

To spin or not to spin: Does Microsoft need Xbox?

November 22 2013, by Ryan Nakashima



The Xbox One is on display at a Best Buy store on Friday, Nov. 22, 2013., in Evanston, Ill. Microsoft is billing the Xbox One, which includes an updated Kinect motion sensor, as an all-in-one entertainment system rather than just a gaming console. (AP Photo/Nam Y. Huh)

Microsoft Chairman Bill Gates donned a cool leather jacket when he first introduced the Xbox onstage in 2000. More than a decade later, the video game console is still the hippest brand in Microsoft's portfolio. But

as the company begins selling its first new Xbox in eight years on Friday, some critics say Microsoft should spin the gaming unit off. They argue that Xbox distracts management from the company's fast-growing cloud computing business and its effort to catch up to rivals in tablet and smartphone sales.

Here are Xbox's pros and cons:

PRO

IT IS PROFITABLE IN THE LONG TERM: The Xbox business has been profitable for the past few years, according to Yusuf Mehdi, Microsoft's vice president of strategy. Mehdi says the company sees the gaming industry growing from an annual \$66 billion to \$78 billion in 2017. And Microsoft hopes to broaden the Xbox's appeal with features that make it more of an entertainment hub.

CON

IT WILL BE A SHORT-TERM PROFIT DRAG: Nomura analyst Rick Sherlund estimates that the Xbox platform will lose at least \$1 billion for Microsoft in 2014 and may not be profitable for another year or so after that. He says a spinoff, even to existing shareholders, would immediately boost Microsoft's profits and stock price. And the timing is right. The company is expected to name a new CEO to replace Steve Ballmer soon and is re-examining its future.

"I can understand the emotional attachment people have to Microsoft owning Xbox," he says. "But if you're trying to bring in new management here and have a course correction, I think this is one of the places you've got to take a look at and reassess."

PRO

ITS AUDIENCE IS HUGE: The Xbox Live online gaming and entertainment service has some 48 million members worldwide, many of whom pay \$5 a month. More than 80 million Xbox 360s have been sold worldwide, providing a user base for Microsoft to sell things like music subscriptions, video rentals, more games and the new Xbox One. The platform is also a window into Microsoft services such as Bing search, Skype Internet calls and SkyDrive cloud storage.



Nikolai Vacca, left, explains Xbox One accessories to customers at a Best Buy store on Friday, Nov. 22, 2013., in Evanston, Ill. Microsoft is billing the Xbox One, which includes an updated Kinect motion sensor, as an all-in-one entertainment system rather than just a gaming console. (AP Photo/Nam Y. Huh)

CON

BUT IT'S NOT AS BIG AS WINDOWS: More than a billion people

worldwide use Windows personal computers, and focusing efforts on polishing Windows 8.1 could have a bigger payoff.

PRO

IT'S A POPULAR BRAND: "There are not a lot of products that Microsoft makes that people are pumped and excited about. Xbox is one of them," says Mike Hickey, a games industry analyst with The Benchmark Co. "To punt that would be a mistake."



People line up outside the Best Buy Theater in Times Square awaiting the opportunity to purchase Microsoft's Xbox One video gaming console at a midnight sales launch, Thursday, Nov. 21, 2013, in New York. (AP Photo/Kathy Willens)

CON

IT'S SLIGHTLY OFF-BRAND: Microsoft prides itself on making software and products that help people to be more productive. But Ballmer, at his final shareholders meeting as CEO on Tuesday, acknowledged the common sentiment that video games can suck up huge amounts of time. "I'm sure we'll lose my 14-year-old for the better part of the next weekend," he said referring to the Xbox One's launch.



One of the first ten people to purchase the Microsoft Xbox One game system exalts in the moment at an event as they receive their equipment in New York Friday, Nov. 22, 2013. Xbox One is a new all-in-one games and entertainment system from Microsoft. (AP Photo/Craig Ruttle)

PRO

IT'S A SOURCE OF INNOVATION: If Microsoft hadn't entered the hardware business, it might not have been able to build the Surface tablet on its own, says Dean Takahashi, author of "Opening the Xbox" and "Xbox 360 Uncloaked." The company has also developed gesture- and voice-recognition technology with its Kinect sensor for Xbox. "They developed some very useful skills in moving into this business," Takahashi says.



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CON

INNOVATION HAS BEEN COSTLY: Microsoft took a \$1 billion charge in 2007 on Xbox hardware defects and a \$900 million charge on unsold Surface inventory this year. And it's not clear whether the company's new user-interface technologies are as advanced as they need to be to make money. As several reviewers have noted, Kinect's voice-recognition ability is hit and miss.

PRO

IT POSITIONS MICROSOFT IN THE LIVING ROOM: Microsoft's Xbox 360 and Sony's PlayStation 3 each sold more than 80 million units globally. Pulling even with the game console leader was a key strategic win for Microsoft because it prevented Sony from taking over the living room. The strategy was intended "to create a halo effect for other Microsoft consumer devices," according to Evercore analyst Kirk Materne.



A man stands over his new Xbox One after he purchased it at a Best Buy on Friday, Nov. 22, 2013., in Evanston, Ill. Microsoft is billing the Xbox One, which includes an updated Kinect motion sensor, as an all-in-one entertainment system rather than just a gaming console. (AP Photo/Nam Y. Huh)

CON

BUT THE WORLD'S GONE MOBILE: By pouring time and energy into a home-bound console, Microsoft largely missed the mobile devices revolution. IHS predicts Microsoft's Windows platform will be the operating system in just 6.5 percent of tablets and 3.9 percent of smartphones sold worldwide this year. Together those devices will account for 1.2 billion units sold. Sherlund says dominating the living room "was a good idea 10 years ago." "Apple and Google did an end run around you with smartphones and tablets," he says. "You had your eye on the wrong ball."

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