

# Microsoft Zune HD – A Strategy Case Study

## 3 Popular Theory Viewpoints

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In previous articles, I've spent a lot of time looking at the MP3 player market, and especially the success of the iPod. (See [Innovation Lessons from Apple – Parts 1-3](#)) An article recently came out from the [Wharton School of Business](#) titled ***"Pushing Zune: Is Microsoft Pushing an Uphill Battle?"***. Is it making progress; does it have a chance; should Microsoft continue investing? This was too intriguing to pass up, so this article looks at the Zune strategy from 3 popular marketing theories to see how these questions might be answered.

This article is intended to be primarily academic and leverages the Wharton publication as a current hot topic to test some published theories. The [author](#) was an early adopter of MP3 players before the iPod and has an affinity for the general topic. He has used the players as case studies or references in his training classes for years. He has also worked at Microsoft but has only observed the Zune group's output from afar as a general consumer. All information used in this article is from public sources and all hypotheses are the sole opinion of the author. Any similarities to actual or intended strategies are coincidental.

(Update, March 2011 - 18 months after the Zune HD was released, Microsoft has stated there will be no more Zune devices produced, effectively exiting the market. The Zune software and services will continue to exist in Windows Phones and Xbox.)

### Selected Excerpts of the Wharton Article

(The complete article can be accessed [HERE](#).)



“When Microsoft on September 15 launched its next-generation Zune HD media player, the software giant billed the device as ‘a significant step forward,’ touting its ability to play high-definition (HD) video and receive HD radio signals, along with a state-of-the-art, organic light-emitting diode (OLED) screen....”

“Indeed, the Zune HD has received positive reviews from the technology press and it has features that the iPod doesn't. For instance, Microsoft has bet on high-definition video to differentiate the device. The Zune HD is among the first

handhelds able to play high-definition video and receive digital HD Radio signals. Apple's iTunes software supports high-definition video, but only when displayed on Apple TV (a set-top box) and on PCs. The Zune HD's OLED screen is more vibrant than typical touch displays -- a potential selling point for tech-savvy consumers looking for state-of-the art features....”

“According to research firm NPD Group, Apple's iPod had 73% of the market as of July 2009. Milpitas, Calif.-based SanDisk had 9% of the market, followed by Sony at 3%. Microsoft trailed with 2%. Peter Fader, a marketing professor at Wharton, says that Microsoft's Zune HD has no chance against Apple. ‘The Zune HD is absolutely doomed to fail, and I don't think Microsoft should continue to push in this direction....’ ‘Somewhere in there is a business strategy for the

Zune,' says Kendall Whitehouse, director of new media at Wharton. 'Microsoft will try and try again and throw money at it until they get somewhere.'"

"The problem? Microsoft isn't competing against just the iPod as much as it is against an entire ecosystem of applications and developers that go along with Apple's device. The number of applications available for the Zune HD pales by comparison with those available for the iPod through Apple's App Store: The Zune HD currently has nine free applications available, while Apple has 85,000 applications available on its App Store for the iPod and iPhone...."

"Microsoft executives acknowledge that the Zune is a work in progress. 'We [are continuing] to expand the brand presence for Zune and ... to build our capability in the music and video delivery marketplace,' said Robbie Bach, president of Microsoft's entertainment and devices division at a July 30 financial analyst meeting.... 'Microsoft is throwing a lot of resources at this', notes Lawrence Hrebiniak, a management professor at Wharton. 'I'm not saying Microsoft should pull out, but I do question whether these markets are really strategic [for the company].'"

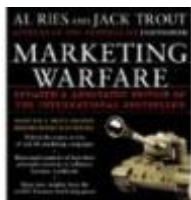
### Our Analysis Tools

We decided to try to assess the strategy from different perspectives to see which might provide the most insight and to also see if they generated similar or divergent results. Our tools came from 3 popular books on how to enter and compete in markets. These are:

- Marketing Warfare – Al Ries & Jack Trout
- The Innovator's Solution – Clayton Christiansen
- Blue Ocean Strategy – W. Chan Kim & Renee Mauborgne

We'll look at each one in succession.

### The Marketing Warfare Viewpoint



Ries & Trout advocate that the most important driver of how to act in a marketplace depends on the competitive industry structure and which player you are. The market leader owns the hill and thus can take a defensive position against attackers. The leader should also be proactively implementing sustaining innovations and blocking tactics to prevent flanking maneuvers.

If you're a relatively strong #2 or #3, you should be trying to find a weakness in the market leader's strength and attempting to breach it by effectively positioning yourself as the opposite choice to this weakness. If you're relatively small player or new entrant, you should be attempting a flanking maneuver on the market leader by focusing on a specific niche that you can be the market leader in. In both strategies, the attack should be focused on as narrow a space as possible to concentrate all of the available resources for success.

For Zune, the iPod is the king of hill and SanDisk a distant but relatively strong #2 as the low cost leader. Apple has attempted to block obvious flanking maneuvers from below through the line extending Nano and Shuffle products and created a new category of device that can download apps and games, the iPod Touch.

The Zune strategy has historically been aimed directly at Apple with an attack on a broad front. Microsoft has developed an entire line to compete directly against the iPod Classic, Nano, and now the Touch. The major new innovation in the previous generations of Zune was the addition

of Wi-Fi. Unfortunately, it was available only for syncing the device to the PC and peer-to-peer sharing (very limited) of music. Per Ries and Trout, this strategy has some big issues by attacking the market leader head on and directly against its strength.

The new Zune HD has upped the ante on some technical specs that may be attractive to a subset of the high end market. It includes a new technology screen, HD Radio, and HD Video output (with an optional docking station). It also appears to be phasing out its low end line competing against the Nano, but it's too early to tell for sure. The HD price points are in-line with the current market offerings and position the Zune offerings in the middle of the pack pricewise, so you're getting more technology for a good price.

Are these sufficient to beat the market leader? Will existing owners of other iPods upgrade to Zune to get an HD Radio and Wireless Sync? Would existing owners of SanDisk players upgrade to Zune for the higher end features? Would non-consumers of any media player look at the Zune as the reason to enter the market? It doesn't seem likely, at least for a large segment of the market.

The big hole for the HD appears to be the lack of games and applications versus Apple. Microsoft needs some kind of hook to get people to try the device in the face of the huge Apple App Store. Looking back a few years, the original Xbox strategy introduced a technically sophisticated platform into a market of strong competitors. They also introduced a high end game, ***Halo: Combat Evolved***, through its acquisition of Bungie Studios. It was the game that created the primary market pull and demonstration of the Xbox capabilities that put it the product on the map, and Microsoft continued to evolve high quality games and upgrades to the console. Could the same strategy work for Zune?

As mentioned above, a recommended strategy to combat a market leader is to find a weakness in a primary strength. Apple has 85,000 apps, but how many are really, truly GOOD apps? And even if they were some good ones, how would you find them as a Touch user? One approach for Zune could be to try to trump the QUANTITY card that the App Store has with a QUALITY card (high performance, graphics, etc) and produce some (a few) highly engaging applications not available from Apple. This would turn the Apple strength into a weakness. They could pull a proven tactic from Xbox and duplicate it. While a major technical challenge, Microsoft potentially has the horsepower to this off.

The more typical approach would be to play catch up on building an App Store and developer community while Apple finds another area of innovation for Microsoft to chase. Without a major advancement in the offering that competes head-to-head on an Apple weakness or finds a defensible market niche, the future of Zune looks bleak from the Marketing Warfare perspective.

### The Innovator's Solution Viewpoint



Clayton Christiansen advocates that the incumbent leader in a market will win against new entrants who attack on the incumbent's turf – namely the feature set and business model prevalent in the industry. This is because the incumbent's strength is in incremental innovation along the performance curve for the existing market.

He advocates 3 possible approaches to creating new-growth businesses. The first is through Sustaining Innovation. Performance improvements are advanced along the most valued

dimensions targeting the most profitable customers in the segment who are willing to pay for improved performance. (Examples: Microprocessors, disk drives, Flash memory). This is the playing field of incumbents.

The second is a Low-End Disruption. This creates a new (lower) performance/cost definition that targets the customers in the lower end of the market that are over-served by existing solutions. This creates a 'good enough' performance for those who are willing to pay less and then move up to the mainstream market using Sustaining Innovation. (Examples: Mini-steel-mills, Dell, Amazon)

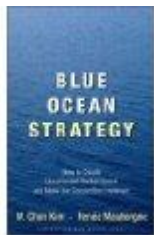
The third is New-Market Disruption. This is similar to the Low-End Disruption in reducing performance and cost, but also improves non-traditional attributes not addressed by current solutions. This targets non-consumers of the current solutions due to lack of money or skill. (Examples: eBay, Blackberry)

In looking at Zune HD, it appears that Microsoft is following a Sustaining Innovation approach with the advanced features. This is right at Apple's strength, as indicated by the long history of product updates along similar performance dimensions, and through capabilities easily duplicated by Apple. Consistent with the discussion from Marketing Warfare, the lack of downloadable applications will likely have low success in creating defections from Apple's best customers. Where else could Microsoft focus Sustaining Innovation, or better yet, what New-Market Disruption could it create? As discussed above, a kick-butt game with focus on quality/performance could be one direction.

Another possibility might be a more direct tie-in to Xbox. The original target market for the iPod was Mac users, not the whole world. Could Microsoft make Zune a MUST HAVE accessory for Xbox 360 users and focus the marketing effort on a niche segment Microsoft already owns before moving up to a broader market? Could they go down the Nintendo Wii path and completely redefine a new job that can be accomplished by tightly coupling Zune & Xbox? For example, could you play a game on both platforms, and be able to continue the same game from one platform to the other and effectively have one continuous play no matter where you are? Ditto for downloaded movies? Or perhaps combine game scores from both the Xbox and Zune and require both to attain top rankings?

At this point, the two product strategies for Zune and Xbox appear to be completely disconnected except for some limited marketing efforts. Zune appears to be a silo and Microsoft continues to attack Apple at its strength and without any significant game-changers that Apple can't easily duplicate. From the Innovator's Solution perspective, the Zune success factors appear to be quite small.

## The Blue Ocean Strategy Viewpoint

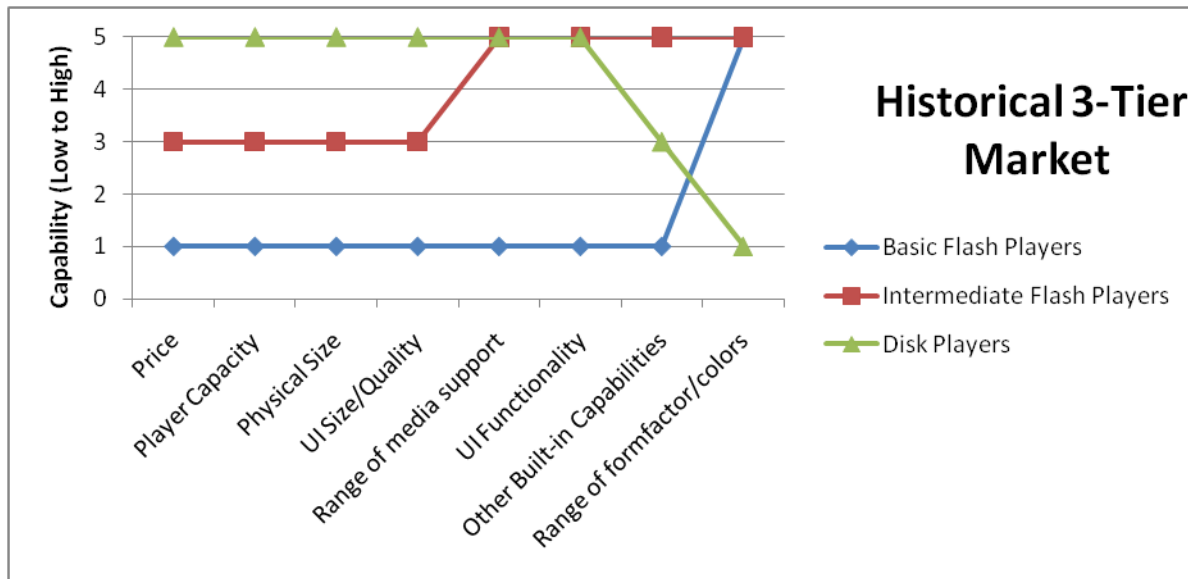


Kim and Mauborgne advocate that competing in the existing space through either a differentiation strategy OR low cost strategy defines a limited potential Red Ocean, whereas combining a differentiated AND low cost strategy creates an unlimited potential Blue Ocean. Differentiation is created by significantly increasing or creating value along some dimension versus competition while simultaneously decreasing or removing value (and thus cost) along others. The goal, like Christiansen's New-Market Disruption, is to attract non-consumers.

Some examples are:

- Southwest Airlines – Created a low-cost, short-trip network between smaller airports when all of the majors were focusing on longer trips between major hubs.
- Cirque de Soleil – Created a new format for circuses by eliminating animals and thrill-oriented acts, while increasing acrobatics and adding stories, themes and suspense.
- yellow tail wine – Created an alternative low cost wine with limited selection but with a fun and easy drinking image targeted at beer and spirit drinkers turned off by the snooty wine image.

An analysis of the media player market shows an historically tiered set of products, primarily driven by price, storage media type, capacity and physical size. At the bottom are tiny Flash-based products that play only music and have a very low price and limited UI (e.g. iPod Shuffle). In the middle is an array of mid-sized and mid-priced Flash-based offerings with moderate storage capabilities, but also play video, display photos, and have an assortment of add-on capabilities like FM Radio (e.g. iPod Nano). At the top end are larger disk-based devices that have huge storage capacities, but limited add-on capabilities. (e.g. iPod Classic) Figure 1 shows the three tiers and the capabilities each offers against various competitive attributes.

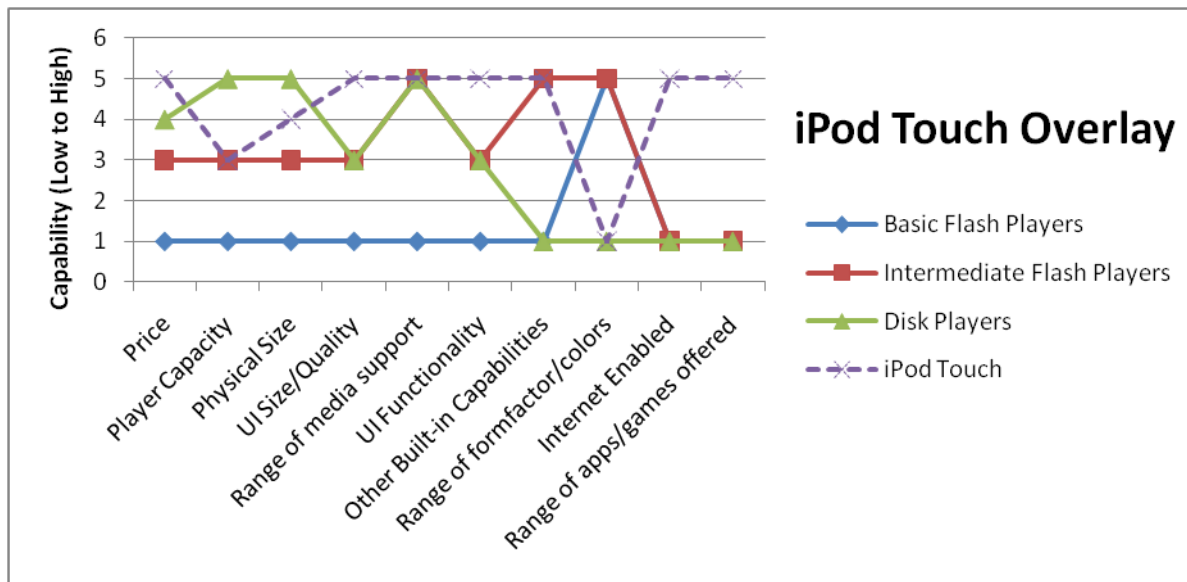


**Figure 1 - Historical Media Player Market**

As can be seen, each tier represents a trade-off of attributes that supports the price offering. In addition to the player attributes listed above, competitors also compete on other offerings, such as the music download services like Apple's iTunes. This was a game-changer for the industry when launched, and helped to create the huge upsurge in adoption of the player by non-consumers. Most competitors today offer a download service in some form, except for SanDisk.

The introduction of the iPod Touch in 2007 (and its big brother, the iPhone) created a new disruption to the market. It redefined the UI experience with a larger display and sophisticated software, but with a trade-off of size, storage and price. It also added full Wi-Fi internet connectivity, an accelerometer and ability to download applications. These created a 4<sup>th</sup> Tier, or actually an overlay on the existing market, but also created something new where only the Touch effectively competes, as shown in Figure 2.





**Figure 2 - iPod Touch Market Overlay**

Enter Zune HD. If we compare it to the Touch in the chart above, we find that it offers a slight improvement to display quality and slight improvement in add-ons (HD Radio and HD Video), but it really does not reposition other offerings in the market in core competitive attributes. At the far right, the current application download catalog puts it marginally above devices not capable of downloads, so it's difficult to see how it can be competitive against the Touch.

Lastly, Zune HD does not extend the market capabilities to the right with attributes that might be attractive to a large, alternative market. Per the Blue Ocean recommendations, these attributes can include any innovation in customer productivity, simplicity of the solution, convenience to the customer, reducing customer risk, increasing fun and image, or even environmental friendliness. The innovations also need not be tied directly to the feature set of the device but can occur across the entire lifecycle of the customer – how they purchase, get delivery of product and content, get supplemental products and services, get support and upgrades, etc.

Similar to the discussion from Innovator's Solution, this is where it seems that Microsoft needs to be innovating, as attempting to compete head-to-head with Apple keeps the battle in the Red Ocean with limited opportunity.

## Summary

In looking at the current Zune HD offering from Microsoft from 3 different strategy theories, it does not appear that Microsoft is going to make any significant gains in the portable media player market as it keeps playing on Apple's turf. The bigger issue, as pointed out in the Wharton article, is one of strategic intent. How does the Zune support the bigger picture for Microsoft, or is it really just an experiment to learn about the market?

Would Microsoft have benefited in a bigger way by just buying an existing company, such as the player piece of SanDisk, to accelerate the learning? If Microsoft's goal is to "build capability in music and video delivery marketplace", does it have to be in the portable device space? Could they take the battle into the living room where Microsoft already has a presence with PC's and

Xbox and focus in a big way on an area not dominated by anyone yet (but is quietly being penetrated by Apple TV)?

What do you think they should do and why?

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