

What's to become of Microsoft's answer to the iPod?

30 July 2009, By John Letzing

Microsoft Corp.'s quarterly earnings report last week featured a number of grim statistics, including a relatively overlooked, albeit steep decline related to its Zune portable media player_potentially adding more uncertainty to the embattled product's future.

Designed to rival Apple Inc.'s iPod, Microsoft's Zune first appeared in late 2006, but has struggled to chip away at the iPod's dominance. While Apple has morphed the iPod since its 2001 debut into a range of models including the [iPod touch](#) and iPhone, [Microsoft](#) has so far limited the Zune to a few different devices distinguished only by size and storage capacity.

"If Zune were going to make a strong move against the iPod, it already would have," said IDC analyst Susan Kevorkian.

To be sure, the Zune provides a tiny, and apparently deteriorating portion of Microsoft's business. Revenue for the non-gaming side of Microsoft's Entertainment and Devices unit, which includes the Zune, tumbled 42 percent to roughly \$211 million for the fourth fiscal quarter ended in June _ or about 2 percent of the software giant's total, according to regulatory filings.

By contrast, iPod sales declined just 11 percent in the same quarter to roughly \$1.5 billion, or about 18 percent of Apple's total in the period.

Microsoft has said it plans to release a new Zune model in the fall that features an iPhone-like touch screen and Internet browser, and high-definition quality video. But patience among investors for a deeper push into the portable media player market by Microsoft, which is already enmeshed in one costly struggle with [Google](#) Inc. in the online [search market](#), may be waning.

"The market reception for Zune is so disappointing that many retailers have even stopped selling it

altogether," said George Kurian, a vice president at Tradition Capital Management LLC, which owns Microsoft shares.

Kurian said Apple has successfully outflanked Microsoft by shifting its iPod users to higher-margin devices like the iPhone.

"Microsoft should abandon Zune and follow Apple's strategy to try to make its presence felt in the high-growth smartphone sector," Kurian said.

The easiest way for Microsoft to do that, he said, would be to simply purchase Palm Inc. Palm's Pre smartphone, released in June, has been touted as a viable rival to the [iPhone](#).

Tradition Capital Management does not own any Apple or Palm shares.

A Microsoft representative was unable to comment.

In a statement released in May, Microsoft touted its forthcoming new Zune as one element in a "Zune experience," which will include a growing selection of video for the device to be made available through the company's popular Xbox game console.

Microsoft also plans to open its own retail stores in the fall. Apple has used its more than 250 retail locations to help showcase iPods, iPhones and other related technology.

And while the earliest iterations of the Zune were mocked in some quarters for their relatively bulky design, the newest Zune will boast a sleeker, edgier aspect, according to images posted on a company Web site.

Still, the reported 42 percent decline in fiscal fourth-quarter revenue attributable in part to the Zune provided a discouraging glimpse into the device's progress. The last mention made in company filings

of the Zune's performance had come in a fiscal second-quarter report, where Microsoft said revenue at its Entertainment and Devices division was undercut by a 54 percent, or \$100 million decline in Zune platform sales.

In terms of market share, the numbers are also daunting. In a survey conducted last fall, IDC's Kevorkian said only 4.8 percent of those with a portable media player reported having a Zune, while 61 percent had some sort of iPod. "That's not to say the game is over, it's just not likely that Microsoft is going to beat Apple at its own game," Kevorkian said.

More recent data from NPD Group Inc. indicates that the Zune's already slim market share may have slipped further. NPD Group analyst Ross Rubin said in the first half of this year, Zune's share was 2 percent, compared to about 70 percent for the iPod.

Microsoft, which funds a number of wide-ranging new product initiatives with proceeds from its Windows and Office software franchises, hasn't hesitated in the past to pull the plug on efforts deemed to have fallen short.

For example, the company has killed or dramatically scaled back products including its portable Smart Display monitor, and SPOT watches with FM radio receivers.

However, the new Zune model in the fall could draw more positive attention to what's remained a relatively obscure product, said Forrester Research analyst Sonal Gandhi.

But Gandhi and others remain skeptical about the product line's longer-term future, barring a thorough reevaluation. "Microsoft does need to be in the mobile entertainment platform space," Gandhi said, "It's just that the Zune is not getting them there."

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