

INNOVATION & TECHNOLOGY

Microsoft vs. The PC Makers

A battle is shaping up over pricing of the new Windows 7 as both sides struggle to profit while hardware prices fall

By Cliff Edwards

As Microsoft prepares to launch a new version of its Windows operating system this fall, the software giant and PC makers are squaring off over pricing for the new software. The battle's outcome will have a broad impact on the cost and capability of PCs available to consumers and corporations.

Microsoft has much on the line with Windows 7, scheduled to be introduced in October. The Redmond (Wash.) company is counting on the new operating system to end years of complaints about its predecessor, the buggy Windows Vista, and to keep the Windows franchise churning out profits. While the early reviews for the new software are strong, many PC makers question the proposed pricing and features. Microsoft wants to charge about \$50 for an entry-level version of the operating system, called Windows 7 Starter Edition, say analysts and PC makers. That's roughly triple the price the company gets for the cheapest version of Windows available now.

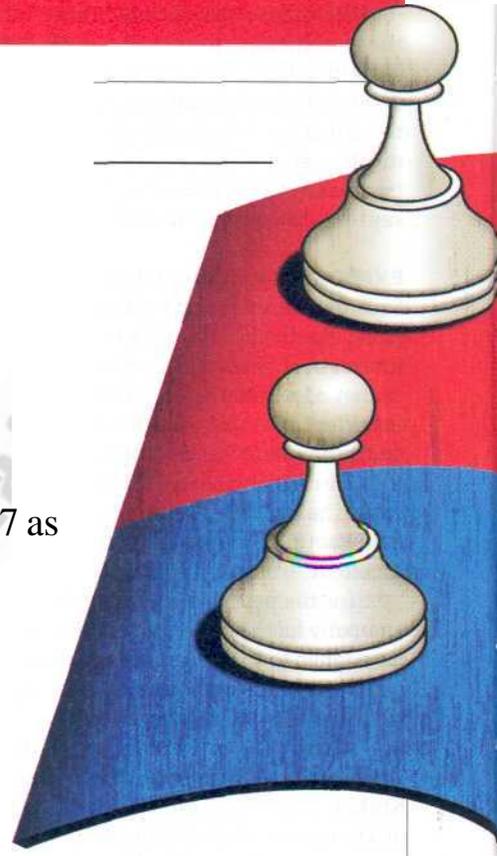
The Starter Edition also will be missing key features such as top-flight

security and graphics, and Microsoft plans to charge customers another \$50 to upgrade to premium versions of Windows 7. PC makers want Microsoft to cut that fee. So far, the software maker has refused to budge. "It looks like Microsoft [is] paying a lot of attention to their own profitability rather than how to expand the market," says Gianfranco Lanci, chief executive of Acer, the Taiwanese personal computer manufacturer.

Microsoft declined to discuss specific pricing plans. CEO Steven A. Ballmer has said the new software will be the "best version of Windows ever."

The standoff points to a broader

problem in the tech industry. The number of PCs sold each year is flat-trending, and the average selling price is falling fast. That leaves Microsoft, Intel, Hewlett-Packard, and Dell, which once shared profits from a fast-growing market, fighting harder for every dollar. "These guys feel like



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Are small, inexpensive netbooks an important new category in computing or simply a blip in the market created by the global economic crisis? In "The Problem with Netbooks," eWeek's Joe Wilcox argues that the whole concept is misleading. He says netbooks may very well disappear by next year.

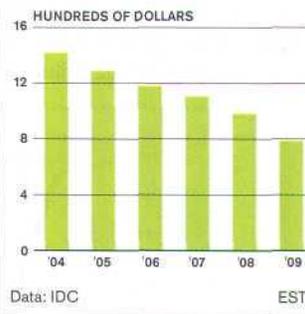


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PRICE CRASH

The average sales price for notebook computers has plummeted



they're getting their wallets picked," says Roger L. Kay, president of Endpoint Technologies Associates.

Notebooks, once the most profitable segment of the business, have seen the most dramatic change. Average prices have tumbled to \$788 from nearly \$1,420 in 2004, according to researcher IDC. The average notebook is now, for the first time, cheaper than the average desktop. The declines in notebook prices accelerated last year with the growing popularity of low-cost netbooks designed primarily for checking e-mail and surfing the Web. Netbooks that sell for less than \$400 account for a fifth of total unit sales.

The tangle between Microsoft and the PC makers is over who wins and who loses as profits get squeezed. PC companies typically pay \$60 to

\$150 for Vista, but they can use the older Windows XP for roughly \$15 for netbooks. Acer, HP, and others often make only about \$20 in profits on a \$400 netbook. If Microsoft raises the price of the operating system for such machines to \$50, the PC maker has to raise prices or watch profits get wiped out. "These are issues we still need to work out," says Phil McKinney, chief technology officer for HP's PC group, who declined to comment specifically on future Windows pricing.

The cost of Windows could rise more sharply on other machines. Microsoft has told PC makers the \$50 Starter Edition will be available only for netbooks with screen sizes smaller than 10.2 inches and chips that aren't capable of playing most games or watching video. Larger netbooks would have to

use Windows 7 Home Premium, which would add \$200 to a unit's cost, says Mike Abary, a senior vice-president at Sony's Vaio PC unit. That could boost the retail price of a mid-range machine by 50%, from \$400 to \$600.

The situation puts Microsoft in a quandary. If the company lowers the price of Windows 7, it could hurt revenues and profits. If it keeps the price high, PC makers might bolt to alternatives, such as the free Linux operating system.

Google is offering PC makers another option. The search giant has been developing the Android operating system, originally to run high-end cell phones. But the software can be adapted for notebooks, and PC makers pay nothing for it up front, though there are often development costs. Acer, the largest seller of netbooks, said in May that it will begin selling an Android-powered netbook this summer.

Both Microsoft and PC makers would like to figure out a way to persuade customers to start spending more for computers. This summer, HP, Acer, Toshiba, and other PC makers will try to entice buyers to trade up to higher-priced, stylish laptops. The idea is to offer machines with the panache of Apple's MacBook Air at about half the price. The notebooks will sell for \$600 to \$900, with better battery life, larger screens and keyboards, and more capabilities than netbooks.

"Our customers tell us that they want mobile, small-notebook PCs to go beyond basic Internet activities and deliver premium capabilities [so they can] play games, view pictures, and watch videos," says Brad Brooks, Microsoft corporate vice-president for Windows consumer product marketing.

Still, PC makers want to be able to offer a broad array of computers, including the low-priced machines customers have been scooping up over the past year. They say Microsoft must reduce its demands for Windows 7 to keep that slice of the market growing fast. "We need to have a similar agenda," says Acer's Lanci. "If we have different agendas, it is very difficult." | **BW** |

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