360's commodity chain. This is good example of Microsoft using foreign direct investment to expand its production capabilities and increase the transnational interconnections through which the Xbox division of the much larger Microsoft Corporation operates.

While FDI is more associated with an in-house model of a commodity chain, manufacturing outsourcing is clearly more a feature of marketized commodity chains (Sparke 2005a, 34). Microsoft, like many contemporary TNC's, has adopted a marketized or network commodity chain through outsourcing. This trend is characteristic of post-Fordism where "TNC's no longer depend on either producing goods domestically or just selling them domestically. They employ people all over the planet and sell products everywhere too" (Sparke 2005b, 26). Other companies manufacture most of the major components of the Xbox 360. The only major contributions from the United States towards the production of the Xbox 360 were the design and a small handful of first party games. Microsoft subcontracts components for its Xbox mainly

through companies based in Asia as stated earlier. Microsoft primarily outsources the production processes of the Xbox but has expanded its operations through mergers and acquisitions by buying two game development companies, Bungee Software in 2000 and Rare LTD in 2001 as stated in the brief history above, this is an example of Microsoft using verticalization to organize the Xbox division of Microsoft. Many TNC's acquire other companies in order to control and stabilize their production process or keep proprietary information private. Microsoft is concerned with all of these general corporate issues as well as more specific issues that apply to the Xbox such as development of proprietary games, software development and support. The practice of a TNC merging or acquiring a foreign company such as Rare LTD is commonly referred to as M & A investment.

The Xbox 360, like its predecessor, has both transnational production chains and internationally targeted sales. In addition to employing many of the same contractors that contributed to the production of the original Xbox, Microsoft has also sought out even cheaper inputs for the new console. Since the Xbox 360 inherited the global legacy of the original Xbox, its targeted sales area is the same. This area includes the largest console markets in the world: the United States, the European Union, and Japan (the home country of console makers Sony and Nintendo.) Primary and secondary markets encompass over twenty-five nations. The targeted growth markets are located in the large but elusive Asian market that comprises Korea, Taiwan, and China. Although these markets are important, they consist of less than ten percent of the original Xbox's gross revenue and the European Union is largely seen as an extension of the United States markets, so for this assignment our group will primarily focus on the United States and Japan. These markets are where Microsoft sees the greatest potential for growth and profits for Xbox 360.

### **Localization: Breaking into Japan**

Localization for the video game industry takes several forms, visually appealing hardware, culturally acceptable and desirable games for individual local markets. This is an essential aspect for Microsoft's Xbox 360, because of the company's previous failures in its main targeted market of Japan. Hoping to achieve an advantage over competition, Microsoft released the Xbox 360 in Japan in early December. Despite the holiday

debut of the console, reactions were not as hopeful as expected. Only 10 people were in line when a central Tokyo store opened its' doors to Xbox sales. One of the major issues Microsoft has had in marketing to Japan are that Japanese customers prefer to buy Japanese products and are therefore more likely to stick with Nintendo or Sony (Suzuki 2005). Despite the low amount of sales, Peter Moore, Vice President of Xbox worldwide marketing and publishing seems very confident in the future success of Xbox within Japan. When asked by Brandweek if he could beat Sony, he responded, "We wouldn't be doing this if we didn't think we could lead the marketplace. Absolutely" (Hein 2005). The Japanese market has been especially hard to capture for Microsoft for several reasons: the local video game market is comprised mainly of role-playing, simulation and puzzle strategy games, the lack of local developers in the video games; the hard architecture was visually unappealing to the local tastes; the already oversaturated local competition. In order to have a more successful launch in Japan, Microsoft employed two outsourced companies, one in Japan and one in San Francisco, to create a synergistic visual design. Also, this time around, they employed Japanese powerhouse game designers such as Capcom and Sega to produce more successful games in that market. The console choice was simplified, opting to only give them one package to be consistent with Japanese business practices. The game console was also released for a cheaper price, bringing their rumored loss to over two hundred dollars per console. Another strategy for the successful globalization of the console into Japan was to outsource "game and a variety of console and peripheral testing services for the Xbox 360" to a company called VMC, which specializes in these types of services (Bernardini, 2005).

### **Xbox Live**

Part of the strategy to create a strong consumer base was to create an alternative community through online gaming. Each customer on "Xbox Live" can create an online profile that includes an individual's personal gaming accomplishments and a real-time update of their current activity. Peter Moore, Global Marketing Chief of Microsoft's Xbox 360 division, says, "We've now built up the Xbox Live service to include 24 countries, and have more than one million paying subscribers at this point, with growth plans to increase that by another 50 percent this fiscal year. We really, truly, honestly believe that this is the future of gaming."

This shows that Microsoft is committed to expanding the online experience for the Xbox's consumer base. The Xbox Live subscription services have helped increase the profitability of the Xbox 360 far beyond what was possible for previous console manufacturers. According to a Microsoft survey, over 80 percent of online video game consumers feel that being able to download content on their gaming console is one of the most desirable features.

The definition of the digital divide is generally "the socio-economic difference between communities in their access to computers and the internet" (Daley, 2004, 1). The digital divide is an every increasing event in today's world as technology continues to get more advanced and people in less developed countries are not able to access the internet compared to the more developed countries such as the US and Japan. In 2001, 8% of the global population used the internet, 35% of that was in the United States and Canada which all together is only 5% of the world's population (Bruner 2003, 74) (World Fact Book, 2006). As this trend progresses further through time, the technological gap becomes even bigger as more a more technologies build on systems already in place that are accessible to a limited group of people. The effects of the digital divide play a role in the access of Xbox Live in less developed countries would not have any access to Xbox Live and therefore are not targeted by Microsoft as a consumer base. This is a challenge for Xbox 360 because they will not be able to globalize their product to the world. Companies like Microsoft can help countries that have a digital divide by donating resources in order to close up the technological gap and promote access to information and promote free use of information that could change the state of a nation.

Microsoft is strategically positioning itself to become a global leader in the video game industry by marketing itself as the dominant transnational corporation in the field. Microsoft has tried to do this through vertically integrating certain aspects of the Xbox division and horizontally integrating others. The impacts of the Xbox 360 and Xbox Live service and the creation of a brand image that focuses on technological systems that are unequally distributed around the globe exacerbate the inequality already in place; reaffirming that the digital divide will continue to progress unless measures are taken to avert this global inequality that largely goes unnoticed when examining a commodity such as the Xbox 360. As Microsoft increases the services

available through its Xbox Live service and restricts access to its console via economic discrimination of resources and access to virtual systems required to access selective content.

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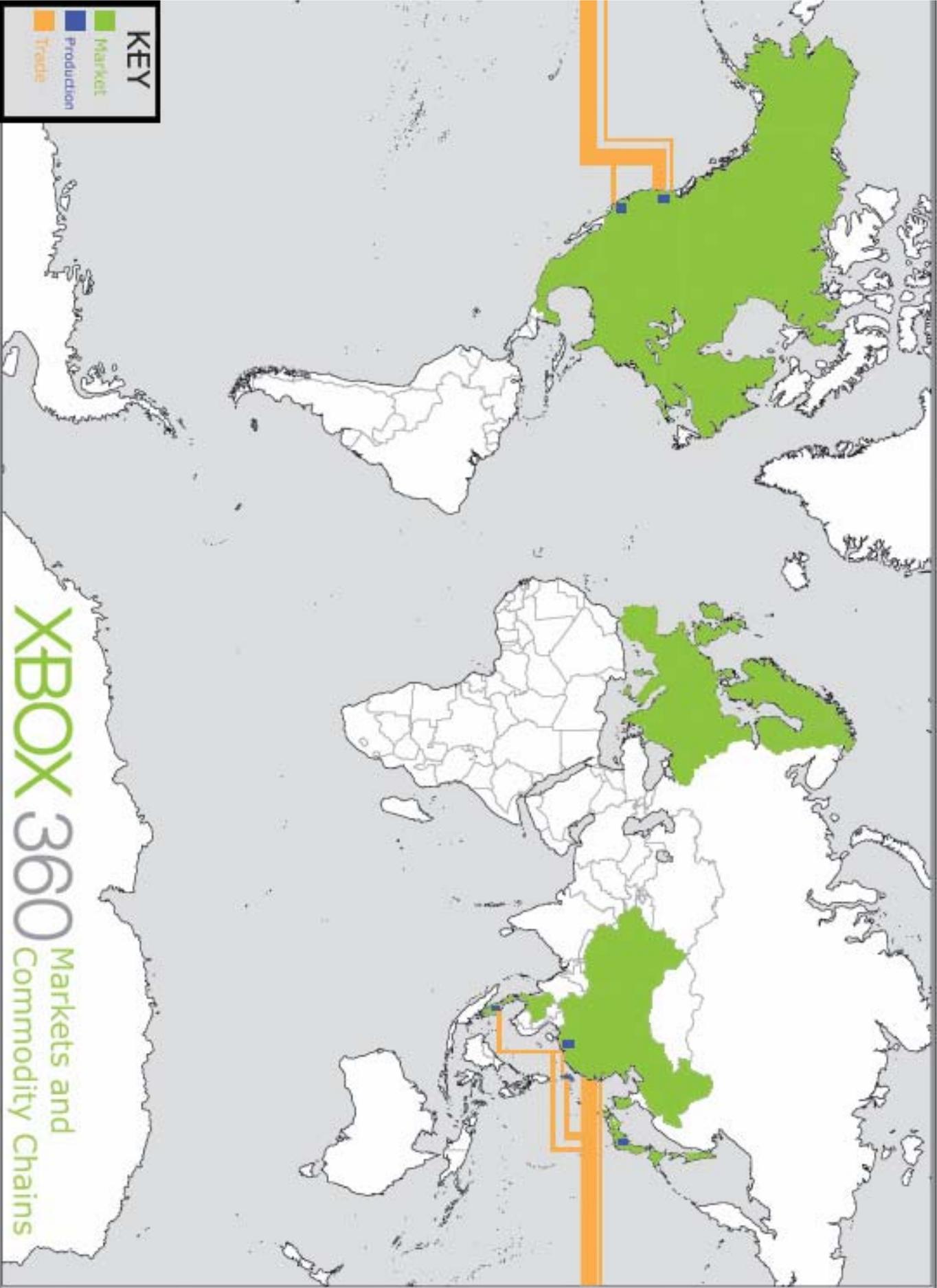
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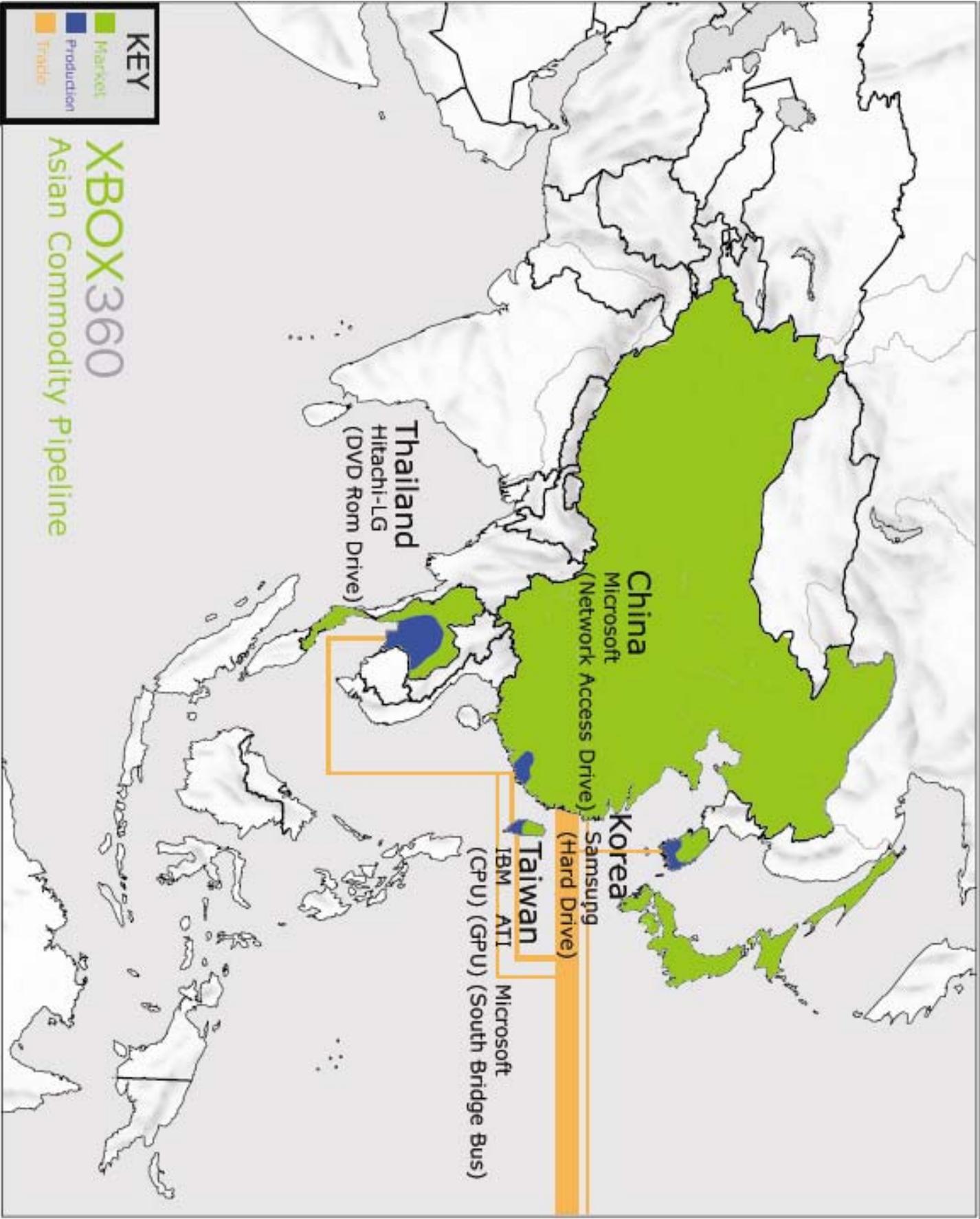
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# XBOX 360 Markets and Commodity Chains



**KEY**

Market

Production

Trade

**XBOX360**

Asian Commodity Pipeline

